Winner! Winner! Chicken Dinner!
Living the Gaming Life

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Panelists: Frank Agostino, Phillip Colasanto, Special Trial Judge Peter Panuthos, and Kathryn Sedo
Roadmap

• Tax treatment of gambling winnings and losses
• Professional vs. amateur gamblers
• Proving gambling winnings and losses in an audit
• Tax treatment of tip income
• Tip Rate Determination/Education Program
• Handling deemed tip income in an audit
Tax Treatment of Gambling Winnings

• Tax Treatment Depends on Whether Gambling Activity is Considered a Business or a Hobby
  • Nine Nonexclusive Factor Test from Sec. 1.183-2(b) is used

• Professional Gambling Losses are Treated Differently Than Other Business Losses
  • See IRC Sec 165(d)

• State Tax Treatment of Gambling Losses may be Different than Federal Tax Treatment
Professional vs. Non-Professional Gambling

• Professional Gamblers use Schedule C to report their income, expenses and losses

• Non-Professional Gamblers report gambling income on a 1040 and gambling losses on Schedule A
  • This can mean that none of the losses are deductible if the gambler does not have enough other deductible Schedule A expenses that exceed the standard deduction
  • The increase in the standard deduction and limitations on deductibility of state taxes, mortgage interest and medical expenses means that fewer taxpayers will itemize their deductions
Criteria for Determining Professional Status

• If taxpayer in “trade or business” of gambling then wagering losses may be deducted to the extent of gains from wagering transactions.  Sec 165(d)
  • In addition taxpayer can deduct expenses incurred, e.g. entry fees, hotel and meal expense, etc.

• The gambling activity must be conducted with continuity, regularity and with the primary purpose of earning a profit it to be considered a trade or business.
  • Facts and circumstances determine whether it is a trade or business
Factors Used to Determine Whether an Activity is a Trade or Business

• Income Tax Regulations under Sec. 183 are used.
• Section 1.183-2(b) lists nine nonexclusive factors that are considered
  • The manner in which the activity is carried out
  • The expertise of the taxpayer or his/her advisors
  • The time and effort expended in carrying out the activity
  • Expectation that assets used will appreciate in value
  • Success of the taxpayer in carrying on other similar or dissimilar activities
  • Taxpayer history of income or loss with respect to the activity
  • Amount of occasional profits, if any, earned
  • Financial status of taxpayer
  • Whether elements of personal pleasure or recreation are involved
Analysis of Nine Factors

• Manner is Which the Activity is Carried out
  • Was it done in a business-like manner?
    • Were accurate books and records maintained?
    • Did taxpayer have a business plan?
    • Whether taxpayer complied with industry standards for operating the business
    • Whether taxpayer attempted changes in an effort to secure a profit

• Casinos track gambling activity by having gamblers use cards

• Casinos must issue W-2g when gambler wins
Analysis of Nine Factors

• Expertise of taxpayer or her advisors
  • Preparing for the activity by extensive study of its accepted business, economic and scientific practices
  • Consulting with experts in the area
Analysis of Nine Factors

• Time and Effort Expended by Taxpayer
  • Devotion of much time and energy that does not have personal or recreational aspects
Analysis of Nine Factors

• Expectation that Assets may Appreciate
  • If activity involves use of assets that may appreciate in value
    this is a factor in favor of the activity being considered entered
    into for profit
Analysis of Nine Factors

• Success of Taxpayer is Carrying out Similar or Dissimilar Activities
  • Past success in similar activities
  • Taxpayer’s success in other unrelated activities
    • This indicates diligence, initiative, foresight and other qualities that generally lead to success in business activities
Analysis of Nine Factors

• History of Income or Loss in Activity
  • History of substantial losses may indicate that taxpayer did not conduct the activity for profit
  • Losses during initial start up do not mean that taxpayer did not conduct the activity for profit, but losses sustained beyond that period may indicate that activity was not engaged in for profit
Analysis of Nine Factors

• Amount of Occasional Profits, If Any, Which Are Earned
  • Occasional profits earned in relation to the amount of losses incurred, the amount of the taxpayer’s investment and the value of the assets used in the activity provide useful criteria in determining taxpayer intent
  • A practical possibility that taxpayer could earn money in a year to exceed expenses can indicate profit objective
Analysis of Nine Factors

• Financial Status of the Taxpayer
  • If taxpayer does not have substantial income or capital from sources other than the activity in question, it may indicate that the taxpayer engages in the activity for profit
  • Conversely, substantial income form other sources especially if the losses generate large tax benefits, may indicate that the taxpayer is not conducting the activity for profit
Analysis of Nine Factors

• Whether Elements of Personal Pleasure or Recreation are Involved
  • Presence of recreational or pleasurable motives in conducting
    the activity may indicate that the taxpayer is not conducting the
    activity for profit
    • Deriving personal pleasure from the activity is in itself insufficient to cause
      the activity to be classified as not engaged in for profit if other factors
      show that the activity is conducted for profit
AMT and State Tax Law Considerations

• Federal tax law allows a deduction for gambling losses when calculating income

• Some states, e.g. Minnesota, do not allow a deduction for gambling losses when calculating AMT
Gambling Winnings: W-2G Reporting Requirements

• Bingo and slots: if the winnings (not reduced by the wager) are $1,200 or more from a bingo game or slot machine
• Keno: if the winnings (reduced by the wager) are $1,500 or more
• Tournament poker: if the winnings (reduced by the wager or buy-in) are more than $5,000
• All other games: if the winnings (reduced, at the option of the payer, by the wager) are both over $600 and at least 300 times the amount of the wager; or, if the winnings are subject to federal income tax withholding (for any amount of winnings)
  - Withholding for: winnings over $5000 from sweepstakes, wagering pools, lotteries, and betting (see W-2G instructions for specifics)
Proving Gambling Winnings and Losses in an Audit

  • Taxpayers should keep contemporaneous records of gambling winnings and losses to comply with IRC sec. 6001 record keeping requirements, but the court will use the Cohan rule and consider the particular facts of the case to allow losses where records are lacking but there is some evidence of losses.

  • Taxpayers whose gambling activity is sporadic throughout the year and whose living depend on sources of income other than gambling winnings may not deduct gambling losses as a business expense but as an itemized deduction because such activity is for amusement rather than profit.
Tax Treatment of Tip Income

• Tips are includable in gross income (I.R.C. § 61);
• Tips are considered services and not gambling income (Bevers v. Commissioner, 26 T.C. 1218 (1956));
• Tips/tokes are not considered gifts (Allen v. U.S. Gov’t., 1991 WL 238264);
Tax Treatment of Tip Income (cont’d)

• Tips/tokes are not considered gifts (Allen v. U.S. Gov’t., 1991 WL 238264);

• Tip income can be offset by tip outs to other service employees (Brown v. Commissioner, T.C. Memo. 1996-310).
  • Can be offset even if not properly recorded (See Sabolic v. Commissioner, T.C. Memo. 2015-32).
Tip Income and Recordkeeping Requirements

• I.R.C. § 6001: requires the keeping of records;

• Records must be accurate and contemporaneously maintained (Treas. Reg. § 6001-1(e); Bruno v. Commissioner, T.C. Memo. 1985-168).
  • Tip Diary; or
  • Documentary records, such as bills, checks, etc. Treas. Reg. § 6053-4(a)(1).

• IRS may recompute tip income if taxpayer does not maintain contemporaneous records.
Contemporaneous Records

- Meilak v. Commissioner, T.C. Memo. 1996-381: Tax Court found that the records did not appear contemporaneously maintained and were unacceptable.
  - Mead notebook discredited by Mead employees.
I.R.C. § 6503

• I.R.C. § 6053 requires employees to report tips to employers.
  • “Employers are expressly excused from any effort to determine whether employees are properly reporting their tips[.]” United States v. Fior D’Italia, Inc., 536 U.S. 238, 256 (2002).
Tip Rate Determination/Education Program

- Tip Rate Determination Agreements (TRDA)
- Tip Reporting Alternative Commitments (TRAC)
- Gaming Industry Tip Compliance Agreement (GITCA)
Gaming Industry Tip Compliance Agreement

• Rev. Proc. 2007-32;
• IRS and casino can enter into agreement and determine tip rates for reporting or withholding.
• Sabolic v. Commissioner, T.C. Memo. 2015-32, taxpayers can opt out of GITCA.
IRS Reconstruction/Recomputation

- I.R.C. § 446: IRS can recalculate taxpayer’s income.
- IRS recomputation is entitled to a presumption of correctness and the taxpayer has the burden of showing that the recomputation is incorrect. Cracchiola v. Commissioner, 643 F.2d 1383, 1385 (9th Cir. 1981).
Methods of Recomputation

- Undercover surveillance programs;
- Formulas;
- Statistical surveys;
- Diaries kept by dealers other than taxpayer (when the tips are pooled and evenly divided);
- Forms W-2 coupled with toke calendars.
Adjustments to Recalculation

• Sebolic v. Commissioner: IRS’s method of recomputation was acceptable but was determined to be less accurate than the taxpayer’s records;

• Williams v. Commissioner: IRS’s recomputation was adjusted because it did not take into account that:
  • One taxpayer worked during a less-busy shift and in a less-busy bar;
  • One taxpayer worked in a casino that was less-visited than the casinos used for comparison.
Adjustments (cont’d)

- **Ward v. Commissioner**: Tax Court adjusted the IRS’s recomputations because it used data from blackjack dealers and applied it to a craps dealer. The Tax Court was concerned because:
  - Blackjack was more popular than craps; and
  - The craps tips were pooled differently than the blackjack tips.
Penalties

• I.R.C. § 6662 penalties apply;
• I.R.C. § 6663 fraud penalty also applies:
  • Clear and convincing evidence;
  • IRS must establish:
    • Petitioners have an underpayment;
    • At least a portion of the underpayment is due to fraud.
• Balot v. Commissioner, T.C. Memo. 2001-73.
Criminal Penalties

Sanctions

• Tomburello v. Commissioner: Tax Court penalized taxpayer $4,000 for bringing a frivolous action, where taxpayer argued that tips received were gifts and not income.

• 9th Circuit determined this was meritless and also applied a $1,000 sanction for bringing a frivolous appeal.
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