DEPARTMENT OF STATE REVENUE

01-20150622.LOF

Letter of Findings: 01-20150622
Individual Income Tax
For the Year 2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Couple provided significant documentation and legal analysis to show that they are entitled to their refund. The Department will adjust the return to reflect their net gambling winnings.

ISSUE

I. Individual Income Tax - Adjusted Gross Income.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Shollenberger v. C.I.R., T.C.M. 2009-306 (U.S. Tax Ct. 2009); Treas. Reg. § 1.165-10; 45 IAC 3.1-1-1; 45 IAC 3.1-1-2; 45 IAC 3.1-1-3; 45 IAC 3.1-1-4; I.R.S. Adv. Mem. 2008-011 (December 12, 2008).

Taxpayers protest the Department's refund denial and the assessment of additional Indiana income tax for the 2014 tax year.

STATEMENT OF FACTS

Taxpayers are individuals, filing jointly, and residents of Ohio. During the 2014 year, Taxpayers occasionally visited various casinos, located in Indiana and outside of Indiana, and played slot machines recreationally. Taxpayers conceded they were not professional gamblers. For each casino visit, Taxpayers had some wagering gains and also had some wagering losses. Also, for each casino visit, Taxpayers recorded their wagering gains and/or losses on a "per session" (usually netted per day/per visit) basis. Pursuant to Indiana tax withholding requirements, the Indiana casinos withheld income tax on Taxpayers' wagering gains, if any, and issued W-2G forms.

In 2015, Taxpayers timely filed their 2014 Indiana Part-Year or Full-Year Nonresident Individual Income Tax Return ("IT-40PNR"), claiming that they were entitled to a refund of $6,811.

Upon reviewing Taxpayers' 2014 return, the Indiana Department of Revenue ("Department") denied Taxpayers' refund claim. The Department also adjusted Taxpayers' Indiana income, resulting in the assessment of additional income tax, penalty, and interest.

Taxpayers protested the assessment. A phone hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Individual Income Tax - Adjusted Gross Income.

DISCUSSION

As a threshold issue, it is the Taxpayers' responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

The Department adjusted Taxpayers' 2014 Indiana IT-40 PNR return. The Department disallowed Taxpayers' requested deduction of $194,559 to the taxable income reported on their Indiana IT-40PNR Schedule C. The Department's disallowance of Taxpayers' $194,559 deduction on their 2014 return resulted in additional tax due.

Taxpayers protested the denial of refund and the additional assessment of the individual income tax. Taxpayers stated that, following the "per session" method outlined by the Internal Revenue Service ("IRS") in its Chief Counsel Attorney Memorandum AM2008-011 (Dec. 12, 2008), 2008 WL 5203844 ("IRS AM 2008-011"), they recorded their gambling winnings/losses (per session) for federal income tax purpose, which resulted in reducing gains by $194,559 (i.e., the total gains after netting minus the total amount stated in the W-2G forms) for 2014 tax year. Taxpayers thus asserted that since Indiana generally follows federal law and regulations in reporting income tax the adjustment should be allowed.

For Indiana income tax purposes, the presumption is that a taxpayer properly and correctly files his or her federal income tax returns and, thus, to efficiently compute what is considered Indiana income tax, the Indiana statute refers to the Internal Revenue Code. However, IC § 6-3-1-3.5(a) simply provides the starting point for determining a taxpayer's taxable income, stating that the term "adjusted gross income" shall mean, "In the case of all individuals, 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code), modified as follows . . . ." The Department's Administrative Rules repeat the basic principle at 45 IAC 3.1-1-1, which states:

> For individuals, "Adjusted Gross Income" is "Adjusted Gross Income" as defined in Internal Revenue Code § 62 modified as follows:
>
> (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> (3) Make all modifications required by IC 6-3-1-3.5(a).

As to nonresidents, IC § 6-3-2-1(a) and IC § 6-3-2-2(a) provide that income derived from Indiana sources is subject to Indiana tax. Thus, a taxpayer, regardless of resident or nonresident, who has winnings from his or her gambling activities in Indiana, is required to report and remit income tax to Indiana on Indiana source income. 45 IAC 3.1-1-2. When the taxpayer is a casual gambler, however, Indiana does not allow the taxpayer to deduct the gambling losses. 45 IAC 3.1-1-3; 45 IAC 3.1-1-4.

Since Indiana refers to federal adjusted gross income as starting point to compute the taxpayer's individual income tax liability, how to calculate the taxpayer's income from gambling gains for federal adjusted gross income tax purposes will subsequently determine the taxpayer's Indiana adjusted gross income for Indiana individual income tax purposes.

In IRS AM 2008-011, the IRS addressed the issue of whether a casual gambler who, during a tax year, (a) visited a casino to play slot machines on ten (10) occasions and (b) for each visit, committed only $100 to play, is allowed to calculate her wagering gains and/or losses based on a "per session" basis (upon redemption of her tokens), as opposed to "per play" basis, for individual income tax purposes. The IRS AM 2008-011, in relevant part, explains:

> A key question in interpreting [I.R.C.] § 165(d) is the significance of the term "transactions." The statute refers to gains and losses in terms of wagering transactions. Some would contend that transaction means every single play in a game of chance or every wager made. Under that reading, a taxpayer would have to calculate the gain or loss on every transaction separately and treat every play or wager as a taxable event. The gambler would also have to trace and recompute the basis through all transactions to calculate the result of each play or wager. Courts considering that reading have found it unduly burdensome and unreasonable. Moreover, the statute uses the plural term "transactions" implying that gain or loss may be calculated over a series of separate plays or wagers.
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> The better view is that a casual gambler, such as the taxpayer who plays the slot machines, recognizes a wagering gain or loss at the time she redeems her tokens. We think that the fluctuating wins and losses left in play are not accessions to wealth until the taxpayer redeems her tokens and can definitively calculate the

amount above or below basis (the wager) realized. For example, a casual gambler who enters a casino with $100 and redeems his or her tokens for $300 after playing the slot machines has a wagering gain of $200 ($300 - $100). This is true even though the taxpayer may have had $1,000 in winning spins and $700 in losing spins during the course of play. Likewise, a casual gambler who enters a casino with $100 and loses the entire amount after playing the slot machines has a wagering loss of $100, even though the casual gambler may have had winning spins of $1,000 and losing spins of $1,100 during the course of play.

Calculating the Taxpayer's Gains and Losses

Under the facts presented, the taxpayer purchased and subsequently lost $100 worth of tokens on five separate occasions. As a result, the taxpayer sustained $500 of wagering losses ($100 x 5). The taxpayer also sustained losses on two other occasions, when the taxpayer redeemed tokens in an amount less than the $100 (basis) of tokens originally purchased. The loss is the basis of the bet ($100 in tokens) minus the amount of the tokens eventually redeemed. Therefore, on the day the taxpayer redeemed $20 worth of tokens, the taxpayer incurred an $80 wagering loss ($100-$20). On the day the taxpayer redeemed $70 worth of tokens, the taxpayer incurred a $30 wagering loss ($100-$70).

On three occasions, the taxpayer redeemed tokens in an amount greater than the $100 of tokens originally purchased. The amount redeemed less the $100 basis of the wager constitutes a wagering gain. On the day the taxpayer redeemed $150 worth of tokens, the taxpayer had a $50 wagering gain ($150-$100). On the day the taxpayer redeemed $200 worth of tokens, the taxpayer had a $100 wagering gain ($200-$100). And on the day the taxpayer redeemed $300 worth of tokens, the taxpayer had a $200 wagering gain ($300-$100).

For the year, the taxpayer had total wagering gains of $350 ($50 + $100 + $200) and total wagering losses of $610, ($500 from losing the entire basis of $100 on five occasions + $80 and $30 from two other occasions). The taxpayer's wagering losses exceeded her wagering gains for the taxable year by $260 ($610 - $350). The taxpayer must report the $350 of wagering gains as gross income under § 61. However, under § 165(d), the taxpayer may deduct only $350 of the $610 wagering losses. The taxpayer may not carry over the excess wagering losses to offset wagering gains in another taxable year or offset non-wagering income.

A casual gambler who elects to itemize deductions may deduct wagering losses, up to wagering gains, on Form 1040, Schedule A. In this case, the taxpayer may deduct only $350 of her $610 of wagering losses as an itemized deduction. A casual gambler who takes the standard deduction rather than electing to itemize may not deduct any wagering losses.

IRS AM 2008-011. (Internal citations omitted).

Nevertheless, the reasoning stated in the 2008 IRS memorandum–that aggregating winnings and losses occurring in a particular period, then including the net winnings (winnings minus losses whenever winnings exceed losses) as income–is the proper measure for determining wagering gains for federal income tax purposes–is persuasive for the reasons stated therein. The treatment of wagering income is determinative regardless of the withholding and reporting requirements under state and federal law.

In this case, Taxpayers provided a comprehensive log of their gaming activities. Taxpayers' log included the date, location, gain or loss by session, and games played. Taxpayers' log included locations both inside and outside Indiana. Taxpayers provided information that they deducted their gambling losses on their IN-IT40PNR Schedule C, rather than having their adjusted gross income be their net winnings.

Based on the information presented, Taxpayers have provided sufficient legal and factual grounds to conclude that their income as reported for Indiana individual income tax purposes was correct, and thus their previously-denied refund claim should be sustained. The Department will use Taxpayers' Schedule C number to adjust their income to reflect their net winnings as in accordance with IRS AM 2008-011.

FINDING

Taxpayers' protest is sustained pending the Department's adjustment.

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An html version of this document.