DEPARTMENT OF STATE REVENUE

01-20210071.LOF

Letter of Findings: 01-20210071
Individual Income Tax
For the Years 2014 through 2017

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Although failing to qualify as a "professional gambler, Out-of-State Individual was entitled to "net" his "per session" gambling losses and gambling winnings on a "per session" basis in determining the amount of "other income" on his Indiana income tax returns. However, Individual was required to make available detailed, supplementary casino documentation in order to justify that claim.

ISSUE

I. Individual Income Tax - Netting Gambling Income and Gambling Losses.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-2; IC § 6-8.1-5-1(c); IC § 6-8.1-5-2(b); *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); *Ferguson v. C.I.R.*, T.C. Summ. Op. 2007-30, 2007 WL 610059 (Feb. 28, 2007); I.R.C. § 165; I.R.C. § 6110; Rev. Rul. 54-339, 1954-2 C.B. 89; I.R.S. Adv. Mem. 2008-011 (December 12, 2008); I.R.S. Tech. Adv. Mem. 8123015 (February 27, 1981); Memorandum of Decision 01-20200250 (July 21, 2020); Memorandum of Decision 01-20190029R (February 27, 2019).

Taxpayer argues that he was entitled to calculate his Indiana gambling income by "netting" his session winnings and losses on a "per session" basis.

STATEMENT OF FACTS

Taxpayer is an individual who resides outside Indiana. Taxpayer regularly filed a Federal 1040 Form Schedule C ("Profit or Loss from Business") to report Indiana casino gambling income. On that return, Taxpayer necessarily maintained that he was a "professional gambler."

During the years in which Taxpayer engaged in Indiana gambling, the Indiana casinos withheld tax on Taxpayer's slot machine winnings which exceeded $1,200. Knowing that this money had been withheld and believing that he qualified as a "professional gambler," Taxpayer filed IT40-PNR returns claiming refunds of those amounts by offsetting total gambling losses against total gambling winnings.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's most recent return; a 2017 IT40-PNR in which Taxpayer sought a refund of approximately $70,000.

The Department requested that Taxpayer supply additional documentation. According to the audit report, "The [T]axpayer and [his] representative did not provide any calculation or explanation of reported losses during the audit period."

The Department then expanded its review to include an examination of gambling activity reported on Taxpayer's 2014, 2015, and 2016 returns. That review resulted in a conclusion that Taxpayer could not account "for his gambling behavior," gambling investments, or his gambling activities' "ultimate profitability."

Because the audit found that Taxpayer "did not carry out [his] gambling activities in a businesslike manner," the Department concluded that Taxpayer was not a professional gambler and could not report his gambling winnings in the manner in which he did.

The Department thereafter issued a "proposed assessment" of approximately $110,000. Taxpayer disagreed with

the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Individual Income Tax - Netting Gambling Income and Gambling Losses.

DISCUSSION

Taxpayer agrees that he is not qualified to report his income as a "professional gambler." The Department here fully agrees with that conclusion. However, as a "casual gambler," Taxpayer argues that he should now be able to "net" his "winnings and losses" on a "per session" basis. Taxpayer concludes that, as a result, the proposed assessment should be reduced to reflect those cumulative per session losses.

The issue is whether Taxpayer has established that he is permitted to "net" his "per session" gambling winnings and losses when reporting "other income" on his Indiana income tax returns. In other words, is Taxpayer permitted to report only his "per session" net gambling winnings - as opposed to each individual winning transaction - in determining his adjusted gross income?

As with any proposed assessment of Indiana tax, it is the Taxpayer's responsibility to establish that the 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).

In general, IC § 6-3-1-3.5(a) provides that federal adjusted gross income is the starting point for determining Indiana adjusted gross income for individuals. For nonresidents, IC § 6-3-2-2(a) provides that income derived from Indiana sources is subject to Indiana income tax.

For federal income tax purposes, "Losses from wagering transactions shall be allowed to the extent of the gains from such transactions." I.R.C. § 165(d). "For Federal income tax purposes, all wagering gains must be included in gross income." Losses therefrom, by a taxpayer who is not in the trade or business of gambling, are not deductible in determining adjusted gross income because such losses do not come within the provisions of section 22(n) [now I.R.C. § 62] of the Internal Revenue Code. Nor are the losses deductible from adjusted gross income in determining net income where the taxpayer has elected to use the standard deduction." Rev. Rul. 54-339, 1954-2 C.B. 89. The effect of this federal tax treatment is that Indiana does not permit a deduction for wagering losses except for professional gamblers because casual gamblers are not running a business and have no reasonable expectation that they can make their livelihood in doing so. *See Ferguson v. C.I.R.*, T.C. Summ. Op. 2007-30, 2007 WL 610059 (Feb. 28, 2007).

Within the definition of "wagering gains," the measure of the gains included in income has been disputed within both the Department and the Internal Revenue Service. For instance, a player enters a casino and wagers $10,000 on a slot machine in one day. The player has three wins, one for $10,000, one for $5,000, and one for $3,000. Each time the wager is $20. The question is then whether the player's income is the $18,000 gross winnings less the $60 wagers resulting in wins as an offset–in other words, $17,940–or the income is the $8,000 net "per session" profit.

In 1981, the Internal Revenue Service issued I.R.S. Tech. Adv. Mem. 8123015 (February 27, 1981). In that TAM, an individual wagered $2 on the results of jai-alai matches. His wagers were structured so that he entered up to 315 combinations of wagers each day. Under one approach, if he bought 200 tickets but only one ticket won for $500, he would report $498 ($500-$2) income and $398 (199 losing tickets times $2) losses. Based on this method, his income totaled $91,000, while his losing tickets cost $98,000.

A second method was suggested as well. Under the second method, his $500 winnings would be netted against the $400 total tickets purchased on that day for $100 income and no losses. Based on the alternative method, his income totaled $22,000, while his losses totaled $29,000.

The 1981 memorandum reasoned that each ticket constituted a separate wager for purposes of I.R.C. § 165(d) and I.R.C. § 3402(q) (relating to withholding on gambling winnings). Thus, the individual had income of $91,000 for federal income tax purposes.

The Department points to I.R.S. Adv. Mem. 2008-011 (December 12, 2008). The document cited is a Chief

Counsel Memorandum which may not be cited as precedent pursuant to I.R.C. § 6110(k)(3). In the memorandum, an example was proposed with a taxpayer who played slot machines; the taxpayer was not a professional gambler. In the fact scenario presented, the taxpayer had some winning days (e.g., she entered with $100 and left with $500) and some losing days (e.g., she entered with $100 and left with nothing). The issue was whether the taxpayer had to count each winning machine pull (less wager on the pull) as income or whether the taxpayer could net winnings and losses each day in determining the taxpayer's income. The 2008 memorandum concluded that netting upon redemption of tokens or money was appropriate in the scenario presented.

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 here. That position is consistent with the Department's long-standing stance on this matter. *See* Memorandum of Decision 01-20200250 (July 21, 2020), 20200930-IR-045200485NRA; Memorandum of Decision 01-20190029R (February 27, 2019), 20190424-IR-045190221NRA.

Further, as a matter of recordkeeping by taxpayers, a "per session" netting approach is a less cumbersome recordkeeping requirement–for instance, keeping a log reflecting one session entry as opposed to potentially hundreds of individual entries–and a recordkeeping requirement more consistent with the reality of actual wagering behavior. The treatment of wagering income is determinative regardless of the withholding and reporting requirements under state and federal law.

Taxpayer now contends that he has provided detailed spreadsheets specifying his "per session" wagering, winnings, and losses. Among other details, the spreadsheets list the date/year of each session, the amount of "starting dollars," the amount of "ending dollars," the W-2G ("Certain Gambling Winnings") income amounts, a "per session adjustment" amount, the time spent in hours for each gambling session.

As casual gamblers, the IRS requires that each taxpayer provide or make available detailed documentation; the IRS requires; (1) casino "cash out slips;" (2) casino "player card activity;" (3) casino "cash-out sheets;" (4) casino "payout slips," (5) individual, "personal gambling activity diaries." *See* IRS Publications 17 and 529. Therefore, Taxpayer will have the opportunity to submit this documentation to the Department within ninety (90) days of the date this decision is issued. At that time, the Department will review any such new documentation and will allow offsetting credits of per-session losses against corresponding per-session winnings to the extent verified by the new documentation.

Taxpayer raises a secondary argument in which he suggests that whether he is qualified as a professional gambler or not, the pending 2014, 2015, and 2016 assessments should be invalidated because they are based entirely on the six-year extended limitations set out in IC § 6-8.1-5-2(b) which provides:

> If a person files a return for the utility receipts tax (IC 6-2.3), adjusted gross income tax (IC 6-3), supplemental net income tax (IC 6-3-8) (repealed), county adjusted gross income tax (IC 6-3.5-1.1) (repealed), county option income tax (IC 6-3.5-6) (repealed), local income tax (IC 6-3.6), or financial institutions tax (IC 6-5.5) that understates the person's income, as that term is defined in the particular income tax law, by at least twenty-five percent (25[percent]), the **proposed assessment limitation is six (6) years instead of the three (3) years** provided in subsection (a). (**Emphasis added**).

Taxpayer postulates that a proper and accurate recalculation of his 2014, 2015, and 2016 taxes will result in an assessment that is less than a 25 percent understatement and that any remaining assessment will be barred by the three-year statute of limitations. *See* IC § 6-8.1-5-2(a). In this case, the Department believes that Taxpayer has the cart well before the horse. Until Taxpayer's records and calculations can be reviewed, any assessment forecast is entirely speculative. However, if Taxpayer provides the new required documentation described above and if review and application of that documentation results in reduced assessments which would have an effect under IC § 6-8.1-5-2(b), the Department will review Taxpayer's secondary argument regarding the statute of limitations and will apply IC § 6-8.1-5-2(b) as appropriate.

FINDING

Taxpayer's protest is sustained subject to submission within 90 days of the date of this Letter of Findings the documentation required by this written decision. Upon review of that documentation the Department's Audit Division will determine if Taxpayer's calculations are correct and the amount of any remaining assessment.

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