

## Gambling: There'll Be Time Enough for Taxes When the Dealin's Done

By: Brad Polizzano, Esq.

Did your client get lucky at the slot machines and receive a Form W-2G? Does your client seek to make a living as a poker player? There are various nuances and recent developments under the federal and state tax laws with respect to gambling that tax professionals should be aware of. Proper advanced planning and guidance could make the tax preparation experience far less onerous and significantly reduce potential audit exposure. Here are some key tips that will put the odds of accuracy more in the taxpayer's favor:



Brad Polizzano, Esq.

### **Under the Internal Revenue Code, all gambling winnings of U.S. residents are taxable.**

I have read on several occasions that only gambling winnings reported on informational returns are taxable: Wrong. Under section 61(a) of the Internal Revenue Code, all income from whatever source derived is includible in a U.S. resident's gross income. Whether the gambling winnings are \$5 or \$500,000, all amounts are taxable.

### **The IRS requires taxpayers to maintain an accurate diary of all gambling winnings and losses.**

If I could provide only one piece of advice to taxpayers with gambling winnings and losses, it would be to keep very, very, very good records of the gambling activity. IRS Publication 529 states a taxpayer must keep an accurate diary or other similar record of all losses and winnings. The diary should contain:

- The date and type of the specific wager or wagering activity.
- The name and address or location of the gambling establishment.
- The names of other persons present at the gaming establishment.
- The amount(s) won or lost.

*The fourth bullet point above brings us to the next tip:*

### **The Internal Revenue Code requires a taxpayer to separately total all gambling winning sessions and all gambling losing sessions.**

In general, a taxpayer cannot simply net all gambling winnings and losses from the year and then report that amount as "other income" on line 21 of Form 1040. (Note an exception for the "professional" gambler, discussed below.) A taxpayer must separately record each gambling winning "session" and gambling losing "session."

Unfortunately, neither the tax code nor the IRS provides any guidance on what constitutes a gambling "session." In *LaPlante v. Commissioner*, T.C. Memo 2009-226, the U.S. Tax Court inferred a taxpayer may net all slot winnings and losses from a single day of

play at a casino as one gambling session. There is no court precedent addressing other casino games, however, such as poker. Because there are different poker game formats (cash and tournament) and game types (Texas Hold'em, Pot Limit Omaha, etc.), it is unclear whether the one session per day *LaPlante* analysis comports with poker.

### **The Internal Revenue Code permits the deduction of gambling losses only to the extent of gambling winnings.**

Gambling losses are reported as an itemized deduction on Schedule A. One with an overall loss from gambling for the year cannot use the net loss to offset other income, create a net operating loss carryback or carryover, or carry to a previous or future tax year to offset gambling winnings in such year. A certain type of gambler, however, treats gambling winnings and losses differently: The professional gambler.

### **The professional gambler reports gambling winnings and losses on Schedule C.**

A professional gambler is viewed under the tax code as engaged in the trade or business of gambling, and pays self-employment tax on the business income. To compute the business income, the taxpayer may net all gambling activity, but cannot report an overall gambling loss. In addition, the taxpayer may also deduct "ordinary and necessary" business expenses incurred in connection with the business.

### **The professional versus amateur gambler status for tax purposes is a "facts and circumstances" determination.**

A taxpayer cannot choose the status that produces a lesser tax bill. In *Commissioner v. Groetzinger*, 480 U.S. 23 (1987), the Supreme Court established the professional gambler standard:

If one's gambling activity is pursued full-time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes with which we are here concerned.

Despite receiving other forms of income in 1978, Mr. Groetzinger was held to be a professional gambler for the year because he spent 60 to 80 hours per week at dog races gambling solely for his own account. Gambling was his full-time job and livelihood. Notably, Mr. Groetzinger had a net gambling loss in 1978. Thus, actual profit is not a requirement for professional gambler status.

In addition to applying the standard established by the Supreme Court, the U.S. Tax Court and state tax courts sometimes apply the following non-exhaustive nine factor test found in the Internal Revenue Code regulations to determine whether a taxpayer

*(continued on page 18)*

## Gambling: There'll Be Time Enough for Taxes When the Dealin's Done

(continued from page 7)

is a professional gambler:

- Manner in which the taxpayer carries on the activity;
- The expertise of the taxpayer or his advisers;
- The time and effort expended by the taxpayer in carrying on the activity;
- Expectation that assets used in the activity may appreciate in value;
- The success of the taxpayer in carrying on other similar or dissimilar activities;
- The taxpayer's history of income or losses with respect to the activity;
- The amount of occasional profits, if any, which are earned;
- The financial status of the taxpayer; and
- Elements of personal pleasure or recreation. (Note the irony for this factor: Gambling for pleasure weighs against professional gambler status!)

The burden of proof is on the professional gambler to prove such status. Again, whether one should file as a professional gambler is a facts and circumstances determination. In most cases, it should be pretty clear where the taxpayer falls.

What if a professional gambler's "ordinary and necessary" business expenses exceed the net gambling winnings for the year? In *Mayo v. Commissioner*, 136 T.C. 4 (2011), the court held the limitation on deducting gambling losses does not apply to "ordinary and necessary" business expenses incurred in connection with the trade or business from gambling. Therefore, a professional gambler may report a business loss, which may be applied against other income from the year.

### Some states further limit a taxpayer's ability to deduct gambling losses for income tax purposes, including New York.

NY Tax Law section 615(f) phases out all itemized deductions based on AGI, yet the Internal Revenue Code excepts only certain items from the reduction of itemized deductions, not including gambling losses. Gambling losses are an itemized deduction, as noted above, and fall into the NY catchall. Application of section 615(f), unfortunately, may result in a taxpayer paying NYS income tax on "phantom" winnings.

For example, suppose during 2011 I had \$2,000,000 in gambling winnings and \$2,000,000 in gambling losses. On my NYS income tax return, I must report and pay tax on the winnings. Because of section 615(f), however, I cannot deduct any of the losses so I must pay tax on the gross winnings!

If commercial casino gambling is approved in New York, I suspect the limitation on itemized deductions in NY will change to mirror current federal law. In Ohio, amateur gamblers cannot deduct gambling losses for state income tax purposes. Taxpayers will be allowed to deduct gambling losses to the extent of gambling winnings in the Buckeye State beginning in 2013, as a result

of the commercial casino expansion there. Other states that do not allow non-professional gamblers to deduct gambling losses include: Connecticut, Illinois, Indiana, Massachusetts, Michigan, West Virginia, and Wisconsin.

From recordkeeping to professional versus amateur gambler status to state income taxes, gambling presents a variety of tax issues. A taxpayer who engages in gambling activity will be in a position to painlessly survive an IRS or state income tax audit with proper planning and guidance.

Just remember: In the end, the house always wins.

*Brad Polizzano, Esq., LL.M. (Tax) is an attorney at the law firm of Karen J. Tenenbaum, P.C.*

## Bond Assistance Program

(continued from page 4)

Current surety companies that have expressed an interest in participating in the program include ACE Group and Travelers.

While the involvement of established surety companies is a crucial piece to the success of this program, the life force of this program is the backing by the New York State government. In light of recent economic times, to see a strong commitment towards the development of MWBEs in the infrastructure/construction segment, we could be drawing closer to that light at the end of the tunnel towards recovery.

*Lori A. Crawbuck, CPA, CCIFP is an Audit Manager in the construction practice at Grassi & Co.*

## SEE YOUR ARTICLE HERE!

The editors of the Chapter newsletter invite you to contribute. If there is something new or exciting that you would like to share with your colleagues, from photos of a recent event, to ideas on how to make the newsletter more interesting and fun...

Please contact the editors at  
[nassaunewsletter@nysscpa.org](mailto:nassaunewsletter@nysscpa.org)