DEPARTMENT OF STATE REVENUE

01-20130575.LOF

Letter of Findings: 01-20130575
Individual Income Tax
For the Year 2012

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 This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Individual Income Tax – Adjusted Gross Income.

Authority: I.R.C. § 61; I.R.C. § 62; I.R.C. § 63; I.R.C. § 165; I.R.C. § 6110; IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; 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).

Taxpayer, a casual gambler, protests the Department's refund denial and the assessment of additional Indiana income tax for the 2012 tax year.

STATEMENT OF FACTS

Taxpayer is an individual and resident of Ohio. During the 2012 year, Taxpayer occasionally visited various casinos, located in Indiana and outside of Indiana, and played slot machines recreationally. For each casino visit, Taxpayer had some wagering gains and also had some wagering losses. Also, for each casino visit, Taxpayer recorded his wagering gains and/or losses on a "per session" (usually per day/per visit) method, which includes the amount of money he designated to play and the amount of money remaining before he leaves for each casino visit. Pursuant to Indiana tax withholding requirements, the Indiana casinos withheld income tax on Taxpayer's wagering gains, if any, and issued W-2G forms.

In 2013, Taxpayer timely filed his 2012 Indiana Part-Year or Full-Year Nonresident Individual Income Tax Return ("IT-40PNR"), claiming that he was entitled to a refund of $2,708 on the income tax withheld by the Indiana casinos on his wagering gains.

Upon reviewing Taxpayer's 2012 return, the Indiana Department of Revenue ("Department") denied Taxpayer's refund claim. The Department also adjusted Taxpayer's Indiana income, resulting in the assessment of additional income tax, penalty, and interest.

Taxpayer 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

The Department denied Taxpayer's refund for the 2012 tax year on the ground that Taxpayer could not claim gambling losses in calculating his Indiana income tax. The Department reasoned that Taxpayer, as a casual gambler, can only claim an itemized deduction concerning the gambling losses to the extent of his gambling winnings in Schedule A of his federal income tax return. Since Indiana does not allow a casual gambler to claim an itemized deduction of gambling losses on his state income tax return, the Department disallowed Taxpayer's requested adjustment of $79,068 to the taxable income reported on the W-2G forms. The Department's disallowance of Taxpayer's $79,068 adjustment on his 2012 return resulted in a deficiency of tax.

Taxpayer protested the denial of refund and the additional assessment of the individual income tax. Taxpayer added that, as a casual gambler, he did not attempt to deduct his gambling losses in his Indiana 2012 Indiana return, IT-40PNR. Taxpayer maintained that he did not deduct a loss–i.e., when he lost all of his wagers for the day. Rather, Taxpayer 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"), he recorded his gambling winnings/losses (per day or per visit) for federal income tax purpose, which resulted in reducing gains by $79,068 (i.e., the total gains after netting minus the total amount stated in the W-2G forms) for 2012 tax year. Taxpayer thus asserted that since Indiana generally follows federal law and regulations in reporting income tax, he should be permitted to use the "per session" method to determine his Indiana adjusted gross income for Indiana income tax purposes. Thus, the issue is whether Taxpayer, a casual gambler, is permitted to use the "per session" method to report his gambling gains–as opposed to each individual winning transaction (per play)–in determining his Indiana adjusted gross income.

In general, the Internal Revenue Code requires a taxpayer to report and pay his or her federal income tax when his or her gross income exceeds a certain amount. Gross income includes all income whatever source derived. I.R.C. § 61(a). Thus, income from gambling winnings is also considered income subject to federal income tax. Shollenberger v. C.I.R., T.C.M. 2009-306, 2009 WL 5103973 *1 (U.S. Tax Ct. 2009). Nonetheless, losses generated from gambling activities are treated differently depending on whether a taxpayer is in the trade or business of gambling. Id. at *2; I.R.C. § 62(a)(1). A taxpayer that is as a casual gambler is allowed to deduct his or her gambling losses only when he or she claims an itemized deduction in his or her Schedule A to the federal

individual income tax return, Form 1040. Shollenberger, 2009 WL 5103973 at *2 (noting the taxpayers/petitioners were casual gamblers and they were not entitled to an itemized deduction of their gambling losses because they elected the standard deduction when they filed their joint federal income tax return for the taxable year at issue.); I.R.C. § 63(e). Also, the casual gambler is allowed to deduct his or her losses only to the extent of the gains from such transactions. I.R.C. § 165(d). "In the case of a husband and wife making a joint return for the taxable year, the combined losses of the spouses from wagering transactions shall be allowed to the extent of the combined gains of the spouses from wagering transactions." Treas. Reg. § 1.165-10.

For state income tax purposes, the presumption is that a taxpayer properly and correctly files his or her federal income tax returns and, thus, to efficiently and effectively 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:
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> (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
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> (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
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> (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. 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.
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> **Calculating the Taxpayer's Gains and Losses**
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> 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).
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> 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).

In this instance, referencing IRS AM 2008-011, Taxpayer noted in his 2012 return an adjustment of $79,068 in filing his Indiana IT-40NPR return. At the hearing, Taxpayer stated that he is a casual gambler and played the slot machines at various casinos in Indiana and outside of Indiana during 2012. Taxpayer stated that, for each visit, he recorded the amount of his wager at the beginning of his play and the remaining amount at the end of each of his visits pursuant to the method outlined in IRS AM 2008-011. Taxpayer further explained that, similar to the casual gambler in IRS AM 2008-011, the casinos only issued W-2G forms, withholding income tax on his winnings, and did not record his losses, if any. Thus, Taxpayer maintained that, for state income tax purposes, he should be allowed to use the "per session" method pursuant to IRS AM 2008-011 in filing his Indiana income tax return because Indiana generally follows federal tax law and regulations. Taxpayer further explained that his 2012 Indiana IT-40NPR return, as filed, resulted in a reduction of his federal adjusted gross income in the amount of $79,068 and, thus, a refund of state income tax is due in the amount of $2,708. To support his protest, Taxpayer submitted additional documentation, including a copy of his activity log–"2012 Slot Machine Activity by Session." The log consists of several columns, including, but not limited to, (1) the amount of money he designated to play at the beginning for each visit; (2) the amount of money remaining at the end of that day when he leaves the casino; (3) amount stated in W-2G form(s), if any; and (4) witness. Taxpayer thus claimed that he was entitled to a refund of the tax withheld on his wagering gains pursuant to the "per session" method outlined in IRS AM 2008-011 and that the Department erred in denying his refund and assessing additional income tax by only considering the income stated in the W2Gs issued by the casinos.

As a preliminary matter, the document Taxpayer cited is a Chief Counsel Memorandum which may not be cited as precedent pursuant to I.R.C. § 6110(k)(3). Nonetheless, as mentioned earlier, for income tax purposes, Indiana generally piggybacks federal law and regulations. Thus, IRS AM 2008-011 can be a useful guide to determine the proper amount of a casual gambler's income (from wagering gains) attributable to Indiana. Specifically, the reasoning offered in IRS AM 2008-011 to support its conclusion that aggregating winnings and losses occurred in a particular period, and then including the net winnings (winnings minus losses, whenever winnings exceed losses) as income is persuasive and well accepted by the federal courts. Additionally, as a matter of recordkeeping, the approach of netting upon redemption of token would have been less cumbersome.

In short, Taxpayer is permitted to report his wagering gains on a "per session" (per day or per visit) basis in determining his Indiana adjusted gross income pursuant to IRS AM 2008-011. For each session, Taxpayer's wagering gain is subject to Indiana income tax; however, Taxpayer is not allowed to claim any losses, if any, to reduce his gain in his 2012 Indiana IT-40NPR return or to carry over the losses to a different taxable year for state income tax purposes. Taxpayer's protest is sustained pending the Department's further review of Taxpayer's supporting documentation, including the activity log for the year at issue and W-2Gs, in determining the amount of refund.

FINDING

Taxpayer's protest is sustained pending the Department's further review of Taxpayer's supporting documentation in determining the amount of the refund. Taxpayer is permitted to report his wagering gains on a "per session" method pursuant to IRS AM 2008-011. For each session, Taxpayer's wagering gain (under per session method) is subject to Indiana income tax; however, for each session, Taxpayer is not allowed to claim any losses (under per session method), if any, to reduce his gains in his 2012 Indiana IT-40NPR return pursuant to 45 IAC 3.1-1-4. Taxpayer is also not allowed to carry over the losses, if any, to a different taxable year to reduce his state income tax liability.

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