DEPARTMENT OF STATE REVENUE

01-20160451.LOF

Letter of Findings: 01-20160451
Individual Income Tax
For the Tax Year 2013

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Individual properly reported his Indiana income from casual gambling on a net "per session" basis and was therefore not subject to additional Indiana individual income tax.

ISSUE

I. Individual Income Tax - Gambling Income.

Authority: I.R.C. § 61; I.R.C. § 62; I.R.C. § 63; I.R.C. § 165; 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); 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 assessment of additional Indiana income tax for the 2013 tax year.

STATEMENT OF FACTS

Taxpayer is an individual residing in Ohio. Taxpayer concedes he is not a professional gambler. During the 2013 year, Taxpayer occasionally visited various casinos, located in 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 netted per day/per visit) basis. 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 2014, Taxpayer timely filed his 2013 Indiana Part-Year or Full-Year Nonresident Individual Income Tax Return ("IT-40PNR"). The Department initially accepted Taxpayer's return as filed and issued a refund of $1,647.00. However, upon further review of Taxpayer's 2013 return, the Indiana Department of Revenue ("Department") adjusted Taxpayer's Indiana income, resulting in an assessment of additional tax, penalty and interest, in part constituting the refund that was originally issued to Taxpayer.

Taxpayer protested the adjustment to his 2013 IT-40PNR. An administrative phone hearing was held and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Individual Income Tax - Gambling Income.

DISCUSSION

As a threshold issue, it is the Taxpayer's 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.

Taxpayer protested the adjustments to his 2013 Indiana IT-40 PNR return and the assessment of additional individual income tax. 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 session) for federal income tax purposes. Taxpayer thus asserted that since Indiana generally follows federal law and regulations in reporting income tax, the adjustment should be allowed.

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 from 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 who is classified 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).

For Indiana income tax purposes, the presumption is that a taxpayer properly and correctly files his or her federal income tax returns. Also, to efficiently compute what is considered Indiana income tax, the Indiana imposition 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 status, 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 his wagering gains and/or losses based on a "per session" basis (upon redemption of his 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.

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 he redeems his tokens. We think that the fluctuating wins and losses left in play are not accessions to wealth until the taxpayer redeems his 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 his 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 his $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).

Thus, the proper measure for determining wagering gains for federal income tax purposes is to aggregate winnings and losses occurring in a particular period, then include the net winnings (winnings minus losses whenever winnings exceed losses) as income. The treatment of wagering income is determinative regardless of the withholding and reporting requirements under state and federal law.

In this case, Taxpayer provided both a summary and comprehensive records of his gaming activities. Taxpayer's log included the date, location, gain or loss by session, and games played. Taxpayer provided information showing that he utilized the "per session" method in reporting gambling gains in order to determine his Indiana adjusted gross income on Schedule A of the IT-40PNR, pursuant to IRS AM 2008-011.

Based on the information presented, Taxpayer has provided sufficient legal and factual grounds to conclude that his income as reported for Indiana individual income tax purposes was correct, and thus he should not have been assessed additional tax, penalties and interest. The Department will use Taxpayer's originally reported income to reflect his net winnings in accordance with IRS AM 2008-011.

FINDING

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

Posted: 01/25/2017 by Legislative Services Agency
An html version of this document.