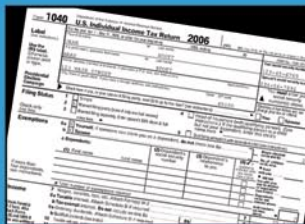


TAX HELP FOR GAMBLERS

Poker & Other Casino Games



Jean Scott, The Frugal Gambler
& Marissa Chien, Enrolled Agent

Foreword by Phil Gordon,
Professional Poker Player

Other Books

by Jean Scott

The Frugal Gambler

More Frugal Gambling

Frugal Video Poker

Frugal Video Poker Scouting Guide

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DISCLAIMER

The information presented in this book is intended as no more than a general guideline for the general public. Tax issues surrounding gambling can be extremely complicated and ultimately depends upon the “facts and circumstances” of each individual taxpayer. Although the authors and the publisher have made every effort to ensure the accuracy of this information, it’s imperative that taxpaying gamblers consult with tax advisors regarding personal situation.

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Foreword **by Phil Gordon**

When I met Marissa Chien about three years ago, my financial life was a mess. Like many professional gamblers, I had neglected many of my financial responsibilities. Being a “winner” makes that easy to do. The money just seems to roll in and there’s always enough to cover whatever tournament buy-ins are required and whatever expenses are necessary.

I’ve been a professional poker player now for about eight years. Knock on wood, I’ve never had a losing year. Not everyone can run so good for so long. By my estimates, about 80% of the professional players you see on TV on a regular basis have been broke or are currently broke. It happens. This is a risky business. And at the end of the day, every dime you can save on taxes is a dime that mitigates your risk of going broke. It’s “saving bets” that counts the most over the long term, not only in gambling, but also with the IRS.

Take my advice: Get on board with a solid accounting plan. You may not be able to use Marissa as your personal accountant like I’m fortunate enough to do. But you can use the solid information in this book, available nowhere else as far as I know, to stay square with the

taxman, neither underpaying nor overpaying what you owe on your gambling winnings.

I used to absolutely dread April 15th. Now it's just another day when I can go down to the casino and win some money and build my bankroll.

Best of luck, and may you be fortunate enough to have to pay some taxes on your gambling winnings year after year.

—Phil Gordon, poker professional

Author's Notes

JEAN SCOTT

This book started out to be a single chapter in my earlier book *More Frugal Gambling*. Due to my own experiences and the questions many casino players asked me, I knew that the tax implications of gambling were a big mystery to most people. So I began researching the subject. I read as many IRS publications as I could find and searched widely for tax information on the Internet. I talked to present and former IRS agents and to many tax preparers and accountants and lawyers.

I discovered that the IRS offers surprisingly few details to guide gamblers through the tax maze in which they find themselves. Furthermore, I found what the IRS does say is often general, vague, open to individual interpretation, and even contradictory. This may have been done intentionally, so that most gambling issues would fit under a large umbrella of general guidelines. Or, more likely, it's typical government bureaucracy that is slow to keep up with changing times.

Whatever the reason, it's difficult for an individual taxpayer to know exactly how to treat his particular gambling circumstances, and it has even ended up confusing the IRS itself. Therefore, you can't call

one IRS phone number and get the final and absolute answer to your questions on gambling and federal income taxes—calling and talking to 10 different IRS representatives might give you up to 10 varying pieces of advice. Two auditors sitting next to each other in the same office could hear the same information and come up with entirely different results.

In addition, I quickly learned that many tax preparers aren't knowledgeable about gambling issues, even if they're experts in other tax areas. For many years before we moved to Las Vegas, I had to educate my otherwise-excellent accountants about gambling issues, though my own knowledge was extremely limited at the time.

However, when we moved to Vegas, Brad and I were fortunate to find a fellow gambler who was also a tax accountant—Marissa Chien. Finally, I had someone who, as a gambler as well as an Enrolled Agent, was knowledgeable about both gambling *and* taxes and could do our tax returns in such a way that we could be relatively certain that all the bases were covered accurately. Marissa gave me so much valuable input for my tax chapter, which she had kindly offered to edit, that I realized this was a much broader subject than I'd originally imagined.

A lightbulb came on in my head: I needed more of Marissa's input to cover this subject adequately, and it was definitely too much for one chapter in a book. It needed a whole book to itself, one that Marissa and I should write together. So that is how *Tax Help for Gamblers* was born.

We've retained most of the text of the original chapter, written in my folksy layman's style. Marissa went through it and added important information to explain some of the whys and hows of this complex subject, including tax-code specifics, relevant court cases, and professional comments. She also prepared the charts and forms in the section on state taxes and in the Appendix, to help readers better see the practical application of the information we cover.

Although the publisher has put a disclaimer in the front of this book, Marissa and I want to add some cautions here. I'm a teacher and a writer by profession, not an accountant or lawyer. Although I try to be clear in differentiating between facts and opinions, I want

to emphasize that no one should base his or her actions solely on the information in this book. Even though Marissa is a qualified Enrolled Agent and has more technical knowledge in this area than I do, she strongly concurs. The information here is provided merely to help you become more knowledgeable about some of the thorny issues in this complex field.

Another caution: There are limitations with any tax information written in this (or any) book. Government tax policy is not a placid pond. It's an ever-changing river, with treacherous rapids along the way. Even professional tax preparers wage a constant battle to keep up to date on the changes; most individual taxpayers don't have a chance. Often, the first versions of commercial software you buy to help you do your own taxes have to be updated during the same tax season. This is the reason many knowledgeable and experienced do-it-yourself taxpayers still have a professional look over their returns just before they submit them to the government.

As always, we advise that you seek the advice of a tax professional to guide you in your *personal* tax decisions.

MARISSA CHIEN

I'm a gambler myself. I owe a lot of what I know about video poker and maximizing my gambling dollar to the expertise of Jean Scott and her writing about smart gambling. Even with my specialization in taxes, when I tried to accurately report my gambling activities on my own tax returns, I began to realize that the laws relating to gambling are not very specific as they pertain to today's gambling environment. Even as a tax professional, I was finding it difficult to find clear guidance.

And if it was intricate for me, it's no surprise that the general public doesn't have a clue. Just from writing a couple of columns a year for the *Las Vegas Advisor* on the subject and preparing other gamblers' returns, not a week goes by that I don't get a call from someone from

around the country asking for my help. No book out there deals with the nuances of gambling and tax returns completely enough to show how the IRS auditors look at this issue, and the IRS publications leave you with more questions than answers. With the proliferation of casinos—combined with the increased focus by the IRS on gamblers—this will become more of a problem for more taxpayers in the future.

Many people say, “I just give my tax preparer any paperwork I get from a casino and he/she takes care of all the details; I don’t need to know all this stuff.” The problem with this is that many of these tax professionals aren’t gamblers themselves, thus aren’t knowledgeable about the accompanying tax issues. So even though you don’t do your own tax returns, you should have at least a basic knowledge of tax issues so that you’re able to choose a knowledgeable tax preparer and provide enough records that he or she can do the best job.

Part I

Federal Taxes

“If you want to make bets, your odds would be better to go to a casino.”

—Ex-IRS Commissioner Charles Rossotti, warning taxpayers just before the tax deadline in April 2001 not to be tempted by falling audit rates to cheat.

1

The Basics

[Editor’s Note: The writer alternates throughout the book between Jean and Marissa. When a change occurs, the writer is identified in the beginning of the first paragraph.]

JEAN: “Paying taxes on my gambling wins? You’ve got to be kidding. Sure, sometimes I win, but my losses are always much larger than my wins by the end of the year. So I don’t have to mess with it on my federal or state tax returns.”

Wrong! You probably should “mess with it,” especially if you hold any of the following common, but *mistaken*, beliefs:

- I can lump together all my wins and losses for the year and, if I have a net loss, I don’t need to put wins or losses on my income tax returns. After all, I didn’t have any gambling income.
- The IRS can’t “catch” me, even if I win a lot of money gambling, as long as it’s done slowly over a considerable period of time in different gambling venues and I get no official forms like a W-2G or 1099.

- Federal and state tax agencies know most gamblers lose over the long term, so they aren't very interested in auditing them.
- If I do get a few W-2Gs, I can just count that total as my gambling income for the year and be safe in an IRS audit.
- If I gamble online, the IRS doesn't get any records of this, so I don't have to report any of my winnings.
- If I gamble on a cruise ship in waters three miles from U.S. soil, I don't need to report my winnings.
- If I play poker only in home games, I do not have to report my winnings.
- Winnings from illegal gambling are not taxable.

Before we go any further, let me emphasize: The purpose of this book is not to moralize about reporting or not reporting your gambling wins and losses. However, as casinos spring up around the country and, as a result, more and more people gamble, the IRS is becoming more interested in this area of potential under-reporting. If you report any W-2Gs, or don't include them when you've been issued them, it's becoming more likely you'll be asked by the IRS to provide more details of your gambling. And it's becoming more likely that you might be questioned about gambling if you come to the attention of the IRS for other reasons, even a routine audit.

MARISSA: However, you should also know that the IRS can't go on "fishing expeditions" if you're being audited. When the IRS audits you, they have to tell you specifically which area of your tax return they're examining. For example, if they're questioning the part of your return that shows you're claiming a room of your home for a business office, they must keep their investigation and questions to that one subject. However, if you open the door by commenting on other subjects, i.e., gambling, then they can question you about that area. (This is the reason it's usually best to have professionals speak for you at an audit—they know to stick carefully to the subject at hand. Taxpayers are often so nervous that they ramble all over the place in their effort to "explain.")

You should be aware that the Criminal Investigative Division (CID) of the IRS is beginning to investigate gamblers more thoroughly. The CID looks for people who willfully, with intent, try to defraud the IRS by under-reporting income or overstating losses and deductions. And they like to jump at the chance to leverage the publicity that they would get by making an example out of a gambler who is not properly reporting his gambling income.

Remember, not reporting income constitutes tax evasion and can have severe consequences. Just look at Richard Hatch, winner of the first TV “Survivor” show, who is in prison for skipping just one “little” detail on his tax return, his win of one million dollars!

JEAN: A Nevada note. On July 1, 2007, Nevada casinos, which for many years had been permitted to operate under the slightly different rules of state statute Regulation 6A, were required to switch to the Title 31 federal reporting rules that other states had been following for years. I discuss these new rules in Chapter 5 under the topic of “Big Brother is Watching You.” The main difference that’s bothering gamblers is that they’re now asked for their Social Security numbers more often and for smaller amounts than \$10,000. It’s a catch-22 situation. You aren’t required by law to give your SS number when buying in or cashing out for amounts that don’t put you over the \$10,000 report trigger for the day. However, the casinos are being more aggressive in asking for it anyway (so they won’t accidentally run afoul of the new reporting rules and find themselves in a messy audit), and they may fill out that dreaded SAR (suspicious activity report) if you refuse to give it.

Supposedly, these stricter federal rules were forced on Nevada to stop money laundering by terrorists after 9/11, but some have speculated that it’s really a way for the government to better track individual gambling action, so more taxes can be collected on previously unreported winnings.

“May you get so many royal flushes that you’ll have an income tax problem.”

—A wish for us from Jean’s friend and Las Vegas e-newsletter publisher, Billhere.

GAMING WINS AS INCOME

JEAN: IRS publications clearly state that gambling winnings are income and must be reported. The instruction booklets that come with tax forms list gambling winnings as one type of income to be put under “Other Income.” One court case put it this way: “It is illegal not to report winnings, and you’re risking possible prosecution for criminal tax evasion.”

This means gambling winnings from legal, or even *illegal*, sources anywhere in the world: lotteries, raffles, drawings, prizes; racetracks; bingo games; and casino games, whether they’re on Native American reservations, cruise ships, the Internet, or in another country. It means all gambling winnings, whether you get a W-2G, a 1099, or no paperwork at all.

MARISSA: Internal Revenue Code (IRC), section 61, states that ... *gross income means all income from whatever source derived*. For example, if you sit down and play a penny slot machine for an hour, happen to win \$1, and walk away, you’re technically required to report it on line 21, “Other Income,” of Form 1040, even though there’s no paper trail to your “income.”

JEAN: Many people think they understand the gambling-income concept. “Hey, I’d be glad to report income for a year in which I actually won money gambling, but that hasn’t happened yet.” What they don’t understand is that the IRS is not talking about one net win-or-loss figure at the end of the tax year, but win/loss figures for individual

gambling sessions. They say: You cannot net out your gambling for the year. You must add up all the winning sessions and all the losing sessions separately. To emphasize this, the IRS puts

“My tax-law professor in law school used to say (when asked if this or that was taxable), “If you find a penny on the street, it’s taxable.”

—From Starr Piercy, Jean’s attorney sister

this, in plain non-technical easy-to-understand language, in the instructions that come with your tax forms: *You cannot reduce your gambling winnings by your gambling losses and report the difference.*

MARISSA: In one famous court case in 1999, *USA v. Scholl*, a heavy gambler was found guilty of under-reporting his gambling income even though he was always a net loser at the end of the year. Those years he had a net loss he didn't report wins or losses. Years he got W-2Gs, he reported only that amount as his win.

The IRS must have information about both gambling income and gambling losses in order to determine whether income tax is owed. Whether Scholl believed (correctly or incorrectly) that he had lost more than he had won is irrelevant; the fact is that Scholl failed to report winnings and losses. "Whether there was an actual tax deficiency is irrelevant because the statute is a perjury statute." [See *United States v. Marashi*, 913 F.2d 724, 736 (9th Cir. 1990).]

Why was he accused of the more serious criminal offense of filing a false federal-income-tax return, rather than the less serious offense of violating tax laws? For one thing, he was a well-known Arizona Superior Court judge and the IRS loves to make examples of prominent taxpayers. However, another part of this case is that he was charged with "structuring"—that is, trying to circumvent the currency transaction reporting limits. He would make \$5,000 cash deposits to different banks on the same day and not inform the banks involved. This is a federal offense. I'm just guessing here, but I think the IRS had a stronger case with the two pieces combined than if they had just one or the other. In any case, he was found guilty—but was sentenced to probation only.

Obviously, this is an extreme example. However, when you sign your return, the fine print says this is what you are doing: *Under penalty of perjury, I declare that I have examined the return and accompanying schedules and statements, and to the best of my knowledge and belief, that they are true, correct and complete.* And be assured that having someone else prepare your return does not relieve you of taking this final responsibility.

ONLINE GAMBLING

JEAN: This is a good place to discuss online gaming. IRS regulations state that U.S. citizens and anyone who is considered a U.S. resident for tax purposes (i.e., resident aliens) must declare as income all gambling wins, from anywhere. IRC, Section 61, states that ... *gross income means all income from whatever source derived.* ... Although it isn't mentioned specifically, this includes cyberspace. It doesn't change just because online casinos don't issue W-2Gs or are headquartered in a country outside the U.S. Therefore, wise players do report wins/losses from online gaming, just as they do from bricks-and-mortar casinos. (However, I'm sure that many "forget" a lot of their wins and "remember" all their losses when April 15 comes around. Obviously, this is a common occurrence in any activity where no paperwork is sent to the IRS from the source of the income.)

This IRS requirement to report *all* income makes the question moot, at least in the taxation area, about whether online gambling is legal or not, no matter how long it takes for this to be decided by the U.S. government, if it ever does become clear-cut. People earn money at more clearly defined illegal activities (i.e., prostitution, bookmaking, etc.) and do report that income—or at least some of it—on their tax returns.

In any case, if you have an online gambling account based in a foreign country with a balance of \$10,000 or more at any time during the year, the Bank Secrecy Act requires you to report it to the IRS by filing a Report of Foreign Bank and Financial Accounts (FBAR). This is from the IRS Web site: *The FBAR is a tool to help the United States government identify persons who may be using foreign financial accounts to circumvent United States law. Investigators use FBARs to help identify or trace funds used for illicit purposes or to identify unreported income maintained or generated abroad.* To file the FBAR, you check the appropriate block on Schedule B of your 1040 tax return and file Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, with the Department of the Treasury (not the IRS).

MARISSA: I'm guessing that most people who earn income illegally aren't concerned about lawfully reporting it on a tax return. That's why criminals often get nailed. It's easier to convict someone for not filing a tax return than it is for drug dealing or prostitution. Remember, Al Capone was arrested and sentenced on tax evasion, which was easier to prove than the actual horrific crimes he committed.

JEAN: An aside here. The IRS end of the government is not supposed to share records with other government entities and the Supreme Court has previously ruled that the government can't use information on a tax return to prove an illegal activity.

MARISSA: Many gamblers have felt "safe" in not reporting their online wins, since online casinos, being headquartered in countries outside the U.S., do not issue any paperwork, like a W-2G, to the U.S. government. If I'd written this section a few years ago, I would have talked about the danger that the government in the future might decide to get records from credit-card companies and money-transfer businesses like SafePay, NETeller, and FirePay, to catch the past actions of online gamblers. This is what they did in 2000, obtaining MasterCard and American Express transactions billed to bank accounts in Antigua, Bermuda, the Bahamas, and the Cayman Islands to look for tax evaders using offshore accounts.

This is no longer a vague fear for online gamblers; it's already happening. Witness the ongoing investigation of NETeller. The U.S. Department of Justice now has complete information on everyone who has or ever had a NETeller account.

JEAN: You may wonder how things have changed since the surprising middle-of-the-night passage of the Unlawful Internet Gambling Enforcement Act of 2006 dealt a stunning blow to online gaming. Actually, it did not address the legality of online gaming, but knocked the legs out from under it, making it difficult for money-handlers to do business with American online players. Although a very few savvy online gamblers have found ways to get around these obstacles, the

average U.S. online gambler has been stopped cold from betting with anything but play money.

Several bills in Congress are currently addressing this situation in different ways: by completely repealing the onerous (at least to gamblers) legislation passed last year, or by making online gaming legal but regulated, or by making poker an exception, because it's a game of skill rather than chance. And there's pressure from other countries that feel the U.S. is flouting international law.

Few want to predict how this will play out in the future. But no matter what's decided, I think I can safely say that the U.S. government will always consider gambling wins as income, no matter from what source they come, and it will want these wins accounted for on a U.S. income tax return. I will even go out on a limb here, but probably a pretty safe one, and predict that there will be more government intervention in gambling matters in the future. And casinos, on land or sea or in cyberspace, will have to submit more, not fewer, records about player action.

DEFINING A "WIN"

JEAN: OK, let's say you now understand that you must report all gambling income to the IRS and your wins are subject to taxes. The first question that may come to mind is, "What exactly is a gambling win?"

MARISSA: In my personal experience representing clients in audits, the IRS seems to define a gambling "win" as the net win one achieves in a particular session.

JEAN: "Okay," I hear you asking, "Just what is a session?"

Is it the few seconds during which you pulled the handle of a slot machine while waiting in line at the buffet and got back four more quarters than you put in? Is it a \$10 win as you played one hand of

blackjack with a coupon on the way to the restroom? Is it a \$500 slot jackpot, although you already had lost \$600 in the same machine that day? What about a \$10,000 jackpot on a lucky trip to a riverboat near your home, which you took to Vegas the next week and blew it all, plus some more? Or three winning months of play in a casino wiped out completely by nine losing months that followed, giving you a net loss at the end of the year?

MARISSA: The problem is that nowhere in the entire tax code does the IRS use the word “session,” much less specifically define it. IRS record-keeping guidelines speak about “specific wager or wagering activity.” Obviously, a “specific wager” is the smallest unit of gambling time. But “wagering activity” is synonymous with “gambling session,” and neither is specifically defined. There’s no basic unit of accountability that will fit all gambling situations.

JEAN: But there’s one key word that every gambler should understand and remember, and that’s “records.” What the IRS has to say about gambling record-keeping gives us a starting point in our quest for the answer to what a session is. We’ll discuss this basic tax obligation in the next chapter.