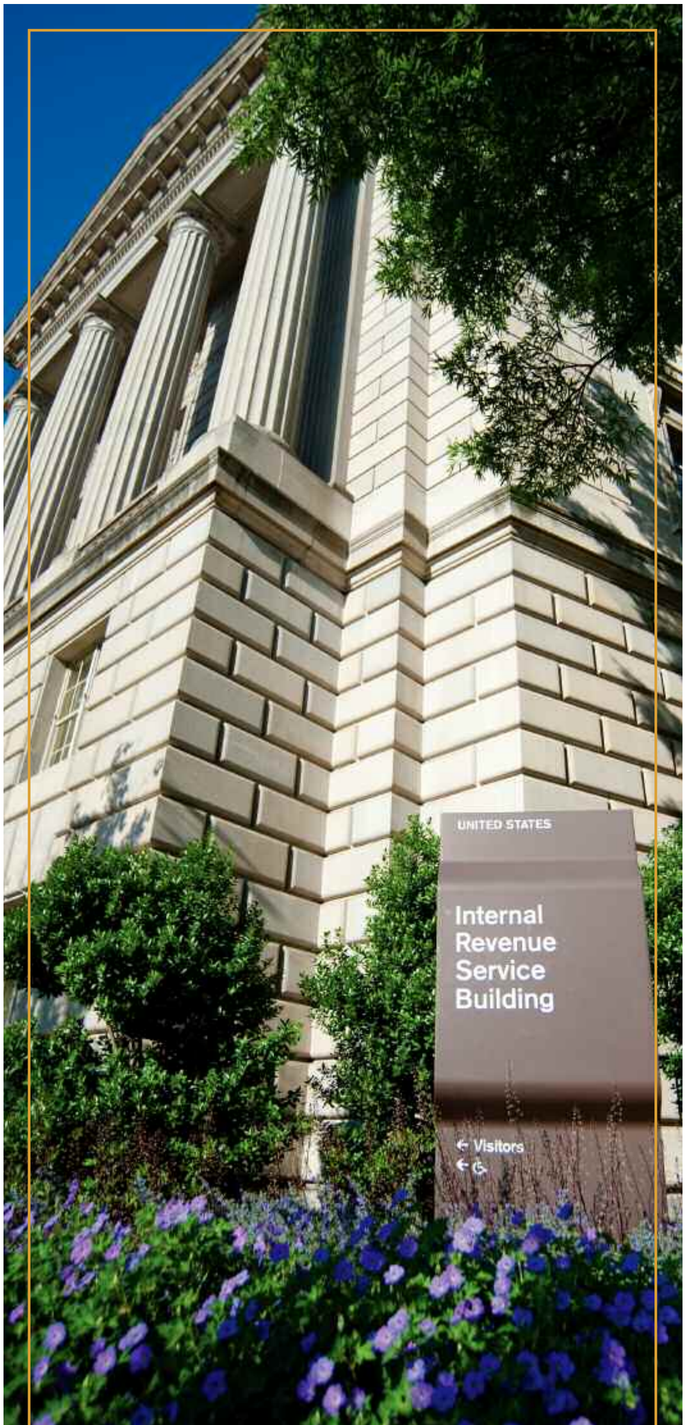


The **Taxation** of **Individual Gambling Winnings** and the **Proposed IRS Amendments** to **Reporting Thresholds**

By Mark Lerner

The Internal Revenue Service ("IRS") is proposing to increase the number of reports of the amounts won by individuals gambling at a casino. The IRS might be better asking whether individual gambling winnings should be taxed at all.

Under current IRS regulations, casinos are required to collect and submit, on a Form W-2G, customers' names, addresses, social security numbers, and signatures for each slot machine payout of $1,200 or more and each keno or bingo payout in excess of $1,500. Amendments proposed by the IRS would lower the thresholds for reporting slot machine, keno, and bingo winnings to $600.

These changes would significantly increase the reporting burden on casino operators and customers without significantly benefiting the national treasury. The changes may even reduce the amount of taxes properly collected.

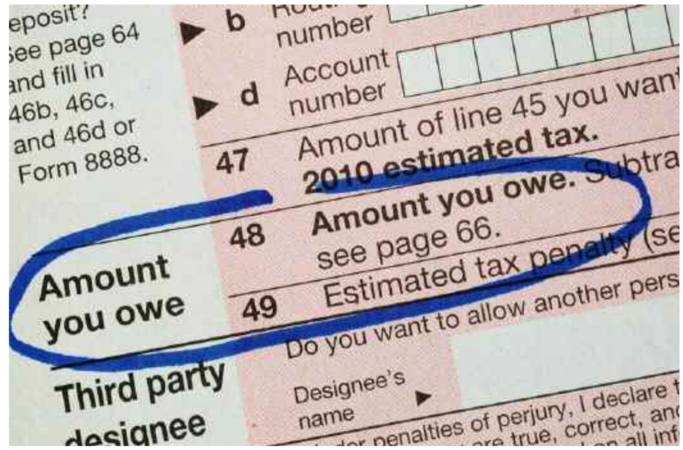
Reporting individual gambling winnings is incredibly complicated. You cannot simply net your losses against your winnings at the end of the year and report any positive difference. An individual must report winnings and losses separately, reporting winnings as "other" income and claiming losses (up to the amount of winnings) as an itemized deduction.

To be deducted, losses must be documented with meticulous specificity. The IRS expects gamblers to produce records that not only include just the amounts won or lost, but the dates and types of gambling, including slot machine and table game numbers, the names and addresses of the gambling establishments, the names of other persons present, and so on.

Record keeping is complicated by the fact that winnings and losses are determined on a session-by-session basis. Sessions begin when a player buys in and end when the player cashes out. The proposed amendment would also end any session and begin a new one at the end of each calendar day. The session concept does not simplify record keeping; it adds yet another factor of which the casual gambler must keep track. Under the proposed amendment, it would become even more complicated whenever an individual's gambling straddles midnight—hardly an unusual occurrence among gamblers in 24-hour casinos with busy swing and graveyard shifts. These are not records likely to be kept by casual, recreational gamblers. While someone who scores a W-2G-worthy win early in the year may be able to document offsetting losses later in the year, those who have a major win near the end of the year may not.

The result is people owing tax even though they don't end up winning any money to pay it. Furthermore, people who do not itemize deductions can only report winning sessions and, therefore, are more likely to owe taxes on their "winnings" even though they have a net loss for the year. Since lower-income taxpayers are much less likely to itemize deductions than higher-income taxpayers, the result is not just a tax on non-existent gambling income but a regressive tax that affects lower-income people disproportionately. The regression would only worsen under the proposed amendments as the amounts reported are halved and affect more people.

All of this is an incentive not to report winnings and, if winnings result in a Form W-2G, to be creative about documentation of offsetting losses. And for what? Taken as a group, individual gamblers show a net loss every year. Taken individually, the overwhelming majority of gamblers show a net loss every year. Those who do manage to show a win as of the end of the year mostly win very little, and those who continue to gamble are likely to lose it back the following year. In theory, the amount of individual gambling winnings available for taxation is zero. For individual gamblers, casino gambling is a less than zero-sum game. On average, gamblers show a net loss for the year. That's why there are casinos.



So how much money can the treasury possibly net each year in taxes on individual gambling winnings? How much would that amount change if the proposed amendments go into effect? To answer these questions, we need to know how much money the IRS actually collects and how much the IRS should accurately collect in these taxes and how much it spends to collect them. Whatever the IRS spends administering the tax, the amount would increase under the proposed amendments as the IRS works to process twice as many W-2Gs. At the same time, the amount likely to be collected will not increase in proportion. Not only are the amounts in question smaller, but the lower reporting threshold makes it more certain that winnings will be offset by actual losses during the year and that taxes will not actually be owed.

We also need to know how much tax revenue from tax-paying casinos is lost when the casinos shut down games and players to issue W-2Gs? Whatever that amount is now, it has to increase under the proposed amendments, since the number of W-2Gs would presumably double. Taxes on casino income are also reduced through increased payroll and other business expenses as casinos process more W-2Gs, not to mention the enormous cost of refitting slot machines and keno and bingo systems to lock up at the lower amounts. The taxes paid by casinos are not insubstantial. The total amount of taxes collected by all U.S. jurisdictions in 2013 totaled $38 billion; the total amount of federal taxes collected was $17.3 billion. Thus, even a small dip in taxable casino income caused by increased numbers of W-2Gs and other associated expenses is likely to have a significant effect on tax collections. Furthermore, from the tax collector's point of view, compared to the complexities of administering taxes on the small amounts individual gamblers contend with, taxation of casinos is relatively simple. Most are taxed, audited, and heavily regulated by local jurisdictions, so most of the work needed for federal tax purposes is already being done at no federal expense.

It just doesn't seem likely that the lowered thresholds would yield enough additional tax revenue to justify the added burden on the individuals, casinos, and the IRS. Even with the thresholds at their current levels, the return doesn't appear to justify the investment.

Most countries, it seems, have sensibly concluded that taxing individual winnings from casinos does not make sense, economically or as a matter of policy. It appears that most other countries do not tax individual winnings from casinos; this includes most European Union countries, the United Kingdom, Canada, and Australia.

The IRS shouldn't be lowering the reporting thresholds. It should be eliminating the individual tax and the reporting altogether and focusing on the relatively easy money to be collected from the only real winners, casinos. Unfortunately, eliminating the tax on individual gambling winnings cannot be done by regulation; it seems a statutory change—literally, an act of Congress—is required. But until that happy day, the IRS should not exacerbate the inequities of the current system by decreasing the reporting thresholds.

[1] Form W-2G, http://www.irs.gov/pub/irs-pdf/fw2g.pdf.

[2] INTERNAL REVENUE SERVICE, *2015 Instructions for Forms W-2G and 5754*, at 4, http://www.irs.gov/pub/irs-pdf/iw2g.pdf.

[3] Howard Stutz, *IRS Suggests Dropping Casino Winnings Threshold To $600*, LAS VEGAS REVIEW-JOURNAL, Mar. 5, 2015 (http://www.reviewjournal.com/business/casinos-gaming/irs-suggests-dropping-casino-winnings-threshold-600); *Information Returns; Winnings From Bingo, Keno, and Slot Machines*, 80 Fed. Reg. 11600 (2015) (to be codified at 26 C.F.R. 1, 26) (proposed Mar. 4, 2015).

[4] IRS Publication 529 (http://www.irs.gov/publications/p529/ar02.html#en_US_2014_publink100027002).

[5] IRS Publication 529 (http://www.irs.gov/publications/p529/ar02.html#en_US_2014_publink100027002).

[6] Memorandum AM2008–11, Office of Chief Counsel, Internal Revenue Service (Dec. 12, 2008); Park v. Commissioner, 2013 U.S. App. LEXIS 13785 (D.C. Cir. July 9, 2013); Shollenberger v. Commissioner, 98 T.C.M. (CCH) 667, 2009 WL 5103973 (Tax Ct. 2009).

[7] CONGRESSIONAL RESEARCH SERVICE, *Itemized Tax Deductions for Individuals: Data Analysis*, http://fas.org/sgp/crs/misc/R43012.pdf (Feb. 12, 2014).

[8] Assuming the machines and systems can be refitted at all. Reprogramming the hundreds of thousands of slot machines located in the U.S. would be a monumental task, involving dozens of manufacturers, hundreds or even thousands of different code sets, and visits to each individual slot machine to install the new programs (online updating is not typically an available option for slot machines or casino gaming systems).

[9] AMERICAN GAMING ASSOCIATION, *Gaming's Quarter of a Trillion Dollar Impact on the U.S. Economy* (2014)(http://www.gettoknowgaming.org/sites/default/files/AGA_G2KG_Fact-Sheet_0.pdf).

[10] CASA, *Taxation of Gambling Winnings in European Countries* (Newsletter No. 23, June 2011) (http://www.casasa.org.za/CASA_Newsletter_Issue_23.pdf).

[11] TIM WORSTALL, *The Reason The UK Doesn't Tax Betting Is Because It Wouldn't Produce Any Revenue*, FORBES, Nov. 29, 2013 (http://www.forbes.com/sites/timworstall/2013/11/29/the-reason-the-uk-doesnt-tax-betting-is-because-it-wouldnt-produce-any-revenue/); Do I Have To Pay Taxes On Online Gambling Winnings?, http://www.cheekypunter.com/faq/do-i-have-to-pay-taxes-on-online-gambling-winnings/

[12] *Do I Have To Pay Taxes On Online Gambling Winnings*, http://www.cheekypunter.com/currency/canadian-dollar/.

[13] *Is Gambling Taxed In Australia?*, http://www.onlinepokiesaustralia.com.au/faq/is-gambling-taxed-in-australia.html.

[14] *See* 26 U.S.C. § 61 (taxable income includes all income not expressly exempted); 26 U.S.C. § 165(d) ("Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.")