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IRS Must Calculate Gambling Winnings Consistently for Citizens and Foreigners, Court Holds by [Jaime Arora](#)

Summary by [taxanalysts](#)

Finding that gains from gambling winnings should be calculated the same for both U.S. citizens and nonresident aliens, the D.C. Circuit on July 9 reversed a Tax Court decision and held that a South Korean individual's gains from slot machine winnings should be calculated on a per-session basis rather than on a per-bet basis.

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Finding that gains from gambling winnings should be calculated the same for both U.S. citizens and nonresident aliens, the D.C. Circuit on July 9 reversed a Tax Court decision and held that a South Korean individual's gains from slot machine winnings should be calculated on a per-session basis rather than on a per-bet basis. Practitioners told Tax Analysts that the decision takes a reasonable approach to calculating gains that upholds the rules for deductions as they apply to foreigners.

During his vacations in the United States, businessman Sang Park frequented the Pechanga Resort and Casino in Temecula, Calif., to play the slot machines. According to details from the Tax Court case (*Park v. Commissioner*, 136 T.C. No. 28 (2011) [PDF](#)), Park had winnings of more than \$400,000 in 2006 and \$100,000 in 2007. Those figures are gross amounts, however, and do not take into account any of Park's losses from his slot play.

The IRS assessed Park income tax deficiencies of \$134,350 and \$23,821 in 2006 and 2007, respectively, and sought to tax Park on each winning pull on the slot machine without allowing him to subtract losses during each gambling session. The Tax Court sustained the IRS's determination that Park was liable for taxes on his winning bets and held him liable for accuracy-related penalties.

The IRS's computation of Park's gains from gambling winnings differs from the treatment afforded U.S. citizens. In a generic legal advice memorandum issued in 2008 (AM 2008-011 [PDF](#)), the IRS Office of Chief Counsel analyzed the calculation of the determination of gains and losses from slot machine play under section 165 and stated that "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." That is, gains are to be calculated on a per-session, not a per-bet, basis.

The D.C. Circuit took issue with the disparate treatment of gambling gains for citizens and for foreigners. In an opinion [PDF](#) by Judge Brett Kavanaugh, the court found that the word "gains" in section 871, which provides for the taxing of NRAs, should be interpreted as it is in section 165(d), which governs wagering for U.S. citizens. Kavanaugh found no support for the IRS's assertion that NRAs' winnings should be treated differently, noting that nothing in the legal advice turned on the fact that the gamblers were U.S. citizens.

Addressing the IRS's argument that section 873 does not allow NRAs to deduct recreational gambling losses from income on their tax returns, the court said, "The point has nothing to do with the issue in this case." It added that the law does not provide guidance on how to measure those losses and winnings in the first place.

Robert D. Grossman Jr. of the Tax Law Center LLC in Las Vegas said that the basic thrust of the opinion is to

distinguish deductions from reductions. The court found that an individual can recognize reductions for losses from winnings to arrive at the bottom line instead of invoking a deduction later on, he said, adding that the approach is similar to the way that taxpayers measure gain on the sale of property -- by reducing the amount realized by the adjusted basis. The court's holding does not violate the prohibition on foreigners taking deductions, he said.

Summer Ayers LePree of Holland & Knight LLP said that while the circuit court's conclusion is reasonable, it is interesting that its opinion focused solely on how to compute taxable gain whereas there does not appear to be any discussion of the issue in the Tax Court opinion.

The court also said that the per-session approach avoids the considerable administrative and practical difficulties of tracking wins from every pull of the slot machine lever.

LePree said that the notion that anyone should be expected to keep track of every single spin of the slot machine and add up every win is simply unrealistic. That level of record keeping also would be unadministrable from the casino's perspective, she said.

The circuit court remanded the case back to the Tax Court for the determination of Park's tax liabilities.

Tax Analysts Information

Code Sections: Section 165 -- Losses
Section 871 -- Nonresident Alien Taxes
Section 873 -- Deductions for Nonresident Aliens

Jurisdiction: United States

Subject Areas: Individual income taxation
Litigation and appeals

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