

Gambling and the Law®: Reporting Big Winners to the IRS

In a decision that is nothing but bad news for the legal gaming industry, the Internal Revenue Service has declared that poker tournaments are subject to the same tax laws that apply to “sweepstakes, wagering pools, certain parimutuel pools, jai alai, and lotteries.”

The least burdensome part of the new regulations is that casinos now have one more form of gambling where big winners have to be treated differently. But the new requirements will also help drive more players to casinos on the internet and overseas, and take money out of circulation for those who stay here.

Casinos are already faced with a bizarre array of reporting and withholding requirements. Besides poker tournaments, there are special rules for keno, slot machines, bingo and sports and race books. And two patrons who win exactly the same amounts at exactly the same game will have different amounts withheld, if one is from a foreign country or refuses to give his Taxpayer Identification Number (TIN) (usually a social security number).

The Internal Revenue Code is very clear: Americans are supposed to report every dollar (and euro and pound) that they win anywhere in the world. But everyone knows that gambling is usually an all-cash business, and if big winners were not reported by the casinos to the IRS, they might forget to include the amounts on their income tax returns.

Of course, it is not the reporting, but the paying, that is so hard. So the law encourages payments, by sometimes requiring casinos to withhold and send parts of the winnings to the IRS, giving the big winner only the remainder.

Part of the problem is how the laws are made. Only Congress can pass tax laws. But the IRS makes the rules. The IRS cannot create a tax. But it sure can create forms and require everyone to report everything they pay out or receive.

The IRS already requires casinos to file forms like the Form W-2G “Certain Gambling Winnings,” Form 5754 “Statement by Person(s) Receiving Gambling Winnings,” Form W-9 to Request a patron’s TIN and Form 945 to report the additional backup withholding that must be taken when the patron refuses to fill out the Form W-9. There is even a form, Form W-8BEN, that a casino should use to tell the IRS that it is not withholding a part of the winnings of a citizen of a foreign country that has a tax treaty with the U.S.

And then there is Form 1099.

The IRS knows that a lot of people don’t report everything they make. So, it created Form 1099: Anyone who pays anyone else \$600 in a year is supposed to report it to the IRS.

The opening of Atlantic City got the attention of the IRS. It decided it wanted all casinos to file a Form 1099 every time any patron wins \$600 or more. But the casinos were able to convince the IRS that a cage cashier does not know when a gambler cashes chips for \$5,000, whether he bought in for \$1,000 or \$10,000 at the tables. This was probably true in 1977.

The IRS had a partial comeback: Casinos do know how much players have bet when they win big at keno, bingo or slot machines. So, the regulations require casinos to report winners of \$1,500 or more at keno, and, for no clear reason a lesser amount, \$1,200, at slot machines and bingo.

The IRS still had casinos in its sights. But Congress can always overrule the IRS. The Republican representatives from Nevada became very influential during the Reagan and Bush 41 presidencies. In 1988, they were able to get an express exclusion for casino table games added to the Internal Revenue Code, hidden in a section dealing with withholding on non-resident aliens:

“No tax shall be imposed ... on the proceeds from a wager placed in any of the following games: blackjack, baccarat, craps, roulette, or big-6 wheel. The preceding sentence shall not apply in any case where the Secretary determines by regulation that the collection of the tax is administratively feasible.”

Congress might not be interested in the reporting of winnings, but it does want a piece of every large prize. As part of the compromise with the IRS in 1976, Congress wrote a law requiring casinos, tracks and lotteries to withhold a part, currently usually 25%, off the top of certain jackpots. This is the law the IRS is misinterpreting to cover poker tournaments today. Congress required withholding only from the following (with the current numbers):

“In general... proceeds of more than \$5,000 from a wagering transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

“Proceeds of more than \$5,000 from a wager placed in a lottery conducted by... a State...

“Sweepstakes, wagering pools, certain parimutuel pools, jai alai, and lotteries.
– Proceeds of more than \$5,000 from–

“(i) a wager placed in a sweepstakes, wagering pool, or lottery
or

“(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.”

Doesn't exactly sound like Congress was thinking of poker tournaments at the time.

In fact, we know Congress was not thinking about table games. It used the same phrase, “wagering pool,” in the Interstate Horseracing Act and the racketeering statutes

dealing with sports betting. Most importantly, “wagering pool” appears elsewhere in the Internal Revenue Code itself, in sections that have been around for 50 years, imposing excise taxes on bookies. As justices of the U.S. Supreme Court pointed out in 1968 and again in 1971, “wagering pool” excludes “gambling such as dice and poker.”

In case anyone was unclear about what types of gambling were being covered, the next year, 1977, Congress added the words “certain parimutuel pools” and “jai alai” to the list of “sweepstakes,” “wagering pools,” and “lotteries.”

This is the statute the IRS is using to go after poker, deciding that poker tournaments are “wagering pools.” As with the opening of Atlantic City, poker has gotten so much attention that the IRS had to figure out a way to get its cut.

Congress was clearly thinking about pool-selling and lotteries, not table games. But even if the IRS is right and a tournament involves a betting pool, why limit it to poker?

The impact of this new rule is bound to be negative. Poker tournaments outside the U.S., including online, pay winners 100% of the amounts they win, not 75%. Satellite games, where players hope to win a \$10,000 seat in the World Series of Poker will now pay only \$7,500. Even everyday tournament poker will be affected. Players who win small tournaments often use their winnings to enter other games. But a \$1,000 winner will now be paid only \$750. So, \$250 has been taken out of circulation.

Casinos might want to fight this. But until the rule is overturned, they have no choice but to harass a whole new class of their big winners.

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Column Update

I just got tipped off that there was apparently a deal cut on the new IRS requirement that casinos withhold 25% of big poker tournament winnings. Buried in the IRS memo is this language: “The IRS will not assert any liability for additional tax or additions to tax for violations of any withholding obligation with respect to amounts paid to winners of poker tournaments... provided that the poker tournament sponsor meets all the requirements for information reporting” under the tax code and regs. What this means is there is absolutely a legal obligation to withhold, but the IRS won't do anything about it, including it won't fine casinos, so long as they file the W-2Gs. I hate laws like this. But the immediate problem is my column #137, “Reporting Big Winners to the IRS.” The column is right about the reporting and everything else, except casinos and poker rooms are told they don't have to obey the law and withhold so long as they file reports on winners.