letters to the editor

Gamblers Get Hammered, But Others Get Pulverized

To the Editor:

Professor Sheldon D. Pollack's special report, "Gross Revenue From Gambling: Some Unintended Consequences" (*Tax Notes*, Sept. 15, 1997, p. 1455) was great! It clearly illustrates how including $500,000 of gambling winnings in gross income and then deducting an equal amount of gambling losses results in a federal income tax increase of $10,183 due to the effect of the phase out of the personal exemption and the partial phase out of the itemized deductions.

What isn't clear is whether this was "unintended." Certainly, a system that uses adjusted gross income to limit or eliminate both personal exemptions and itemized deductions must intend to treat taxpayers with itemized deductions differently from those with business income that is netted "above the line." Accordingly, a taxpayer with business income of $500,000 and business expenses of $500,000 would have the same tax as one who never went into business, thus saving $10,183 compared to a gambler with the same gross and net. In establishing phaseouts and other floors and ceilings to itemized deductions and personal exemptions, Congress must have been aware of their "unintended" consequences.

As for gamblers, the article does an excellent job of comparing the IRS theory that each separate win is subject to tax (LTR 8710006) with the pragmatic taxpayer approach of not reporting gambling winnings unless the winnings are reported to the IRS by the casino.

Although LTR 8710006 states that taxpayers must use the gross income approach, actions speak louder than words, and there do not appear to be many IRS agents at the casinos and race tracks jotting down names and license plate numbers of millions of taxpayers who fail to report their gross gambling winnings. If they did, who knows how much could be raised just from the last three years for back taxes, interest, and penalties. But why stop there? Since the IRS believes that each separate win must be reported as gross income, the statute of limitations is probably open for *six* years under section 6501(e) since many gamblers surely fail to report gross gambling winnings that exceed 25 percent of their reported gross income.

Pity the poor television game show contestant given the opportunity to "bet it all." On "Jeopardy," for example, if the other contestants are not involved in Final Jeopardy because they finished the Double Jeopardy round with a loss, is the sole finalist who has $10,000, bets $9,000, and loses subject to tax on $10,000? The IRS seems to think so — even though the show only pays the contestant $1,000.

As sorry as one might feel for the unfortunate gambler, what about the unfortunate investor who grosses $500,000 only to find out that $500,000 of related expenses are deductible only as itemized deductions and then only to the extent they exceed 2 percent of the taxpayer's adjusted gross income? In that case, the taxpayer's regular tax is $39,921, an increase of $14,526 compared to the nongambler and $4,343 compared to the gambler.

Unlike deductions for gambling losses, which are deductible for both regular and alternative minimum tax purposes, investment expenses, state and local taxes, and most miscellaneous itemized deductions are not allowable in calculating the alternative minimum tax. Thus the investor's inability to deduct $500,000 of investment expenses for alternative minimum tax purposes results in an additional tax of $138,579 and a total tax of $178,500. This results in an increase of $153,105 over the taxpayer who simply reports $150,000 of gross income.

Did Congress intend that a taxpayer who earns $150,000 and who also makes $500,000 from an investment while incurring $500,000 of related expenses pay a tax of $178,500, 119 percent of the taxpayer's net cash flow? Probably not. If not, the solution is very simple. Get rid of all phaseouts and floors. Such an approach would not only be fair, but it would make tax calculations much simpler!

Sincerely,

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(See table on next page.)

Table 1

	Regular Tax (no gambling)	Gambling ($500,000)	Investment ($500,000)
Gross Income			
Salary	$150,000	$150,000	$150,000
Gambling	0	500,000	0
Investment	0	0	500,000
Adjusted Gross Income	150,000	650,000	650,000
Itemized Deductions			
Taxes	25,000	25,000	25,000
Gambling	0	500,000	0
Investment Expenses	0	0	500,000
Less 2% of AGI	0	0	(13,000)
Subtotal	25,000	525,000	512,000
Less: Phaseout	0	(15,962)	(15,962)
Net Itemized Deductions	25,000	509,038	496,038
Gross Exemptions	17,850	17,850	17,850
Exemption Phaseout	0	(17,850)	(17,850)
Taxable Income	107,150	140,962	153,962
Regular Tax	25,395	35,578	39,921
Alternative Minimum Tax	0	0	138,579
Total Federal Tax	25,395	35,578	178,500
Tax Increase	N/A	10,183	153,105
Tax as a Percent of Net Cash Flow	16.93%	23.72%	119.00%