

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

Release Number: **AM2008-011**

Release Date: 12/12/08

CC:ITA:B01  
POSTN-138904-08

Third Party Communication: None  
Date of Communication: Not Applicable

UILC: 165.08-00, 61.00-00

date: December 05, 2008

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subject: Reporting of Wagering Gains and Losses

This Chief Counsel Advice responds to your request for assistance about a recurring issue in litigation. This advice may not be used or cited as precedent.

ISSUE

How does a casual gambler determine wagering gains and losses from slot machine play?

FACTS

The taxpayer (Mrs. X) is a casual gambler. The taxpayer uses the cash receipts and disbursements method of accounting and files her returns on a calendar year basis. The taxpayer properly substantiates all gains and losses incurred in her

wagering transactions pursuant to § 6001 of the Internal Revenue Code and Rev. Proc. 77-29, 1977-2 C.B. 538.

The taxpayer is retired on a modest, fixed income. Therefore, she carefully limits the amount of money she gambles. Her practice is to commit only \$100 to slot machine play on any visit to a casino. She wagers until she loses the original \$100 committed to gambling or until she stops gambling and “cashes out.” Upon cashing out, the taxpayer may have \$100 (the basis of her wagers), less than \$100 (a wagering loss), or more than \$100 (a wagering gain).

The taxpayer went to a casino to play the slot machines on ten separate occasions throughout the year. On each visit to the casino, the taxpayer exchanged \$100 of cash for \$100 in slot machine tokens and used the tokens to gamble. Taxpayer did not use cash, credit or “player’s cards” to gamble. On five occasions, the taxpayer lost her entire \$100 in tokens before terminating play. On the other five occasions, the taxpayer redeemed her remaining tokens for the following amounts of cash: \$20, \$70, \$150, \$200 and \$300.

### ANALYSIS

Section 61 provides that gross income means all income from whatever source derived. Rev. Rul. 54-339, 1954-2 C.B. 89, holds that wagering gains are included in gross income. See Umstead v. Commissioner, T.C. Memo. 1982-573, 44 TCM 1294, 1295 (1982).

Section 165(a) allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(d) provides that losses from wagering transactions are allowed only to the extent of the gains from such transactions.

Section 1.165-10 of the Income Tax Regulations provides that losses sustained during the taxable year on wagering transactions shall be allowed as a deduction but only to the extent of the gains during the taxable year from such transactions.

#### Wagering Gains and Wagering Losses

Section 165(d) uses the words “gains” and “losses” from wagering transactions without ascribing a technical meaning to the terms. In the absence of a stated definition to the contrary, the literal language of the statute should control. If the language of a statute is plain, clear, and unambiguous, the statutory language is to be applied according to its terms, unless a literal interpretation of the statutory language would lead to absurd results. United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989); Burke v. Commissioner, 105 T.C. 41, 59 (1995). In ordinary parlance, a wagering “gain” means the amount won in excess of the amount bet (basis). See Rev. Rul. 83-103, 1983-2 C.B. 148, at 149, holding that in calculating wagering gains, the cost (or basis) of the wager is excluded. That is, the wagering gain is the total winnings less the amount of the wager. The term wagering “loss” means the amount of the wager (basis) lost.

Casual gamblers may deduct their wagering losses only to the extent of their wagering gains; gamblers may not carry over excess wagering losses to offset wagering gains in another taxable year or offset non-wagering income. Skeeles v. United States, 118 Ct. Cl. 362 (1951), cert. denied, 341 U.S. 948 (1951). Casual gamblers may not net their gains and losses from slot machine play throughout the

year and report only the net amount for the year. See United States v. Scholl, 166 F.3d 964 (9<sup>th</sup> Cir. 1999).<sup>1</sup>

A key question in interpreting § 165(d) is the significance of the term “transactions.” The statute refers to gains and losses in terms of wagering transactions. Some would contend that transaction means every single play in a game of chance or every wager made. Under that reading, a taxpayer would have to calculate the gain or loss on every transaction separately and treat every play or wager as a taxable event. The gambler would also have to trace and recompute the basis through all transactions to calculate the result of each play or wager. Courts considering that reading have found it unduly burdensome and unreasonable. See Green v. Commissioner, 66 T.C. 538 (1976); Szkirscak v. Commissioner, T.C. Memo. 1980-129. Moreover, the statute uses the plural term “transactions” implying that gain or loss may be calculated over a series of separate plays or wagers.

The better view is that a casual gambler, such as the taxpayer who plays the slot machines, recognizes a wagering gain or loss at the time she redeems her tokens. We think that the fluctuating 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. See Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955). For example, a casual gambler who enters a casino with \$100 and redeems his or her tokens for \$300 after playing the slot machines has a wagering gain of \$200 (\$300 - \$100). This is true even though the taxpayer may have

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<sup>1</sup> Gamblers must report wagering gains, even though their losses over a tax year exceed their gains. That increases a casual gambler’s AGI and has a significant tax impact (especially on low income taxpayers), because many tax benefits phase out as AGI increases, e.g., exclusion of social security payments.

had \$1,000 in winning spins and \$700 in losing spins during the course of play. Likewise, a casual gambler who enters a casino with \$100 and loses the entire amount after playing the slot machines has a wagering loss of \$100, even though the casual gambler may have had winning spins of \$1,000 and losing spins of \$1,100 during the course of play.<sup>2</sup>

#### Calculating the Taxpayer's Gains and Losses

Under the facts presented, the taxpayer purchased and subsequently lost \$100 worth of tokens on five separate occasions. As a result, the taxpayer sustained \$500 of wagering losses ( $\$100 \times 5$ ). The taxpayer also sustained losses on two other occasions, when the taxpayer redeemed tokens in an amount less than the \$100 (basis) of tokens originally purchased. The loss is the basis of the bet (\$100 in tokens) minus the amount of the tokens eventually redeemed. Therefore, on the day the taxpayer redeemed \$20 worth of tokens, the taxpayer incurred an \$80 wagering loss ( $\$100 - \$20$ ). On the day the taxpayer redeemed \$70 worth of tokens, the taxpayer incurred a \$30 wagering loss ( $\$100 - \$70$ ).

On three occasions, the taxpayer redeemed tokens in an amount greater than the \$100 of tokens originally purchased. The amount redeemed less the \$100 basis of the wager constitutes a wagering gain. See Rev. Rul. 83-130, supra. On the day the taxpayer redeemed \$150 worth of tokens, the taxpayer had a \$50 wagering gain

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<sup>2</sup> We note that § 6041 requires gambling businesses to report payments over certain dollar amounts, "gross receipts" reporting. The amount reported as gross receipts from many types of gambling is not reduced by the amount (basis) of the wager. See Rev. Proc. 77-29, 1977-2 C.B. 538. However, such reported payments are not necessarily taxable wagering gains. A gambling business may issue an information return for a casual gambler's winning spin, but the gambler continues play and wagers and loses that amount during slot machine play. Wagering gain or loss is determined at the time the casual gambler redeems his or her tokens at the end of slot machine play.

(\$150-\$100). On the day the taxpayer redeemed \$200 worth of tokens, the taxpayer had a \$100 wagering gain (\$200-\$100). And on the day the taxpayer redeemed \$300 worth of tokens, the taxpayer had a \$200 wagering gain (\$300-\$100).

For the year, the taxpayer had total wagering gains of \$350 (\$50 + \$100 + \$200) and total wagering losses of \$610, (\$500 from losing the entire basis of \$100 on five occasions + \$80 and \$30 from two other occasions). The taxpayer's wagering losses exceeded her wagering gains for the taxable year by \$260 (\$610 - \$350). The taxpayer must report the \$350 of wagering gains as gross income under § 61. Scholl, supra. However, under §165(d), the taxpayer may deduct only \$350 of the \$610 wagering losses. The taxpayer may not carry over the excess wagering losses to offset wagering gains in another taxable year or offset non-wagering income.

Skeeles, supra.

A casual gambler who elects to itemize deductions may deduct wagering losses, up to wagering gains, on Form 1040, Schedule A. In this case, the taxpayer may deduct only \$350 of her \$610 of wagering losses as an itemized deduction. A casual gambler who takes the standard deduction rather than electing to itemize may not deduct any wagering losses. See Rev. Rul. 54-339, 1954-2 C.B. 89.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call Clifford M. Harbourt at (202) 622-4800 if you have any further questions.