



Gambling Winnings

Beware of the U.S. tax rules

It's well known that Canada doesn't tax gambling winnings unless the taxman concludes that you are carrying on the business of gambling and are considered a professional gambler. Not so in the United States, where lottery winnings and gambling are generally taxable.

A recent U.S. tax case sheds some light on how our neighbour to the south attempts to tax non-U.S. citizens ("aliens") or non-U.S. residents when they come to gamble in U.S. casinos.

Sang J. Park and Won Kyung O v. Commissioner of Internal Revenue Service

This past July, the United States Court of Appeals issued its decision in the appeal case (*No. 12-1058, Sang J. Park and Won Kyung O v. Commissioner of Internal Revenue Service*) of Mr. Sang Park, a South Korean businessman who gambled thousands of dollars at slot machines on casino outings during his trips to the U.S. He was appealing the decision of the U.S. Tax Court, which found him liable for over \$100,000 in U.S. tax on his slot machine "winnings."

Under U.S. tax law, the Internal Revenue Service (IRS) taxes non-resident alien gamblers (i.e., gamblers that are neither U.S. citizens nor residents) differently than U.S. citizen gamblers in that they generally pay U.S. tax on their gross U.S. source gambling winnings, which is collected by withholding. (Note that non-resident aliens are exempt from tax on blackjack, baccarat, craps, roulette and Big-6 Wheel winnings.)

By contrast, a U.S. citizen or resident who gambles is entitled to offset his or her gambling winnings with any gambling losses incurred. A similar rule applies to Canadians under the Canada-U.S. tax treaty, discussed below.

The issue before the Court in the case of the South Korean businessman was the period of time over which gambling win-

nings from casino games, such as slots, are to be measured. In other words, are gamblers required to pay taxes on every winning bet, such that each winning pull of the slot machine constitutes a win (the "per-bet" approach)? Or alternatively, can they simply pay tax on the total net gains, after subtracting losses, from a session of gambling (the "per-session" rule)?

THE TAKE-AWAY

Under U.S. tax law, the IRS taxes non-resident alien gamblers (i.e., gamblers that are neither U.S. citizens nor residents) differently than U.S. citizen gamblers in that they generally pay U.S. tax on their gross U.S. source gambling winnings, which is collected by withholding.

Consider the example of a U.S. citizen playing a slot machine in Las Vegas. On his first pull he gets very lucky and wins \$2,000 but by the time the evening is over, the slot machine has taken the \$2,000 back such that his net economic gain is zero. In this case, the U.S. citizen gambler would have no income and no tax payable since the IRS measures and taxes his total session of gambling, which resulted in \$0 income.

Now imagine the non-resident alien on a Vegas weekend. She also wins \$2,000, but by the end of the session has lost her winnings. Despite her being in exactly the same financial situation as the U.S. citizen gambler, according to the IRS's approach, the non-resident alien has to report and pay tax on \$2,000 of income (her winnings on the initial bet) because the IRS interprets the tax rules as requiring non-resi-

dent aliens to pay tax on a per-bet basis.

Clearly this is unfair, and the appellate court reversed the lower court's decision and found that a per-session approach was also the right way to tax non-resident aliens, such as Mr. Park, on their gambling winnings. As the Judge wrote, "After a night of gambling, it's no fun to walk out of the casino a loser. But it's even worse when the IRS, on your way out, tries to tax you on each individual bet that you happened to win over the course of your losing night."

CANADA-U.S. TAX TREATY

Canadians who gamble in the U.S. are not really impacted by this decision since the Canada-U.S. tax treaty contains a special provision not found in any other U.S. treaty. Under Article XXII, paragraph 3, the U.S. will permit a Canadian resident to file a refund claim for any U.S. tax withheld on gambling winnings after taking into account a deduction for U.S. gambling losses the Canadian resident incurred.

This is typically done by filing Form 1040NR "U.S. Nonresident Alien Income Tax Return" and reporting both gambling winnings and gambling losses. To this return, the Canadian resident would attach a copy of Form 1042-S, "Foreign Persons U.S. Source Income Subject to Withholding" showing the taxes withheld by the casino.

You should, however, keep records of your gambling losses if you plan to file such a refund claim. As the IRS states on its website, "It is important to keep an accurate diary or similar record of your gambling winnings and losses. To deduct your losses, you must be able to provide receipts, tickets, statements or other records that show the amount of both your winnings and losses." 

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