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# The Other March Madness: What the IRS Thinks of Your Bracket

## All gambling winnings are taxable, while gambling losses are deductible—but with restrictions

By
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As March Madness gets under way, millions of people are grappling with critical questions: Can you trust Oregon? Which no. 5 seed will go down this year? Is a busted bracket tax-deductible?

The American Gaming Association estimates that more than 70 million Americans will wager $9.2 billion this year on the NCAA men's basketball tournament through office pools, Nevada sports books, illicit offshore sites and bookies, compared with $9 billion last year.

Naturally, Uncle Sam wants his cut, and the tax code's rules for gamblers have a whiff of "heads I win, tails you lose."

To begin with, all gambling winnings are taxable, whether or not the game was legal.

Meanwhile, gambling losses are deductible—but only with restrictions. Typically taxpayers can claim losses only up to the amount of their winnings, and taking losses can require elaborate record keeping.

"The burden of proving losses falls on the taxpayer, while gambling winnings are often reported to the IRS," says Donald Zidik, a CPA with the accounting firm Marcum LLP in Needham, Mass.

In 2013, the most recent year for which IRS data are available, taxpayers claimed about $30 billion of gambling income and deducted about $17 billion in losses on nearly two million individual tax returns. Total 2013 earnings were 50% higher than a decade earlier, and the total number of gamblers was nearly 25% higher.

Here is what to know about gambling income and deductions.

**Was it business or pleasure?** Recreational gamblers report their winnings on Line 21 of the 1040 form, as "other income." They can also owe income tax on "comps" such as free lodging and travel.

According to an IRS spokesman, these gamblers can deduct losses both from legal and illegal games, if they itemize write-offs on Schedule A (line 28) instead of taking the standard deduction.

The good news is that such losses needn't exceed 2% of adjusted gross income to qualify for a write-off. Taxpayers must have records proving them, however.

The IRS advises gamblers to keep a diary recording the date and type of wagers, the name and address of the gambling business, the names of other people present, and the amounts won or lost. "This can take some of the fun out of it, but it's necessary if you want deductions," says Scott Kaplowitch, a CPA with Edelstein & Company LLP in Boston. For more information, see IRS Publication 529, Miscellaneous Deductions.

By contrast, professional gamblers claim both their winnings and losses on Schedule C, because for them it qualifies as a full or part-time "trade or business." In such cases, the taxpayer can deduct other reasonable costs as well, such as for entertainment, travel, meals and coaching.

The trouble with that option: The IRS often scrutinizes taxpayers who claim to be professional gamblers, according to Mr. Kaplowitch. Recently he won an audit on this issue for a client who is a full-time poker player with a six-figure income, he says.

He adds that gamblers who qualify for Schedule C can deduct losses only up to the amount of their winnings—but they can carry over and deduct excess expenses against profits from other years. In addition, they often must show a profit in three out of five years, or the IRS may argue that the business is actually a hobby.

**Know what the IRS will get**: The payer of gambling winnings is supposed to issue a Form W-2G to taxpayers who win more than $1,200 from bingo or slot machines; $1,500 or more in proceeds (winnings minus wagers) from keno; and $5,000 from poker tournaments (winnings minus wager or buy-in).

Otherwise, payers of winnings should notify the IRS when a taxpayer receives more than $600 a year—assuming the payout is at least 300 times the amount of the wager. The agency often matches such notices with taxpayer returns, looking for unreported income.

**Beware of borrowing to bet**: The most harrowing tales of taxes on gambling often involve high rollers with large lines of credit, for example at casinos. After the bettors lost, the casinos forgave the debt—but the IRS counted this forgiveness as taxable income. In one case, this forgiveness added $255,000 to the taxpayer's income.

The lesson, says Michael Graetz, a former Treasury official who now teaches at Columbia University's Law School, is: "Only gamble what you have, or you could find yourself in real trouble."

**Don't forget state taxes**: Many states tax gambling winnings, although California exempts the winners of its state lottery. New York imposes tax even on out-of-state winners of its lottery, however. Several states, including Connecticut, Massachusetts, Michigan and Wisconsin, tax gambling winnings but disallow many deductions for losses.

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