WINSTON SHIRLEY 4292 Old Lake Drive Decatur, Georgia 30034-6427,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. INC. 96-153
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

FINAL ORDER

The Revenue Department assessed income tax against Winston Shirley ("Taxpayer") for the years 1993 and 1994. The Taxpayer appealed to the Administrative Law Division, and a hearing was conducted on April 30, 1996. The Taxpayer's accountant, W. Clyde Barron, appeared on his behalf. Assistant Counsel Antoinette Jones represented the Department.

The issue in this case is whether gambling losses claimed by the Taxpayer on his 1993 and 1994 Alabama returns were properly disallowed by the Department.

The Taxpayer regularly gambles at the Macon County Greyhound Park ("Victoryland" or "dog track"). According to the Taxpayer's accountant, the Taxpayer goes to the dog track daily and bets almost exclusively on high-odds trifecta and superfecta races.[1]

The Taxpayer filed Alabama income tax returns and claimed gambling winnings of $177,106.80 in 1993 and $296,683.00 in 1994. He also claimed corresponding gambling losses of $177,106.80 in 1993 and $297,008.00 in 1994. As discussed below, gambling losses

[1]In a trifecta, the bettor is required to pick the first three dogs finishing in exact order. A superfecta requires the bettor to pick the first four dogs in exact order. Generally speaking, but not necessarily, superfectas usually have larger payouts than trifectas.

may be deducted, but only up to the amount of reported winnings.

The Department audited the Taxpayer, and requested records to verify his claimed gambling income and losses. The Taxpayer's accountant provided the Department examiner with W-2G forms that had been issued by Victoryland to the Taxpayer in both years. The dog track issues a W-2G form any time a bettor wins more than $600.00 on a particular race. The winnings shown on the W-2G forms equaled the gambling income reported by the Taxpayer in each year. In other words, he did not report any winnings under $600.00 in either year.

Concerning the claimed losses, the accountant provided the examiner with a summary sheet of the Taxpayer's daily wins and losses that was prepared by the Taxpayer. The accountant also offered bundles of losing tickets.[2] The examiner briefly reviewed the tickets, found that they were in no particular order, and thus disallowed the tickets as insufficient to verify the claimed losses. The examiner consequently disallowed the losses. Preliminary assessments were entered for the resulting additional tax due.

The Taxpayer's accountant later attended an informal conference to discuss the disallowed losses. The accountant did not offer any additional records at that time. Rather, he argued that the Taxpayer was a professional gambler, that he bet only on

[2]The accountant claimed at the April 30 hearing that he also provided some race programs and tip sheets. That claim was adamantly denied by the examiner.

high-odds races, and that the records previously offered to the Department examiner were sufficient to verify the losses.

The Department again disallowed the losses because the proffered records were insufficient, and also because the Department did not believe that the Taxpayer had never won less than $600.00 on a race. The Department then entered the final assessments in issue, which the Taxpayer timely appealed to the Administrative Law Division.

Gambling losses can be deducted, but only up to the amount of gambling winnings. Code of Ala. 1975, §40-18-15(7) and Department Reg. 810-3-.17-.01(1)(a)(12). See also, 26 U.S.C. §165(d).

As with all deductions, the burden is on the taxpayer to prove gambling losses. Donovan v. Commissioner, 359 F.2d 64 (1966); Betson v. Commissioner, 802 F.2d 365 (9th Cir. 1986). Whether a taxpayer has adequately established his gambling losses is a question of fact in each case. As stated in Norgaard v. Commissioner, 939 F.2d 874 (9th Cir. 1991):

> The question of the amount of losses sustained by a taxpayer is a question of fact to be determined from the facts of each case, established by the taxpayer's evidence, and the credibility of the taxpayer and supporting witnesses. *Green v. Commissioner*, 66 T.C. 538, 545-46 (1976) *acq.* 1980-2 C.B. 1. The credibility of the taxpayer is a crucial factor. *See Mack v. Commissioner*, 429 F.2d 182, 184 (6th Cir. 1970) (that the tax court allowed some deduction based on the taxpayer's net worth method of proof "was a testament to the persuasiveness and seeming integrity of these taxpayers"). In some cases, courts have found losing tickets or other records and corroborating testimony by the taxpayer insufficient to establish that the taxpayer

> suffered deductible losses. However, in other cases, the tax court has allowed the taxpayer to deduct some or all of their losses on the basis of their losing tickets and credible corroboration by the taxpayer.

Norgaard, at page 878.

In this case, the Taxpayer's accountant initially presented some losing tickets in support of the claimed losses. However, the tickets were not offered at the April 30 administrative hearing because, according to the accountant, after the Department examiner initially reviewed and rejected the tickets, the Taxpayer simply threw them away. I find it unbelievable that any taxpayer would discard his tax records simply because they were rejected in an initial examination by a revenue examiner. If the records were valid and supported the taxpayer's returns, any reasonable person would have maintained the records to present at the next audit step, or on appeal.

In any case, even if the tickets had been presented at the April 30 hearing, they still would not have been sufficient to establish the Taxpayer's losses. Ticket stubs, even if organized by day and race, which the Taxpayer's apparently were not, are generally not sufficient to verify gambling losses. As stated in Department of Revenue v. Shirley A. Givens Johnson, Admin. Law Docket Inc. 90-126, decided January 3, 1991:

> Concerning dog track losses, losing ticket stubs alone are insufficient to adequately prove losses. Losing tickets are discarded after every race, and it would be a simple matter to collect enough tickets discarded by other bettors to support any amount of claimed losses.

> The Department should not be required to accept such unreliable evidence. Rather, a taxpayer should be required to produce contemporaneous records showing races attended and the amounts won and lost on specific races (racing programs, tip sheets, log books, etc.). The Department should be allowed discretion in reviewing a taxpayer's records, and less meticulous records could be accepted in some cases. However, the Department properly rejected the tickets provided by the Taxpayer in this case.

Department v. Johnson, at page 2.

Losing tickets are in some cases sufficient to verify claimed losses, but only if the tickets are supported by the believable, direct testimony of the taxpayer. See generally, Norgaard, supra, footnote 3, at page 878. For example, in Wolkomir v. Commissioner, which is cited in the above footnote, the claimed losses were allowed based on the "forthright, credible, and candid testimony of the taxpayer."

Unfortunately, the Taxpayer in this case failed to meet with the Department, and also failed to personally appear at the April 30 hearing. The Taxpayer was within his rights in not appearing. However, by doing so he obviously failed to offer any credible testimony supporting his claimed losses or otherwise explaining his gambling activities during the subject years.

The Taxpayer argues in the alternative that his losses should be estimated based on the *Cohan* rule. In Cohan v. Commissioner, 39 F.2d 540 (C.A.2 1930), the taxpayer established that he had some deductible expenditures, but failed to keep adequate records. The court held that it was reasonable to allow the taxpayer to estimate

his deductions in that case.

The *Cohan* rule cannot be applied in this case because the Taxpayer has not proved that he is entitled to some deduction. That is, he has not established with reasonable certainty that his unreported winnings were not in excess of his total losses.

The court rejected the *Cohan* rule in Norgaard, supra, as follows:

> The tax court may have considerable latitude in estimating the amount of the allowable deduction, however, the *Cohan* rule does not "require that such latitude be employed." *Williams v. United States*, 245 F.2d 559, 560 (5th Cir. 1957). "The District Court may not be compelled to guess, or estimate . . . even though such an estimate, if made, might have been affirmed." *Id.* In order to qualify for the estimation treatment under *Cohan*, the taxpayer must establish that he is entitled to some deduction. *Edelson v. Commissioner*, 829 F.2d 828, 831 (9th Cir. 1987). "Until the trier has that assurance from the record, relief to the taxpayer would be unguided largesse." *Williams*, 245 F.2d 560.
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> Had the Norgaards provided a credible evidentiary basis from which the tax court could have estimated, first, their unquantified, unreported winnings, and second, their losses, they could have benefited from application of the rule of *Cohan*. The tax court is permitted to make a reasonable estimate of both a taxpayer's unquantified, unreported winnings and his losses in order to determine the existence of deductible losses. However, the rule of *Cohan* cannot be applied in the presence of unquantified, unreported winnings unless both winnings and losses are estimated. Neither winnings nor losses can reasonably be estimated in the absence of a credible basis for doing so.
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> Here, the tax court implicitly found that the Norgaards had not presented credible evidence from which it could have estimated their unquantified, unreported winnings and/or their losses. In those circumstances, there was

> no way for the tax court to determine whether the claimed losses equalled or exceeded the unquantified, unreported winnings. As the tax court has explained, "Petitioner, being unable to estimate his unreported winnings and offering no satisfactory evidence to establish such winnings, has failed to lay a proper foundation for the application of the *Cohan* rule." *DeMonaco v. Commissioner*, 41 T.C.M. (CCH) 718 at 720 (1981).
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> Given the fact that the Norgaards did not lay the proper foundation for the tax court to apply the rule of *Cohan*, we hold that its failure to estimate their deductible losses was not clearly erroneous.

Norgaard, at page 879.

The issue here is whether it is reasonable to believe that the Taxpayer never won less than $600.00 on any race. In my opinion, it is not. Even if the Taxpayer bet on only high-return trifectas and superfectas, as his accountant claims, odds are good that he sometimes must have won less than $600.00 on a race.

The 1994 W-2G summary from Victoryland (State exhibit 10) shows numerous races on which the Taxpayer won just over $600.00. For example, on January 29, February 23, and March 4, the Taxpayer won $622.00, $657.00, and $601.00, respectively, on superfectas. Trifectas generally pay less than superfectas. Exhibit 10 shows that on March 29 and April 11, the Taxpayer won $606.00 and $624.00, respectively, on trifectas, to cite only a few examples. Given the above, it is not reasonable to believe that the Taxpayer never won a race that paid less than $600.00.

The Department also offered into evidence the daily results for the Victoryland races on April 29, 1996 (State Exhibit 8).

That exhibit shows that of the 11 trifecta races, 8 paid less than $600.00. While Exhibit 8 admittedly involves a race date after the years in issue, it is not unreasonable to assume that the payouts would have remained relatively the same.

In summary, I do not believe that the Taxpayer, who bet almost daily on trifectas and superfectas over a two year period, never won less than $600.00 on a race. It follows that he had gambling winnings at Victoryland during 1993 and 1994 that he failed to report on his Alabama returns. Given that the Taxpayer had unreported winnings, neither the Department nor the Administrative Law Division can now reasonably determine if the Taxpayer's losses, which must now be estimated, exceeded those unreported winnings in the subject years. Consequently, the *Cohan* rule cannot be applied.

The Taxpayer is an experienced professional gambler. He certainly knew or should have known what records he was required to keep to verify his winnings and losses. He kept some records, but destroyed them during the audit. He did so at his own peril. The credibility of the Taxpayer is also vital in deciding if the claimed losses should be allowed. However, as indicated, the Taxpayer never met with the Department and also failed to appear at the April 30 hearing. In the absence of any records or testimony from the Taxpayer, the claimed losses must be disallowed.

The above considered, the final assessments are affirmed as entered. Judgment is entered against the Taxpayer for 1993 income

tax of $12,693.28, and 1994 income tax of $6,369.64, plus applicable interest.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 9, 1996.

BILL THOMPSON
Chief Administrative Law Judge