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| TERRY PHILLIPS<br>P.O. Box 611552<br>Birmingham, AL 35261, | § | STATE OF ALABAMA<br>DEPARTMENT OF REVENUE<br>ADMINISTRATIVE LAW DIVISION |
| Taxpayer, | § | DOCKET NO. INC. 03-617 |
| v. | § | |
| STATE OF ALABAMA<br>DEPARTMENT OF REVENUE. | § | |

**OPINION AND PRELIMINARY ORDER**

The Revenue Department assessed Terry Phillips ("Taxpayer") for 2000 and 2001 Alabama income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on December 16, 2003 in Birmingham, Alabama. The Taxpayer attended the hearing. Assistant Counsel J.R. Gaines represented the Department.

The issue in this case is whether the Department correctly computed the Taxpayer's gambling income and losses in the subject years.

The Taxpayer filed Alabama income tax returns and reported gambling winnings of $118,434 in 2000 and $245,459 in 2001. Those amounts corresponded exactly with the winnings shown on the W-2Gs received by the Taxpayer in both years.[1] The Taxpayer also claimed gambling losses equal to his reported gambling winnings in 2001. He claimed losses of $115,314 in 2000, or $3,120 less than his reported W-2G winnings in that year.

The Department audited the Taxpayer and requested records substantiating the gambling losses claimed on the returns. The Taxpayer provided the Department examiner with log books in which he claimed that he had recorded his gambling winnings and

[1] W-2Gs are issued by a gambling establishment if an individual wins more than $600 on any single wager.

losses.[2] The examiner rejected the log books as incomplete. She instead estimated the Taxpayer's gambling income and losses as follows: She started with gambling winnings as shown on the Taxpayer's W-2Gs in each year. She deducted the tax withheld from the W-2G winnings and also estimated living expenses of $40,000 in each year to arrive at W-2G winnings available to lose. She added 20 percent of the W-2G income as an estimate of how much the Taxpayer had won under $600, which, when added to the W-2G income, reflected the Taxpayer's estimated gross winnings in each year. She then arrived at taxable gross income by allowing the Taxpayer losses equal to his W-2G winnings that were available to lose, and also 50 percent of his estimated winnings under $600. The examiner's method for computing the Taxpayer's taxable income is illustrated below by her computations concerning the 2000 tax year.

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| $118,434.00 | Total W-2Gs |
| $ (3,243.00) | Tax withheld from W-2Gs |
| $115,191.00 | |
| $ (40,000.00) | Living expenses for 2000 estimated (TP has no other income source) |
| $ 75,191.00 | W-2G winnings available to lose |
| | |
| $118,434.00 | Win per W-2Gs |
| $ 23,687.00 | 20% more gross winnings under $600 estimated based on W-2Gs and opportunities available |
| $142,121.00 | Gross winnings |
| $(75,191.00) | Amount available from W-2Gs winnings allowed as losses |
| $(11,844.00) | 50% of additional winnings under $600 allowed as losses |
| $ 55,086.00 | Taxable income |

The Taxpayer objects that the examiner over-estimated his winnings under $600 because he only bets on long-shots, and thus rarely wins less than $600 on a race. He

[2] Four randomly selected pages from one of the Taxpayer's log books are attached to this Final Order. The W-2 amounts noted on the pages were recorded by the Department examiner.

also argues that the estimated living expenses of $40,000 per year is excessive.

Gambling losses can be deducted, but only up to the amount of gambling winnings. Code of Ala. 1975, §40-18-15(7) and Dept. 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. *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, 878 (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.

The Taxpayer provided logbooks, which he claims accurately reflect his gambling winnings and losses during the subject years. I agree with the Department examiner, however, that the logbooks are sparsely detailed and incomplete and cannot be accepted. The Taxpayer's entries are also incorrect. For example, his recorded winnings in December 2001 totaled $20,230, although his W-2Gs received in that month totaled $37,232. Likewise, he recorded winnings in September 2001 of $24,304, while his W-2Gs showed winnings of $36,445. The Taxpayer also failed to provide losing tickets supporting the logbooks, or any other reliable evidence concerning his gambling losses.

All taxpayers are required to keep complete and accurate records from which the

Department can accurately determine the taxpayer's correct income tax liability. Code of Ala. 1975, §40-2A-7(a)(1); *State v. Mack*, 411 So.2d 799 (Ala. Civ. App. 1982). If a taxpayer fails to keep adequate records, the Department can use any reasonable method to compute the taxpayer's liability. The taxpayer cannot then complain that the liability so computed is inexact. *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990); *Adamson v. Commissioner*, 745 F.2d 54 (9th Cir. 1984); *Denison v. C.I.R.*, 689 F.2d 777 (10th Cir. 1982); *Webb v. C.I.R.*, 394 F.2d 366 (5th Cir. 1968).

The method used by the Department examiner to compute the Taxpayer's gambling income in this case was reasonable under the circumstances. The examiner could have disallowed all of the Taxpayer's claimed losses because they were not property verified. She did not, and instead allowed him all of his W-2G winnings that were available to lose, and also one-half of his estimated winnings under $600.

The Taxpayer argues that the examiner mistakenly estimated that his winnings under $600 totaled 20 percent of his W-2G winnings. However, that amount is not unreasonable, and, as indicated, the Taxpayer failed in his duty to keep accurate records concerning his actual winnings under $600. He also failed to report any non-W-2G winnings on his returns. Under the circumstances, the Taxpayer cannot now complain that the Department's estimate may be high.

I agree with the Taxpayer, however, that the estimate that he needed $40,000 a year after taxes to live is excessive. The Taxpayer is an addicted gambler that lived frugally in the subject years so that he would have more money to gamble. A more reasonable estimate of living expenses would be $20,000 a year. The Department should recompute the Taxpayer's liability accordingly. A Final Order will then be entered for the adjusted

amounts due.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered March 16, 2004.