Individual Tax Issues: Part 1

Chapter 6

Pg 215

1

Learning Objectives

- Understand the new charitable contribution deduction rules
- Know when a taxpayer is eligible to deduct an investment theft loss
- Understand when a taxpayer can deduct an investment theft loss
- Know how to report wagering gains and losses
- Understand recordkeeping for wagering gains & losses

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Pg 217

Issue 1

New Charitable Contribution Deduction Rules

3

0.5% Floor on Contributions

Pg 217

- For tax years beginning after December 31, 2025
- Deduction allowed only above 0.5% of the contribution base
- Contribution base = AGI (generally)
- **Result**: Reduce the total deductible charitable contribution by 0.5% of AGI

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0.5% Ordering Rules

Pg 217

The floor is applied to contributions in this order:

- Capital gain property to 30% organizations
- Capital gain property to 50% organizations
- Other contributions to 30% organizations
- Qualified conservation contributions
- Other contributions to 50% organizations
- Cash contributions to 50% organizations (60% limit)

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0.5% Floor: Carryforward of Disallowed Amounts

Pg 217

- Amounts disallowed by the 0.5% floor can carry forward to the **5 succeeding years**
- But only if a carryover exists under a percentage limit that year [I.R.C. § 170(d)(1)(C)]

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Example 6.1: Deduction Does Not Exceed Contribution Floor – No Carryforward Pg 217

- Facts:
  - Valentina and Leo: $350,000 AGI
  - Made a $1,500 cash contribution to a food bank
  - 0.5% floor = $1,750 (AGI $350,000 x 0.5%)
  - Gift is below the floor → deduction = $0
  - No amount carries forward

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Example 6.2: Deduction Exceeds Contribution Floor – No Carryforward Pg 217

- Facts:
  - Same as 6.1; Contribution is now $2,000
  - 0.5% floor = $1,750 (AGI $350,000 x 0.5%)
  - Deduction = $250 ($2,000 - $1,750)
  - Not limited by percentage limits → no carryforward

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Example 6.3: Deduction Does Not Exceed Contribution Floor – Carryforward Pg 217

- Facts:
  - **Becky**: $120,000 AGI in 2026
  - $40,000 contribution to a 30%-limit foundation
  - **30% limit**: Becky can deduct $36,000 ($120,000 x 30%); carries forward $4,000 ($40,000 - $36,000)
  - **0.5% floor** reduces another $600 ($120,000 x 0.5%)
  - **Total contribution** = $35,400 ($36,000 - $600)
  - **Total carryforward** = $4,600 ($4,000 + $600)

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Cross-Reference: Qualified Charitable Distribution (QCD) Pg 218

- **Qualified Charitable Distribution (QCD)**: a nontaxable IRA distribution made directly to charity by the IRA trustee
- Taxpayer must be age 70 ½ or older
- 2026 annual exclusion: $111,000
- One-time $55,000 (for 2026) to a charitable remainder unitrust or a charitable gift annuity if it is funded only by QCDs
- *See* pages 231-232 in the ***2025 National Income Tax Workbook*** for further discussion on QCDs

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Planning Pointer: Bunching Contributions pg 218

- Bunch gifts into one year to clear the 0.5% floor
- **Donor advised fund**: large gift now, donor or fund adviser recommends grants to charities in subsequent years

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60% Cash Limit Pgs 218-219

- 60%-of-AGI limit for cash to 50% charities is now permanent (see pg 218 for partial list)
- Does **not** apply to **noncash contributions**
- If both cash and noncash contributions are made, the 60% limit is applied first

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Example 6.4: Cash Contribution to 50% Organization Applied First

Pg 219

- Facts:
  - Emile: $200 cash to a land conservancy (50% organization)
  - 60%-of-AGI limit applies to the cash contribution
  - If Emile also donated land: land donated limited to 50% of AGI minus the cash subject to 60%

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Limit on Itemized Deductions

Pg 219

- For tax years after 2025, §68 is amended to limit itemized deductions for taxpayers in the 37% bracket
- Reduces itemized deductions by 2/37 of the lesser of:
  - Total itemized deductions; or
  - Amount of taxable income (without regard for the limit and increased by the itemized deductions) that exceeds the 37% bracket threshold
- Effective value of itemized deductions: 35¢ per dollar, rather than 37¢

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Limit on Itemized Deductions

Example: Not in Book

37% bracket threshold is $640,600

AGI $800,000, Itemized deductions $125,000

Taxable income $675,000

Itemized deductions reduced by

2/37 of the lesser of

$125,000 itemized deductions or

$159,400 ($800,000 - $640,600)

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Limit on Itemized Deductions

Pg 219

- Limit is applied after other limits (AGI limitation on charitable contributions or the 0.5% floor limitation)
- **Does not apply** when determining **QBI**

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Deduction for Non-Itemizers

Pg 219

- Higher standard deduction made permanent in tax years after 2025
- I.R.C. § 63(c) amended to increase basic standard deduction amounts

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Deduction for Non-Itemizers

Pg 219

Figure 6.1: 2026 Standard Deduction Amount

Filing Status	Standard Deduction
MFJ and surviving spouses	$32,200
HoH	$24,150
Unmarried individuals (other than surviving spouse and HoH)	$16,100
MFS	$16,100

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Deduction for Non-Itemizers Pg 219

- Starting in 2026, taxpayers who do not elect to itemize can deduct up to $1,000 ($2,000 MFJ) for cash contributions to 50% organizations
- **Not allowed for**:
  - Supporting organizations (§ 509(a)(3))
  - Donor-advised funds
- New deduction is permanent; not indexed for inflation

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Example 6.5: Deduction Limited by the 0.5% Floor – Claimed as a from-AGI Deduction Pg 219

- **Facts**:
  - Same as 6.1, but Valentina & Leo take the standard deduction
  - They can deduct the full $1,500 contribution
  - The deduction is a below-the-line (from AGI) deduction

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Law Change: Contributions to Scholarship Granting Organizations Pg 219

- New I.R.C. §25F; for tax years ending after December 31, 2026
- Credit for qualified contributions to scholarship granting organizations
- Maximum Credit: $1,700
- Non-refundable. Carry forward 5 years

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Tax Credit for Contributions to Scholarship Granting Organizations

2025 Book, Pg 579

Scholarship Granting Organization is:

- IRC 501(c)(3) organization AND
- IRC 501(a) exempt from tax
- Does **not include** a private foundation

Reduced by any **State tax credits**

Contribution used for the credit cannot also be used as a charitable contribution for IRC 170

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Tax Credit for Contributions to Scholarship Granting Organizations

2025 Book, Pg 580

Qualified Contributions means:

- Cash contribution to a scholarship granting organization
  - To fund scholarships for eligible students
  - Within the state in which the organization is listed
- Provide scholarships for qualified **elementary** or **secondary** qualified education expenses

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Tax Credit for Contributions to Scholarship Granting Organizations

Not in Book

- As of October 20, 2026:
  - 31 States have opted in to participate
  - Michigan has **not** opted in
  - SGO lists are due by February 15, 2027. IRS will then publish the list

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Pg 220

Issue 2

Investment Theft Losses

25

Investment Theft Losses: Overview

Pg 220

- Internet investment scams:
  - Common targets – cryptocurrency, real estate, precious metals and coins
  - Funds stolen via legitimate-looking websites
- Taxpayers may be able to deduct theft losses incurred in a trade or business or a transaction entered into for profit

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Requirements to Deduct a Theft Loss

Pg 220

- Prove the theft occurred
- Prove the amount of the loss
- Prove the year the loss was discovered
- No reasonable prospect of recovery at year-end

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Transaction Entered Into For Profit

Pg 220

- Under I.R.C. § 165(h)(5), individuals may deduct:
  - Personal casualty losses only to the extent of personal casualty gains and
  - For losses attributable to a federally- or state-declared disaster
- The OBBBA makes these deduction limitations permanent

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Transaction Entered Into For Profit

Pg 220

- Personal casualty losses include theft losses not connected with a trade or business or a profit-seeking transaction
- As a result, a theft loss is generally deductible under §165 only if incurred in a transaction entered into for profit

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Determining Profit Motive: Tax Court Focus

Pg 220

- Tax Court examines taxpayer's motive to determine whether a transaction was entered into primarily for profit
- *Wright v. Commissioner*, T.C. Memo. 2024-100: taxpayers claimed theft loss on foreign currency exchange transactions
- The court applied a set of guidelines to assess profit motive

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Wright Guidelines for Assessing Profit Motive Pg 220

1. **Motive, not potential**: the ultimate issue is profit *motive*, though profit potential is a relevant factor
2. **Economic profit**: profit motive refers to economic profit independent of tax savings
3. **Overall scheme**: deductibility is judged by the whole transaction, not just the losing legs of a position

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Wright Guidelines for Assessing Profit Motive Pg 220

4. **Primary motive**: with multiple motives, the primary one controls – objective facts outweigh self-serving statements of intent
5. **Timing**: focus is on intent when the transaction was initiated, though all surrounding circumstances are relevant

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Cross-Reference: Hobby Loss Rules Pg 221

- I.R.C. § 183 and its regulations provide guidance on when an activity is considered **engaged in for profit**
- *See* the "Agricultural and Natural Resource Tax Issues" chapter for the factors courts use to determine whether an activity is engaged in for profit

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Investment Scams

Pg 221

- **C.C.A. 202511015 (Jan. 17, 2025)**: the IRS addresses theft loss deductions for **scam victims**
- The memo analyzes **five scams** involving fraud and deceit
- In each scenario, the taxpayers had **no prospect of recovering** the stolen funds

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Practitioner Note: Impersonator Scam Variations

Pg 221

- The scam targets victims' retirement and non-retirement accounts by convincing them their funds are compromised or in danger and must be moved immediately to "safeguard" them
- Scammers commonly impersonate **bank employees, tech support, and other officials**
- They use genuine-looking emails, paper correspondence, and **spoofed phone numbers**

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Taxpayer 1 – Compromised Account Scam

Pg 221

- **Victim**: Brian Davis
- **Scammer**: Chad Smith, an impersonator posing as a bank fraud specialist
- Chad falsely claimed Brian's computer and bank accounts were compromised, with attempted unauthorized withdrawals
- Chad spoofed the bank's phone number, gained Brian's trust, and created a sense of urgency

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Taxpayer 1 – Compromised Account Scam Pg 221

- Chad induced Brian to authorize distributions from **IRA and non-IRA accounts** and transfer funds into new investment accounts Chad controlled
- Chad falsely claimed the rolled-over IRA fund would keep their **tax-deferred status** with no federal tax consequences

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Taxpayer 1 – Compromised Account Scam Pg 221

- Chad immediately moved all funds to an **overseas account** and stole them
- Bank and law enforcement confirmed that the transfer **could not be undone** – little to no prospect of recovery
- Brian's motive was to **safeguard and reinvest** all funds in new accounts, just as before the distributions
- Therefore, the losses were incurred in a transaction **entered into for profit**

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Taxpayer 1 – Compromised Account Scam Pg 222

- The loss qualifies as a **theft loss** with no reasonable prospect of recovery → deductible in the year of the theft
- Deduction **limited to Brian's basis** in the property
- Brian owes tax on the **IRA distribution** and will recognize **gain or loss** on disposition of non-IRA assets
- These consequences give Brian **basis in all stolen funds** for calculating the deductible theft loss

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Practitioner Note: Pig Butchering Scams Pg 222

- Pig butchering scams vary, but generally promise **large returns from nonexistent investments**
- Named "pig butchering" because the scam "**fattens up**" the victim with fake returns to induce larger investments
- Recent crypto surges of 100%-1,000% lead taxpayers to chase "too good to be true" returns and "get rich quick" pitches
- Some scams demand **fees, taxes, or other payments** to withdraw funds – **increasing the victim's loss**

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Taxpayer 2 – Pig Butchering Investment Scam Pg 222

- **Victim**: Laura; received an unsolicited email from "Global Crypto Co." promising large crypto profits
- The email linked to a legitimate-looking platform claiming to use **proprietary investment methods**
- Laura deposited a small amount, saw the balance grow, and **successfully withdrew** funds – reinforcing trust
- Laura repeated with a larger amount and again withdrew successfully

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Taxpayer 2 – Pig Butchering Investment Scam Pg 222

- Convinced of legitimacy, Laura invested significantly more using **IRA and non-IRA funds**
- When she tried to withdraw, she got an **error message** and customer support did not respond
- She discovered others defrauded by the same site; contacted law enforcement & her financial institution
- The overseas transfer **could not be undone** – little to no prospect of recovery; scammer never identified

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Taxpayer 2 – Pig Butchering Investment Scam Pg 222

- Laura transferred the funds **for investment purposes** → transaction entered into for profit
- Qualifies as a theft loss → deductible in the year of theft
- Laura owes tax on the IRA distribution and recognizes gain or loss on non-IRA assets, giving her basis in all stolen funds for the deduction

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Taxpayer 3 – Phishing Scam Pg 223

- **Victim**: Violet; received an unsolicited email from the "Securities and Fraud Commission" claiming her retirement accounts were compromised
- The email used **official-looking letterhead**, was digitally signed by a "fraud protection analyst," and included a link, phone number, and instructions to call
- Violet called and spoke with **Archer Carter**, who posed as a fraud analyst on her case

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Taxpayer 3 – Phishing Scam Pg 223

- Archer directed Violet to click the email link and log into her **tax-deferred retirement account** – giving him access to her computer
- Archer captured her **username and password** as she typed, and repeated this for her non-IRA account
- The next day, all funds had been **distributed to an overseas account** – Violet never authorized the distributions

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Taxpayer 3 – Phishing Scam Pg 223

- Law enforcement confirmed the transfer **could not be undone** – little to no prospect of recovery
- Unlike Brian and Laura, Violet **did not authorize** the distributions or transfers
- When the taxpayer didn't authorize the transfer, the loss does not result from the taxpayer's actions
- The relevant transaction becomes the **original investment** and the taxpayer's motive at that time

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Taxpayer 3 – Phishing Scam Pg 223

- Violet contributed to the IRA and non-IRA accounts to **invest and grow funds for retirement income** – demonstrating profit motive
- Theft of the invested property establishes the loss was incurred in a transaction **entered into for profit**
- Qualifies as a **theft loss** with no reasonable prospect of recovery → deductible in the year of theft
- Deduction limited to basis

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Taxpayer 4 – Romance Scam Pg 223

- **Victim**: Wayne; received an unsolicited text from "Angel Cruz" and developed a virtual romantic relationship
- Angel claimed a close relative urgently needed **expensive medical care** she couldn't afford
- Wayne authorized distributions from **IRA and non-IRA accounts**, then transferred the money to Angel's overseas account for the purported medical bills

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Taxpayer 4 – Romance Scam Pg 223

- After the transfer, Angel **stopped responding**
- Wayne realized the relationship was fake (texts and videos were **AI-generated**) and his funds were stolen
- The institution and law enforcement confirmed the transfer **could not be undone** → little to no prospect of recovery

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Taxpayer 4 – Romance Scam Pg 224

- Wayne's motive was **not to invest or reinvest**, but to voluntarily transfer funds to Angel (under false pretenses)
- Despite the fraud, there was **no profit motive** → not a transaction entered into for profit
- The loss is a **personal casualty loss** under § 165(c)(3)
- Personal casualty losses are disallowed except against casualty gains or attibutable to a declared disaster → Wayne had **neither → theft loss not deductible**

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Practitioner Note: Romance Scam Variation Pg 224

- In a common variation, the scammer establishes the **romantic relationship**, then directs the victim into a **fraudulent investment scheme**
- The analysis is then the same as **Taxpayer 2** (pig butchering scam)
- In that case, the victim **has a profit motive** for the investment, making the loss potentially deductible

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Taxpayer 5 – Kidnapping Scam

Pg 224

- **Victim:** Elena; "Audrey Parnell" contacted her by text and phone claiming to have **kidnapped her grandson** for ransom
- Elena demanded to speak to her grandson and **heard his voice** begging for help
- Audrey directed Elena to transfer money to an **overseas account** and warned her not to contact law enforcement

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Taxpayer 5 – Kidnapping Scam

Pg 224

- Under **immense duress**, Elena authorized distributions from **IRA and non-IRA accounts** and sent the funds to Audrey's overseas account
- The next day, Elena contacted family and her grandson and learned **no kidnapping had taken place**
- The voice was an **AI clone** → no kidnapping had occurred

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Taxpayer 5 – Kidnapping Scam

Pg 224

- Law enforcement and her institution confirmed the transfer **could not be undone, no prospect of recovery**
- Elena's motive was **not to invest**, but to voluntarily transfer funds under false pretenses and duress
- Despite the fraud and duress, there was **no profit motive**
- The loss is a **personal casualty loss**
- Elena had **no casualty gains** and **no declared disaster** → **theft loss not deductible**

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Practitioner Note: Ponzi Loss Safe Harbor Pg 224

- C.C.A. 202511015 concludes that **Taxpayers 1–5 could not use** the Ponzi loss safe harbor provided in Rev. Proc. 2009-20 (discussed later)
- The theft losses **did not result from a specified fraudulent arrangement**
- In the pig butchering scam (Taxpayer 2), the scammer was **never identified, charged, or the subject of a criminal complaint**

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Existence of Theft Pg 225

- Theft includes but is not limited to **larceny, embezzlement, and robbery**
- Further defined as any **felonious taking** of money or property punishable under state or federal law (e.g., burglary, extortion, kidnapping for ransom, blackmail, swindling, false pretenses, and any criminal appropriation of another's property)
- Courts consistently require that the taking be accompanied by **criminal intent**

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Existence of Theft Pg 225

- Courts look to the **criminal law of the jurisdiction** where the loss occurred
- To qualify as a theft loss, the taxpayer must prove the loss resulted from a taking of property that was **illegal under state law** where the theft occurred and **done with criminal intent**

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Example 6.6: Obtaining Money by False Representation

Pg 225

- Julian invested **$200,000 cash** in a start-up company in Brookline, MA
- The president promised a "ground floor" opportunity and large returns
- After 3 years struggling to be profitable, the company **liquidated and** dissolved
- Creditors were paid, but **no funds remained to distribute to investors**
- Julian concluded his shares were **worthless** and wanted to claim a **theft loss** based on alleged false pretenses

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Example 6.6: Obtaining Money by False Representation

Pg 225

- Under MA law, obtaining money by false/fraudulent representation requires:
  1. A **false statement of fact** was made
  2. The defendant **knew or believed** it was false when made
  3. The defendant **intended** the listener to rely on it
  4. The listener **did rely** on it and consequently parted with property

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Example 6.6: Obtaining Money by False Representation

Pg 225

- To prove the existence of a crime, Julian must prove the president **knew the company was failing** when promising large returns
- If the president did not **knowingly make a false statement**, there was no illegal taking
- **Result**: Julian's investment was a **bad business decision → capital loss**, not a theft loss

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Year of the Deduction

Pg 225

- A theft loss is generally treated as sustained in the tax year the taxpayer **discovers** the loss
- It is **not** deductible in the year the theft actually occurs (unless that's also the year of discovery)
- If, in the year of discovery, there is a **reasonable prospect of recovery**, **no portion** of the loss is currently deductible

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Year of the Deduction

Pg 225

- The loss becomes deductible only in the year the taxpayer can determine, with **reasonable certainty**, that there will be no reimbursement or recovery
- Whether a reasonable prospect exists is a **question of fact** based on the totality of the circumstances

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Example 6.7: Prospect of Insurance Recovery

Pg 226

- **2024:** Bettina (calendar-year taxpayer) invested **$10,000** in an internet scam.
- The scammer gained her trust and promised a "guaranteed moneymaker"
- **2025:** She tried to get information on her investment
- The phone was disconnected, emails rejected, and the website gone—concluding the investment was a **scam** and her money stolen

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Example 6.7: Prospect of Insurance Recovery Pg 226

- **2025:** Bettina submitted an insurance claim; the insurer **disputed liability** (created a reasonable prospect of recovery)
- **2026:** The claim was **settled,** Bettina received **$2,000** in proceeds
- **No loss deduction** allowed for 2024 or 2025
- **2026:** $10,000 – $2,000 = **$8,000 theft loss deduction**, when no reasonable prospect of recovery remained

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Allowable Losses Pg 226

- The deductible loss is generally limited to the taxpayer's **adjusted basis** for determining loss under I.R.C. § 1011
- Basis is usually **cost** – the amount paid or money invested
- A taxpayer generally **may not** take a loss deduction for income, or the unrealized gain from an investment that has not been included in gross income

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Allowable Losses Pg 226

- Theft loss generally = **initial investment + additional investments – amounts withdrawn**
- Further **reduced by** reimbursements, other recoveries, and any claims with a reasonable prospect of recovery

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Allowable Losses

Pg 226

To claim the theft loss deduction:

- Complete **Form 4684, Casualties and Thefts**
- Use **Section B** (Business and Income-Producing Property) to report theft of investment property
- The resulting loss flows to **Schedule A (Form 1040), Itemized Deductions**

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Example 6.8: Reporting a Theft Loss Deduction

Pgs 226-227

- **Jan 2026:** Alice invested **$5,000** in a company that claimed to buy precious metals for investors and promised large returns
- **Nov 2026:** Alice learned she was a **scam victim,** and her money was irretrievably gone
- She reports the loss on **Form 4684, Section B** (Figure 6.2)
- The loss carries to **Schedule A (Form 1040), line 16**, with her itemized deductions (Figure 6.3)

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Ponzi Scheme Safe Harbor

Pg 228

- Rev. Proc. 2009-20, 2009-14 I.R.B. 749, provides an **optional safe harbor method** for qualified investors claiming theft losses from **Ponzi-type schemes**
- A taxpayer is eligible if they establish they are:
  1. A **qualified investor**
  2. Who incurred a **qualified loss**
  3. From a **qualified investment**
  4. In a **specified fraudulent arrangement**

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How Ponzi Schemes Work

Pg 228

The scammer receives **cash or property** from investors and claims to earn income for them

The scammer reports **fictitious income,** and any payments to investors are made from **other investor's funds**

Ultimately, the scammer steals the invested cash or property

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Qualified Investor

Pg 228

- Generally means:

1. a **U.S. person** who qualifies to deduct theft losses under §165 and Treas. Reg. §1.165-8
2. Must **not** have known of the arrangement's fraudulent nature before it became **public knowledge**
3. The investment **cannot be a tax shelter** with regard to that investor
4. Must have **transferred cash or property** to a specified fraudulent arrangement

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Specified Fraudulent Arrangement

Pg 228

- An arrangement in which a **lead figure**:
  - Receives **cash or property** from investors
  - Purports to **earn income** for the investors
  - Reports income amounts that are **partially or wholly fictitious**
  - Makes payments, if any, of purported income or principal **from other investors' funds**
  - **Appropriates** some or all of the investors' cash or property

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Qualified Loss

Pg 228

- A loss from a specified fraudulent arrangement where the conduct causing the loss meets **one** of two conditions:
  - **Condition 1:** Indictment/Information
  - **Condition 2:** Criminal Complaint

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Qualified Loss–Condition 1:Indictment/Information

Pg 228

- The **lead figure** (or one of them) was charged by **indictment or information** (not withdrawn or dismissed) under state or federal law
- The charge was for **fraud, embezzlement, or a similar crime** that, if proven, would meet the §165 definition of **theft** in the relevant jurisdiction

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Qualified Loss-Condition 2: Criminal Complaint

Pg 228

- The lead figure was the subject of a state or federal **criminal complaint** (not withdrawn or dismissed) alleging **fraud, embezzlement or a similar crime**, **and** either:
  - **(a)** the complaint alleged an admission, or the lead figure executed an **affidavit admitting** the crime; **or**
  - **(b)** a **receiver or trustee** was appointed, or the arrangement's **assets were frozen**

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Tax Treatment

Pg 229

- A loss from **criminal fraud or embezzlement** in a transaction entered into for profit is a **theft loss, not a capital loss**
- It is **not subject to** the §165(h) personal loss limits, which do not apply to profit-seeking transactions
- The loss amount includes **amounts invested and amounts reported as gross income**

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Tax Treatment

Pg 229

- For a qualified investor with a qualified loss who follows the safe harbor procedure of Rev. Proc. 2009-20, the IRS won't challenge:
  1. The loss deducted as a **theft loss**
  2. Treating the year the theft was **discovered** as the discovery year
  3. The amount of the deduction is
     a) **95%** if the investor does **not** pursue third-party recovery
     b) **75%** if the investor **is pursuing or intends to pursue** third-party recovery

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Tax Treatment

Pg 229

4. The taxpayer **subtracts** any actual recovery and potential insurance or SIPC recovery

- The deduction amount is **not** further reduced by potential direct or third-party recovery
- The investor may have **income or an additional deduction** in a later year depending on the actual amount eventually recovered

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Pg 230

Issue 3

Wagering Gains and Losses

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Wagering Gains and Losses

Pg 230

- Casual gamblers must report **all wagering gains**
- Can deduct wagering losses **only to the extent of gains**
- **OBBBA** limits the deduction to **90% of wagering losses** for the tax year
- Wagering losses are an **itemized deduction**
- Gains and losses are generally calculated using a **session method** (not per-transaction)

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Gambling Income

Pg 230

- Rev. Rul. 54-339 holds that **wagering gains are included** in gross income
- Gain = **payouts – wagers placed** to produce those payouts
- Report all wagering gains on **Schedule 1 (Form 1040)**
- Gains may be determined **per transaction, per session, or per yearly session**

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Gambling Income

Pg 230

Shollenberger vs Commissioner

- George and Lillian Shollenberger took **$500** to the casino
- George won a **$2,000 slot jackpot**
- They each used **$200 of winnings** for additional play and left with **$1,600**
- They reported **no wagering gains**; the IRS asserted **$2,000** in winnings

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Gambling Income

Pg 230

Shollenger vs Commissioner - Holding

- The IRS conceded: entering with $500 and leaving with $1,600 = a **$1,100 wagering gain**
- Gross income is calculated by **subtracting the bets placed** to produce the winnings
- This subtraction is a **preliminary computation in determining gross income – not** a deduction from AGI or taxable income

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Practitioner Note: Wagering Loss Limits

Pg 230

- Subtracting wagers to determine **gains during a session** matters because of the **limits on wagering losses** (discussed next)
- If the Shollenbergers had instead claimed a **$2,000 gain** and a **$900 loss**, the loss would be **limited** – increasing the amount included in **taxable income**

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Gambling Losses

Pg 231

Prop. Treas. Reg. §1.165-10:

- Allows a deduction for **90% of wagering losses**, but only up to **wagering gains** for the year
- For **joint filers**: 90% of the spouses' **combined losses** is deductible, only to the extent of their **combined gains**

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Gambling Losses

Pg 231

Losses from wagering transactions:

- Includes any otherwise-allowable deduction incurred in **carrying on a wagering transaction**
- Applies to the **actual cost of wagers** and, for professional gamblers, other related expenses
  - **Example**: a professional gambler's **travel costs** to/from a casino are subject to the § 165(d) limitation

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Gambling Losses

Pg 231

No carryover of wagering losses

- Gamblers **cannot carry over** excess wagering losses to offset gains in another year
- Losses **cannot offset non-wagering income**

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Gambling Losses

Pg 231

Example 6.9: Limit on Casual Gambler's Deduction

- Adam, a casual gambler, had **$10,000 of wagering gains** and **$10,000 of wagering losses** in 2026
- He can deduct only **$9,000** ($10,000 × 90%) of his losses
- He must include **$1,000** ($10,000 − $9,000) of gambling income in taxable income

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Practitioner Note: Professional Gamblers

Pg 231

- Professional gamblers report **gross winnings** and may **deduct gambling expenses**
- *Commissioner v. Groetzinger*, 480 U.S. 23 (1987): gambling is a **trade or business** if pursued **full-time, in good faith, and with regularity**, for the **production of income for a livelihood** – not a mere hobby
- The taxpayer's **primary purpose** must be **income or profit**

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Losses Are Itemized Deductions

Pg 231

- Casual gamblers deduct allowable gambling losses as Other Itemized Deductions - Sch A
- If claim standard deduction, gambling winnings are taxable in full

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Losses Are Itemized Deductions

Pg 231

Bon Viso v. Commissioner – Facts

- Bon Viso gambled recreationally – sports betting, slots, and lottery tickets
- **2013:** won **$5,060** on slots across three casinos; he and his wife sustained **$6,983.25** in losses
- They reported **no winnings or losses** and claimed the **standard deduction**
- Received three **Forms W-2G**; the IRS asserted a **$5,060 deficiency** since the forms didn't reflect wagers placed

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Losses Are Itemized Deductions

Pg 232

Bon Viso v. Commissioner – Holding

- Those **in the trade or business** of gambling deduct losses against winnings as a **business expense**
- Those **not** in the business deduct losses (up to winnings) only as an **itemized deduction**
- Because the Bon Visos took the **standard deduction**, they **could not** deduct their losses to offset winnings

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Calculating Gains and Losses

Pg 232

OBBBA §165 Loss Limit Language

- The deduction for wagering losses in a tax year:
  - (A) equals **90%** of such losses for the year; **and**
  - (B) is allowed **only to the extent of gains** from such transactions that year
- This language may permit **netting** gains and losses across the tax year

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Calculating Gains and Losses

Pg 232

Sessions & Netting Approaches

- **A.M. 2008-011** (Dec. 5, 2008): IRS Chief Counsel weighed the term "transactions" and adopted a **sessions rule**
- **Notice 2015-21** proposes a **safe harbor** for a session of electronically tracked **slot machine** play
- The **Tax Court** has applied an approach that **nets winnings and losses throughout the year**

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Sessions Rule

Pgs 232-233

- The IRS Chief Counsel reasoned that a **transaction-by-transaction** approach is **unduly burdensome and unreasonable**
- Better view: a casual gambler (e.g., a slot player) recognizes a **wagering gain or loss when redeeming tokens**
- Fluctuating wins and losses **left in play** are **not accessions to wealth** until redemption
- Only at redemption can the taxpayer definitively calculate the amount realized **above or below basis** (the wager)

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Sessions Rule

Pg 233

Example 6.10: Casual Slots – Wagering Gains

- Monte, a casual gambler, entered the casino with **$100** and played the slots
- During play: **$1,000** in winning spins and **$700** in losing spins
- He redeemed his tokens for **$300**
- Under the session method: **$300 – $100 = $200 wagering gain**

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Sessions Rule

Pg 233

Example 6.11: Casual Slots – Wagering Losses

- In 2026, Mabel played slots across **10 sessions** (**Figure 6.5**)
- Totals: **$1,000** wagered, **$740** redeemed → net **$(260)** for the year
- Per-session results ranged from **$(100)** losses to a **$200** gain

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Sessions Rule

Pg 233

Example 6.11: Casual Slots – Wagering Losses

- Total **wagering gains:** $50 + $100 + $200 = **$350**
- Total **wagering losses:** ($100 × 5) + $80 + $30 = **$610**
- Losses exceeded gains by **$260** ($610 − $350)

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Sessions Rule

Pg 233

Example 6.11: Casual Slots – Wagering Losses

- Mabel reports the **$350 of gains** as gross income
- She can deduct only **$350** of losses (limited to wagering gains)
- Deductible losses are below the **90% cap** of $549 ($610 × 90%)
- She **cannot carry over** excess losses or use them to offset **non-wagering income**

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Slot Machine Records Electronically Tracked Sessions

Pgs 233-234

Notice 2015-21:

- Proposes an **optional safe harbor** for determining wagering gain or loss from **electronically tracked slot machine play**
- Applies only to **individual taxpayers** and only to **wagering gains and losses** (**not** non-wagering gambling expenses)
- Gain or loss is determined **at the end of each session**:
  - Payouts > wagers = **gain**; wagers > payouts = **loss**

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Slot Machine Records Electronically Tracked Sessions

Pg 234

- Defining a "Session" of Play
- A session **begins** at the first wager on a certain game type and **ends** at the last wager on the same game type before the **end of the calendar day**
- Time is set by the **time zone** where the wager is placed
- A session is always tied to a **calendar day** (12:00 a.m.–11:59 p.m.) and ends no later than day's end

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Slot Machine Records Electronically Tracked Sessions

Pg 234

Session Determination Rules

- **Same establishment, same day:** stopping and resuming play is **part of the same session**
- **Consistency:** if the taxpayer uses this session definition once at an establishment, they must use it for **all** electronically tracked slot play that year **at that establishment**
- **Different establishments:** playing at one, then another, creates **two sessions** (even on the same day)

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Example 6.12: Gambling Sessions - Electronically Tracked Slot Machines Pg 234

- **Jan. 1, 2026**: Daisy played slots at Hook Um Casino from **8:00–10:00 a.m.**, using a player's card to track activity
- She took a break to shop, returned at **6:00 p.m.**, and played until **11:59 p.m.**
- **One session:** all play was at one casino on one day

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Tax Court Approach Pg 234

- The Tax Court uses a **per-year approach** relying on casino reports that **net gains and losses at each establishment** annually
- This contrasts with both the per-transaction and per-session methods

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Tax Court Approach Pg 234

Boneparte v. Commissioner, T.C. Memo 2017-193 – Facts

- James Boneparte regularly gambled in Atlantic City (baccarat, other table games, and slots); kept **no contemporaneous written log**
- For 2012, he had annual statements from **14 casinos**, most showing only **net annual gain/loss**
- Casino reports showed a **total net loss of $(14,887)**
- He included **$18,000** of gambling income and claimed an **$18,000** itemized loss deduction

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Tax Court Approach

Pg 235

Boneparte v. Commissioner – The Court's Math

- The IRS argued the deduction was limited to the **$14,887 net loss**
- The court clarified $14,887 loss was **gains minus losses**, not total losses alone
- If gains = $18,000 and net = $(14,887), then **total losses = $32,887** ($18,000 + $14,887)

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Tax Court Approach

Pg 235

Boneparte v. Commissioner – Holding

- Total all **winning** transactions; total all **losing** transactions (the § 165(d) losses)
- If total losses exceed total gains, the deduction equals the **total gain**
- James's deduction was limited to his **$18,000 wagering gain**

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Tax Court Approach

Pg 235

Bright v. Commissioner, No. 10095-22 (TC 5-4-2023) - Facts

- Jacob Bright gambled extensively in 2019 across three casinos (Mystic Lake, Treasure Island, Diamond Jo)
  - slots, blackjack, and sports betting
- Used **player's cards**; casino reports showed **net losses** at each ($22,375; $16,580; $894)

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Tax Court Approach

Pg 235

Bright v. Commissioner – Facts

- **Forms W-2G:** $110,553 gross winnings; return reported **$240,895** gross receipts
- Reported losses to the extent of his winnings on **Schedule C** as a sole proprietor

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Tax Court Approach

Pg 236

Bright v. Commissioner – Holding

- The court found Jacob was **not a professional gambler** → gains go in **other income**; losses are an **itemized deduction** on Schedule A (not Schedule C)
- Despite weak records, the court **estimated losses** per establishment using W-2G winnings vs. casino net results for total losses of $191,756.

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Practitioner Note: Wagering Gain

Pg 236

- In both *Boneparte* and *Bright*, the taxpayers **claimed to be professional gamblers**, reporting gross receipts and expense deductions on **Schedule C**
- The IRS determined **neither was a professional gambler**, so they **could not deduct expenses**

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Practitioner Note: Wagering Gain

Pg 236

- *Boneparte:* he also reported **$18,000** in wagering gains as a casual gambler – the IRS **did not dispute** that amount
- *Bright:* he reported **$240,895** gross receipts on Schedule C; when expenses were disallowed, he argued his **wagering gains differed** from the gross amount
  - But Bright **lacked substantiation** for his wagers or other expenses incurred to generate the gains

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Bingo, Keno, and Slots

Pgs 236

W-2G Reporting Thresholds

- Treas. Reg. § 1.6041-10 sets reporting rules for **bingo, keno, and slot machine** winnings
- Payers must report on **Form W-2G** if:
  - **Bingo or slots:** winnings (not reduced by the wager) are **$1,200 or more**
  - **Keno:** winnings (reduced by the wager) are **$1,500 or more**

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Bingo, Keno, and Slots

Pgs 236-237

Proposed Increase – OBBBA

- Proposed regs raised the bingo/keno/slots threshold to **$2,000 for calendar year 2026**, inflation-adjusted thereafter
- Reflects the **statutory increase** in the reporting threshold made by the OBBBA
- Payers may report **each payment** or use an **aggregate reporting method** for a non-foreign person's winnings from one game type during a reporting period

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Bingo, Keno, and Slots

Pg 237

The Information Reporting Period

- Begins at the **first wager** on a game type at an establishment; ends at the **last wager** on the same game type at the same establishment before the period ends
- Always a **24-hour period** – the payer may select a **calendar day** or a **gaming day**
  - **Calendar day:** 12:00 a.m. to no later than 11:59 p.m. the same day
  - **Gaming day:** a 24-hour period **other than** a calendar day

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Practitioner Note: Information Reporting Period

Pg 237

- The **Notice 2015-21** safe harbor grouping **session ends at midnight**
- A **gaming day does not** end at midnight
- As a result, a taxpayer's **session** under the safe harbor may **differ** from the **gaming day** reported on Form W-2G

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Sweepstakes, Wagering Pools, and Lotteries

Pg 237

W-2G Reporting

- The payer must file **Form W-2G** if winnings from a **sweepstakes, wagering pool, or lottery** (including state-conducted lotteries):
  - **Meet or exceed** the applicable reporting threshold, **and**
  - Are at least **300 times** the amount of the wager
- The payer may **subtract the wager** from total winnings to determine if reporting is required

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Sweepstakes, Wagering Pools, and Lotteries

Pg 237

W-2G Reporting - Updated Threshold

- For tax years beginning **after 2025**, the minimum threshold for reporting (and backup withholding) increased to **$2,000**
- The amount will be **adjusted for inflation** beginning in **calendar year 2027**

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Poker Tournaments

Pg 237

- The payer must file **Form W-2G** if winnings from **each sponsored poker tournament** meet or exceed the applicable reporting threshold, **reduced by the wager or buy-in**
- Winnings and losses from **other tournaments** the payer sponsored during the year are **not taken into account** when determining the applicable threshold

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Horse Racing, Dog Racing, Jai Alai, and Other Wagering Transactions

Pg 237

- For horse racing, dog racing, jai alai, and other wagering transactions not covered earlier, the payer must file **Form W-2G** if winnings:
  - Meet or exceed the applicable **reporting threshold**, **and**
  - Are at least **300 times** the amount of the wager
- All wagers placed in a **single parimutuel pool** and represented on a **single ticket** are **aggregated** and treated as **one wager** for determining the wager amount

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Recordkeeping

Pg 238

- W-2G winnings often **won't match** reportable wagering gains
- Payers report **aggregate payouts**; taxpayers report **wagering gains** (generally winnings less amounts wagered)
- The payer may report **per transaction** while the payee calculates **per session**
- The payer's **information reporting period** may differ from the taxpayer's

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Recordkeeping

Pg 238

- For casual gamblers, recordkeeping is **essential** to substantiate both wagering **gains and losses**
- Useful records include **casino markers**, **buy-in transactions** (ATM withdrawals, credit card, or electronic), and **cash-out transactions** (check, credit card, or electronic)

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Gambling Diary or Record

Pg 238

- An accurate **diary or similar record**, regularly maintained and supplemented by verifiable documentation, is usually acceptable to substantiate winnings and losses
- The diary should contain at least:
  1. **Date and type** of wager or wagering activity
  2. **Name** of the gambling establishment
  3. **Address/location** of the establishment
  4. **Names of others** present with the taxpayer (if any)
  5. **Amounts won or lost**
  6. **Number** of Table or Machine

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Gambling Diary or Record

Pg 238

Verifiable Documentation includes (but is not limited to):

- **Forms W-2G or Forms 5754**
- wagering tickets;
- canceled checks;
- credit records;
- bank withdrawals; and
- statements of actual winnings or payment slips from the establishment

Figure 6.7 – Sample Gambling Diary

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Substantiation for Specific Wagering Transactions

Pg240

Rev. Proc. 77-29

1. **Keno:** purchased keno tickets validated by the establishment; casino credit records; check-cashing records
2. **Slot machines:** machine number and all winnings by **date and time** played
3. **Table games** (blackjack, craps, poker, baccarat, roulette, etc.): the **table number** and casino credit card data showing whether credit was issued in the **pit or cashier's cage**

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Substantiation for Specific Wagering Transactions

Pg 240

Rev. Proc. 77-29

4. **Bingo:** number of games played, **cost of tickets**, and amounts collected on winners (plus casino receipts)
5. **Racing** (horse, harness, dog): record of races, wager amounts, amounts collected and lost (plus unredeemed tickets and racetrack payment records)
6. **Lotteries:** record of ticket purchases, dates, winnings, and losses (plus unredeemed tickets, payment slips, and winnings statements)

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Questions
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