

The U.S. TAXFAX

TOPIC: HOW TO RECOVER TAXES WITHHELD ON GAMBLING WINNINGS

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In this edition of the U.S.TAXFAX we will discuss how Canadians can recover U.S. taxes withheld on gambling winnings.

Gambling Winnings of U.S. citizens and residents:

U.S. citizens and residents (i.e. resident aliens) must include gambling winnings in taxable income and pay income tax at the individual marginal rates on their good fortune. They are able to deduct gambling losses to the extent of winnings in the year, however, the winnings must be included in gross income while the losses may only be claimed as an itemized deduction. This means that the benefit of the losses are often not realized because itemized deductions can be limited in certain situations.

Gambling Winnings of U.S. Non-Residents

In contrast, gambling winnings paid to a non-resident of the U.S. are generally subject to 30% withholding. The payor of the winnings must submit the withheld tax to the IRS. An exception to this general withholding rule is winnings of a non-resident from wagers on blackjack, baccarat, craps, roulette, or the Big-6 wheel. Proceeds from these types of wagers are not subject to income tax or the 30% withholding because the collection of tax is not yet administratively feasible (this has been the case for years and is not expected to change).

The payor of gambling winnings must withhold taxes on winnings above a de minimis amount.

Taxes must be withheld if proceeds from the wager are greater than the following thresholds:

1. A wager placed in a State conducted lottery and the proceeds are greater than \$5,000;
2. A wager placed in a sweepstakes, wagering pool, or lottery other than a State conducted lottery and the proceeds are greater than \$1,000; or
3. Any other wagering transactions and the proceeds from the wager i) exceed \$1,000.00 and ii) are at least 300 times as large as the amount of the wager.

The definition of "other wagering transactions" includes casino games such as slot machines, video poker, poker, and keno. This means that a casino must withhold 30% of a slot machine jackpot that is greater than \$1,000.00 and at least 300 times the original wager.

Protocol to the Canada U.S. Tax Treaty:

Prior to the Canada-U.S. tax treaty's protocol, Canadians were subject to 30% withholding on certain gambling winnings and could not recover this withheld tax. However, the treaty protocol changed this by adding Article XXII(3) to the treaty. This article states that, effective January 1, 1996, losses incurred on wagering transactions of Canadian residents, the gains of which would be subject to the 30% withholding tax, shall be deductible to the same extent that losses would be deductible if they were incurred by a U.S. resident.

This article sounds very good to those Canadians who have incurred large losses to win that one big jackpot. However, it should be

noted that in order to claim losses it is necessary to substantiate the amount of all winnings (not just the ones where 30% was withheld) and losses incurred in a particular year. Furthermore, losses incurred from blackjack, baccarat, craps, roulette or Big-6 wheel are not deductible from taxable winnings as they are not taxable in the first place.

The IRS has issued some guidelines on what they will accept as sufficient record of winnings and losses. They mention that an accurate diary or similar record is required and should include:

1. The date and type of your specific wager or wagering activity
2. The name and address or location of the gambling establishment
3. The names of other persons present with you at the gambling establishment, and
4. the amount(s) you won or lost.

In addition to the diary, they also mention other supporting documentation such as wagering tickets, canceled checks, credit records, bank withdrawals, and statements provided by the gambling establishment.

For specific wagering transactions, the following items can be used to support winnings and losses.

Keno: Copy of the keno tickets purchased that were validated by the gambling establishment, copies of casino credit records and casino check cashing records.

Slot Machines: A record of the machine number and of all winnings and losses by date and time the machine was played.

Table Games: (poker, wheel of fortune, etc.): The number of the table played. Casino credit card data indicating whether the credit was issued in the pit or at the cashier's cage.

Bingo: A record of the number of games played, cost of tickets purchased and amounts collected on winning ticket. Supplemental records include any receipts from the casino, parlor, etc.

Racing (horse, dog, etc.): A record of races, amount of wagers, amounts collected on winning tickets and amounts lost on losing tickets.

It should be noted that the above record keeping suggestions are intended as general guidelines and they are not all inclusive. It has been our experience that the IRS is fairly flexible when it comes to substantiating winning and losses for the year.

How to Recover the Taxes:

For those who feel they have enough documentation to back up winnings and losses the following steps must be taken to recover the taxes withheld.

If the individual does not already have a U.S. Individual Taxpayer ID Number (ITIN) or a Social Security Number (SSN), the first step is to apply for a U.S. ITIN. See a previous edition of the U.S.TAXFAX or visit our website at www.kvdb.com for information on applying for an ITIN. The IRS will not issue a refund without a valid ID number.

The second step is to file Form 1040NR, U.S. Non Resident Alien Income Tax Return. A treaty disclosure statement must be attached to the return setting out the facts as well as the treaty sections relied upon. Keep in mind that gambling losses can only be offset against winnings from the same calendar year. The correct amount of U.S. tax liability is calculated as follows: Total winnings for the year less total losses for the year multiplied by 30%. If losses exceed winnings, 100% of the taxes withheld can be recovered. We have found that submitting an incomplete or incorrect return can significantly delay the refund.

Please remember, the information presented is general in nature and does not constitute professional advice. It is recommended that accounting, legal or other professional advice should be sought before acting upon any of the information contained herein.