New Developments in Gaming Taxation and Regulation: an Update

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Abstract

The gaming industry is facing increased regulatory interest. Congress has authorized a commission to investigate gaming in the United States. The Internal Revenue Service continues to interpret ambiguous areas of the tax code in an attempt to raise gaming tax revenues. Regulatory changes in currency transaction reporting have also resulted in some significant changes for the industry. The purpose of this paper is to provide an update on tax and regulatory issues currently facing the gaming industry. Specifically, the paper will address tax and regulatory developments in: (a) tip compliance, (b) cash transaction reporting, (c) complimentaries, (d) employee cafeterias, (e) outstanding chips and tokens, (e) marker discounts, and (f) high-denomination slot win reporting. **KEY WORDS**: *gaming, taxes, regulatory interest, IRS*

Introduction

The gaming industry has long been a testing ground for new IRS rulings and innovations. While IRS interest in the gaming industry may be the result of the IRS's continuing adjustments to the new service economy in the U.S., many have argued that the gaming industry has been targeted by the IRS due to perceptions of high income and the view that gaming is a social vice (Ivancevich & Fried, 1995). Evidence of this regulatory interest in gaming comes not only from the IRS, but also from other regulatory bodies and Congress, which recently established a federal commission to investigate the effects of gaming in the United States.[1]

This article is an update of the Ivancevich and Fried (1995) article, "Contemporary Tax Issues in the Gaming Industry," which discussed some major tax issues facing the gaming industry as of mid-1995. Since 1995, new rulings and court decisions have affected many of these tax issues and new issues have developed. The purpose of this paper is to provide an update on the many important tax issues facing the gaming industry, and to provide information on new regulatory developments. Specifically, the paper will address tax and regulatory developments in: (a) tip compliance, (b) cash transaction reporting, (c) complimentaries, (d) employee cafeterias, (e) outstanding chips and tokens, (f) marker discounts, and (g) high-denomination slot win reporting. While many of these issues stem from IRS involvement in the Las Vegas gaming market, how these issues are resolved is likely to affect gaming properties throughout the nation.

Tip Compliance

Ivancevich and Fried (1995) discussed the successes of Tip Compliance 2000, a tip reporting agreement developed for the Las Vegas gaming market, and proposals for a nationwide program. Presently, the IRS is still working on a nationwide tip compliance agreement for the casino industry. The proposed agreement, with a working name of the Tip Rate Determination Agreement--Gaming Industry (TRDA), is expected to be in place by the end of 1997.

As with Tip Compliance 2000, the agreement is still not mandatory and is based on voluntary participation in which participants' tips are not subject to audit by the IRS in exchange for participation. The TRDA for gaming differs from Compliance 2000 in that employees will have no amnesty for previous years' unreported tip income. Additionally, the October 21, 1996 ruling by the U.S. Court of Federal Claims against the IRS (Bubble Room Inc. vs. United States 96-2 USTC para. 50, 550, 78 AFTR 2D-96-5477 Cl.Ct (1996)) will generate more employee audits by the IRS as it essentially negates the employer-only audit method. According to this decision and another ruling involving Morrison's Restaurant (Morrison's vs. United States 918 F. Supp. 1506 (1996)), the IRS would have to do employee audits on a case by case basis rather than performing employer audits. Not surprisingly, the IRS was not pleased with these two decisions. The IRS liked being able to apply the employer-only audit method because it does not have the resources to do individual audits of all employees. Instead, the IRS enjoyed the privilege of being able to do a blanket audit using employer records. The IRS has appealed both decisions, and the Morrison's decision has since been overturned by the U.S. Court of Claims. Therefore, it appears that this issue will continue to affect the industry in the future until it is resolved.

Cash Transaction Reporting

As noted in Ivancevich and Fried (1995), gaming establishments in Nevada are subject to the provisions of the State of Nevada Regulation 6A for cash transaction reporting and money laundering prevention rather than the national money laundering provision, United States Code Title 31. Gaming establishments in all other states are subject to Title 31 provisions. New Title 31 provisions, including a requirement for after the fact aggregation, clarifications of cash in and cash out, a requirement for the completion of cash equivalent document, and a requirement

Table 1. Overview of Significant Changes in Regulation 6A

- "6A Licensee" is defined as a licensee with over $10 million in annual gross gaming revenue and $2 million in table games win (a.k.a. "10 and 2 threshold"). **[6A.010(9)]**
- The Board Chairman may classify a casino with gross gaming revenue of greater than $1 million but less than the 10 and 2 threshold as a 6A licensee. **[6A.010(9)(b)]**
- "Patron" definition includes exemptions for banks, foreign banks, currency dealers or exchangers, employees performing job duties, nonrestricted licensees (including slot route operators and satellite sports books), chip/token exchange company chip runs, and persons conducting transactions in non-gaming areas. **[6A.010(8)]**
- Cash for cash exchange transactions and cash for check transactions involving coin are reportable, and no longer prohibited. **[6A.020(6)]**
- Prohibited transaction threshold increased from $2,500 to $3,000. **[6A.020]**
- Only one form is used for reportable transactions, a federal CTRC-N, rather than the Nevada CTR and CTIR forms. **[6A.030(9)]**
- All cash payouts greater than $10,000 are reportable, including jackpot payouts, verified winnings in the form of chips/tokens, race and sports winning tickets, etc. **[6A.030(l)(b)]**
- Foreign chip redemptions greater than $10,000 (no longer greater than $1,000) are reportable. **[6A.030(l)(b)]**
- Multiple transactions over $3,000 (no longer $2,500) require aggregation for reporting purposes. To determine if the $ 10,000 reporting threshold has been reached, transactions are aggregated with:

  1. Other same type (similar) transactions **[6A.040(2)(a)];**
  2. All dissimilar cash-in transactions occurring during a "single visit" **[6A.040(2)(b)];** or
  3. All dissimilar cash-out transactions occurring during a "single visit." **[6A.040(2)(c)]**

- Player rating records must be retained for five years if the records contain cash activity and are used for Regulation 6A purposes. **[6A.050(2)(g)]**
- Compliance programs, compliance specialist, and training programs are required. **[6A.060(4)]**
- Funds transfer requirements address documentation requirements for wire transfers. **[6A.080]**
- "Structuring transactions" is defined. A 6A licensee may not assist a patron who is attempting to structure transactions. **[6A.090]**
- Suspicious activity is to be reported on a federal SARC form and a suspicious activity analyst is to be established. This section is not effective until 10/01/97. **[6A.100]**
- The Board Chairman has the ability to approve the conduct of a transaction that otherwise would be prohibited, or may waive the reporting of a transaction. **[6A.110]**

Source: Nevada Gaming Control Board (02/05/97)

for a money laundering compliance program, went into effect in June 1995. In addition to these new provisions for Title 31, the Treasury Department has said that future provisions will include a requirement for suspicious transaction reporting and a "know your customer" program. Because of the new and proposed changes to Title 31, it had been argued that the gap between Regulation 6A and Title 31 was approaching a point where the Treasury might consider revoking 6A (Ivancevich & Fried, 1995).

In response to this fear, the Nevada Gaming Control Board (NGCB) began working with the Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department, to agree on a new approach for preventing financial crimes in Nevada. The two groups began meeting in February 1996 and came up with several proposed measures to help reduce the gaming industry's regulatory requirements while giving federal authorities an improved ability to identify financial crimes. These meetings have resulted in several changes to Regulation 6A. Some of the more significant changes in the Regulation are presented in Table 1 and many are also discussed in detail below. In the following discussion, the comments regarding the rationale for these changes to the Regulation are based on interviews conducted with Greg Gale, Chief of the Audit Division of the State of Nevada Gaming Control Board.

The first major change to Regulation 6A is a change in the definition of a 6A Licensee. The threshold for classifying as a 6A Licensee has been raised to the level of "10 and 2." This "10 and 2" threshold means that only licensees with more than $10 million in annual gross gaming revenue and $2 million in win from table games would be subject to the provisions of Regulation 6A. Before the change, a $1 million overall threshold applied. The $2 million threshold for table games was instituted because money laundering is not as likely in slots as in table games. For casinos that fall between the old threshold level of $1 million in gross gaming revenue and the new $10 and $2 threshold, Title 31 will now apply. This change would remove 142 small gaming operations (61 percent of all operations) from regulatory purview. A related change in 6A is that the Chairman of the Gaming Control Board can classify a casino having more than $1 million in gross gaming revenue but less than the new $10 and $2 threshold as a 6A licensee. This provision is intended to help classify gaming properties that may fluctuate between categories from year to year as 6A licensees and by that reduce the chance of a casino having to change its reporting requirements on a year to year basis.

Another significant change to Regulation 6A is a change in what constitutes a "patron." This definition now specifically exempts "banks, foreign banks, currency dealers or exchangers, employees performing job duties, nonrestricted licensees (including slot route operators and satellite sports books), chip/token company chip runs, and persons conducting transactions in non-gaming areas" from this definition. As such, certain transactions between Nevada casinos and these parties are now exempted from 6A reporting. This exemption is expected to eliminate 20% of the Nevada currency transaction reports filed annually. The logic behind this change is that these transactions are not likely to be sources of money laundering activities since they are transactions occurring in the normal course of business.

The new provisions of Regulation 6A also allow for exchanges of cash for cash and cash for check above the prohibited transaction threshold, provided these exchanges involve coin. These transactions are no longer prohibited because it is unlikely that money laundering attempts are going to involve large number of coins. While these transactions are no longer prohibited, they are reportable if they amount to over $10,000 in a 24 hour period. Furthermore, the threshold for prohibited transactions increased from $2,500 to $3,000. Each of these changes represents an attempt to streamline reporting requirements and reduce unneeded paperwork for low risk transactions.

A highly touted change in the regulation is the requirement that multiple transactions over the new $3,000 threshold be aggregated for reporting purposes, and if these transactions exceed $10,000 in a 24 hour period when aggregated, they must be reported. All similar transactions must be aggregated over this limit and all dissimilar cash-in transactions within a single visit and cash-out transactions within a single visit must be aggregated for reporting purposes to determine if the $10,000 reporting threshold has been met.

The interesting twist on this requirement is determining what constitutes a single visit. The industry view, and a view cited by the Gaming Control Board, is that if the player leaves the table for any reason, this action ends the first visit. If the player later returns, the return commences a second visit. Furthermore, if a slot player is playing two slot machines, the player is deemed to have one visit on the first machine and a separate visit on the second machine. Similarly, if a player goes to window #1 at the cage and does some business, and then goes to window #3, the visit at window #1 is deemed to have terminated and a new visit is started at cage window #3. These examples are based on the terminology that the visit must be continuous and uninterrupted. An interruption is construed as ending one visit and starting another.

While these changes in Regulation 6A are quite substantial, they represent the culmination of negotiations between the Gaming Control Board and FinCEN to modify Regulation 6A to avoid revocation of the regulation.

Another very important change in Regulation 6A is that, effective in October 1997, suspicious transactions must now be reported on a federal Suspicious Activity Report for Casinos (SARC) form. This reporting requirement is intended to allow FinCEN and NGCB to implement effective methods to detect and deter money laundering and other financial crimes such as tax evasion and fraud. The NGCB's stance is that the judgement whether or not a certain transaction is suspicious should be left to the casino. However, the IRS is currently compiling a set of guidelines about what types of transactions might be considered suspicious, and FinCEN is expected to publish formal guidelines on such transactions within the next year. When a suspicious activity is noted, it must be filed on a SARC form if the activity involves cash of more than $3,000. If the amount is less than $3,000, the casino may voluntarily file a SARC if the activity is a possible violation of law or regulation. Concerning extended civil liability for a casino filing a SARC, following the Bank Secrecy Act, the same civil liability protection would be extended to non-bank financial institutions, including casinos. Federal regulations specify that any depository institution, any director, officer, or agent of that institution shall be protected from civil liabilities when reporting on suspicious activities.

Other interesting changes included in the new provisions of Regulation 6A is a definition of structuring and a provision prohibiting casino employees from helping a patron attempting to structure his or her transactions to avoid currency transaction reporting. Structuring is defined as "willfully conducting or attempting to conduct a series of cash or noncash transactions in any amount and in any manner to willfully evade or circumvent the reporting requirements or provisions of 6A." This is the first time that structuring has been defined. In a recent speech to the International Association of Hospitality Accountants in Las Vegas, Kathy Gannon of the Gaming Control Board provided some helpful tips on complying with the new regulation, particularly in the structuring area (K. Gannon, personal communication, April 1997). For instance, casinos are still allowed to give out player information cards describing the regulation, but are strongly encouraged to have the NGCB review these cards before using them. On the card, saying that non-cash transactions are not reportable is acceptable, but providing a detailed list of transactions qualifying as non-cash is not acceptable. Furthermore, while casino employees can answer a factual question about the cut off time for currency transaction reporting, this time should not be posted or printed on a flyer. Casino employees are encouraged not to answer any question where the answer could be construed as coaching. It is perfectly acceptable for an employee to say that he or she cannot answer the question, or the employee could also choose to restate the regulation. However, the employee should avoid coaching, as such action is considered a felony criminal offense punishable with up to a 5-year jail term.

The new regulation also results in the replacement of the Nevada CTR (Currency Transaction Report) and CTIR (Currency Transaction Incident Report) forms with a federal CTRC-N form, Form 8852. The new CTRC-N is now available over the Internet, and each property classifying as a 6A property has been mailed a single copy that can be reproduced and used for reporting purposes. This new filing report incorporates the features of previous forms and can be filed directly with the IRS in Detroit, rather than with the NGCB. The NGCB will have access to the IRS database and will get copies of the forms for the first six months after the new regulation goes into effect. After the first six months, the NGCB will no longer be provided with copies, but will retain its access to the IRS database.

Therefore, if the employees' cafeteria is at or above break-even, the cost of operating the facility is fully deductible.

Other noteworthy changes include the requirement for 6A compliance (including the appointment of a compliance officer to ensure accountability and communication between different casino departments) and training programs, requirements that all cash payouts greater than $10,000 including verified winnings and foreign chip redemptions by persons other than foreign chip brokers be reported, and requirements that player rating records be retained for five years when cash or Reg 6A activity is included therein. The fact that all cash payouts greater than $10,000 including verified winnings must now be reported is a very significant change. For instance, reportable transactions are now possible in bingo and keno, since payouts are now reportable if they exceed $10,000, even if they are from verified winnings. Previously, verified winnings were exempt from currency transaction reporting. As a result, many more employees will now have to be properly trained for Regulation 6A purposes.

While these changes in Regulation 6A are quite substantial, they represent the culmination of negotiations between the Gaming Control Board and FinCEN to modify Regulation 6A to avoid the revocation of the regulation. The message before these changes had been clear -- either update the regulation to be more in line with Title 31 or lose the regulation and be subject to the provisions of Title 31. Those in the Nevada gaming industry still feel that Regulation 6A is a better alternative than switching to Title 31, even given the recent changes. These changes in Regulation 6A are effective as of May 1, 1997.

Deductibility of Complimentaries

As discussed in detail in Ivancevich & Fried (1995), one of the most significant tax issues facing the gaming industry has been the deductibility of complimentary expenses (comps). When entertainment expenses were first limited in their tax deductibility via the Tax Reform Act of 1986, the rules according to IRC Section 274(n) mandated that only 80 percent of these expenses were deductible. In 1993, Congress changed this deductibility amount to 50 percent. When the law was enacted, the limit in deductibility was not considered to affect comps, because comps were considered by the casino industry to be generally available to the public and items available to the public were exempted from the provisions of 274(n). However, because "items available to the public" was not strictly defined, the Las Vegas District IRS office began to question whether comps were truly exempt from the provisions of 274(n). The Las Vegas District IRS office based their concerns on the issue of whether comps were actually generally available to the public or only to select members of the public who happened to gamble with large sums of money. The Las Vegas District IRS Office decided to pursue the deductibility of comps, arguing that both inside and outside complimentaries are entertainment expenses subject to a 50 percent deduction because they are not generally available to the public. Inside comps refers to rooms, food, beverage, or show tickets given to patrons for use at the property giving the comp. An outside comp refers to items given to patrons for use at another casino (e.g., Casino A gives a high-roller show tickets to Casino B's show).

The industry has maintained that the intention of the Tax Reform Act of 1986 (TRA 1986) was not to restrict complimentaries, but to "curb abuses" such as the "three martini" lunch (Ivancevich & Fried, 1995). This industry viewpoint that complimentaries are generally available to the public stems from a 1986 Joint Committee Conference Report on free rooms stating that this in fact is the case (R. Darnold, personal communication, April 1997). The first step in resolving this issue was to work within the framework of the IRS National Office to determine if the National Office agreed with the Las Vegas District's interpretation. Trent Fewkes, Gaming Industry Specialist at the Las Vegas District IRS, has indicated that the National Office of the IRS has opined that inside comps are available to the public and are not subject to the 50 percent deduction, but outside comps should be subject to the reduction (T. Fewkes, personal communication, February 1997).

Therefore, all outside comps are subject to a 50 percent disallowance for years 1994 and after, and a 20 percent disallowance in years 1992-1994. The IRS has indicated that any comps before 1992 will not be challenged.

While the Las Vegas District office did not find support from the National IRS Office on the issue of inside comps, the issue of outside comps was solved to their satisfaction. Industry representatives were quite pleased that inside comps will not be held the 50 percent rule, since these comps add up to substantial amounts within the industry. However, the comp issue is not completely over based on discussions with Trent Fewkes, Gaming Industry Specialist for the Las Vegas District of the IRS (T. Fewkes, personal communication, February 1997). Fewkes is currently researching whether or not travel expenses should be subject to the 50 percent rule. According to Fewkes, IRC 274 allegedly applies to travel and entertainment, but finding information specifically applying to travel IRC 274 is hard. Since this may be a grey area in the law, Fewkes wonders if airfare for a high roller flown in at the expense of the casino should be subject to the 50 percent rule. At present, he is leaning toward this type of interpretation, but is still researching the issue. Therefore, more rulings may yet come with respect to the deductibility of comps.

Employee Meals and Employee Cafeterias

The IRS was also pursuing a 50 percent disallowance for employee meals at employee cafeterias. This issue, which went to court via a case involving Boyd Gaming *(Boyd Gaming Corporation vs. The Commission* 106 T.C. No. 19 (May 23, 1996)), has now been addressed via a court opinion. The intricacies of this case are quite complex, and while the issue has been addressed in court, the battle on this issue is not yet over. Section 274(n) states that expenses for food and beverage at employee cafeterias can be exempted because of subsection (e), the subsection relating to de minimis fringes. According to Trent Fewkes, the value of meals provided to employees at an employer operated facility for employees is excludable from gross income as a de minimis fringe only if on an annual basis, the revenue from the facility is greater than or equal to the direct cost of operating the facility (T. Fewkes, personal communication, February 1997). Therefore, if the employees' cafeteria is at or above break-even, the cost of operating the facility is fully deductible. One way that companies have generated "revenue" from employee cafeterias is by raising the pay of employees by an amount equal to the cost of employee meals, and then charging the employees for the meals. This technique results in additional compensation being added to employee paychecks and then immediately deducted as the cost of employee meals.

However, according to Fewkes, there is a catch. The tax court judge ruled that if substantially all meals qualify under Section 119 of the tax code, then employee meals would not be subject to the 50 percent deduction required under Section 274(n). The judge indicated that the rule says that Section 119 items are not subject to the 50 percent disallowance, but that he did not have the basis to decide if employee meals classify as Section 119 meals, since this was not the issue being contested in the case. The judge was never asked to rule on the Section

119 test. Boyd requested a ruling for a partial summary judgement that if substantially all employees classified as Section 119 employees, then the exemption would apply. The judge ruled in Boyd's favor. However, the IRS reserved the right to question the Section 119 status and this issue is currently being tried.

According to Trent Fewkes, the big stumbling block with respect to the industry's position that these meals are exempted from the 50 percent deduction is that the judge ruled that substantially all employees must qualify under Section 119 (T. Fewkes, personal communication, February 1997). Noting that the definition of substantially has not been determined with respect to this issue is important. For instance, substantially has been determined to range anywhere from 75 percent to 95 percent depending upon what section of the Tax Code one looks at (R. Darnold, personal communication, April 1997). Fewkes seems to think that a determination of 90 percent would be reasonable, and if this were determined to be the case, then more than 90 percent of the employees of the property must qualify as needing to have meals provided by the employer on the employer's premises for the employer's convenience. Fewkes believes this employer "convenience issue" will make this threshold difficult to prove for casinos since the criteria for qualifying as meeting the employers' convenience is quite stringent. To satisfy this criteria, meals must be provided for substantial non-compensatory business reasons. Four provisions apply to convenience under Section 119. Section 119 gives four examples of employee meals that qualify for the exception: (a) if the casino needs to have the employees available for emergencies, (b) if meals are restricted to short meal periods and the employee couldn't be expected to eat elsewhere in such a short period of time, (c) the employee could not otherwise secure proper meals within a reasonable time period, and (d) the employees are restaurant/food service employees since all such employees automatically classify as Section 119 employees. Only if it can be shown that substantially all of the employees must have meals served on the premises for purposes of the convenience of the employer according to one of these four provisions would the requirements for exemption fit. Therefore, substantially all employees must classify as Section 119 employees or the 50 percent rule will apply. Fewkes does not believe that employers will be able to justify that accounting personnel, valets, or other personnel would fit this requirement. Fewkes suggests that the door has been opened for future litigation. In addition, Fewkes believes that the IRS will also begin charging employment taxes on the value of employee meals provided to employees that do not qualify as Section 119 employees. As discussed in Ivancevich and Fried (1995), if employers increase employee wages by the amount of employee meals and then charge the employees for those meals, this whole issue is eliminated for those employees classifying as Section 119 employees, even if the substantially all criterion is not satisfied. However, for employees not covered by Section 119, the increase in wages will be taxable without the offsetting deduction for the employees' meals. Furthermore, state unemployment taxes would have to be payed on the increased wages. Hence, if casinos charge for the meals,

... the industry does not believe that all outstanding tokens should be treated as revenue.

Table 2. Computation of Revenue Recognition for the Outstanding Chip Liability

Alternative 1

	Total chips/tokens in service
minus	Total chips/tokens on hand
=	Total outstanding chips/tokens
minus	Outstanding chips/tokens of denominations ≥$100
minus	Chips/Tokens in players hands of denominations < $100
minus	One week's foreign chip returns & two weeks' foreign token returns for < $100 denominations
=	Result

This result would then be compared to the income from outstanding chips already recognized and any adjustment necessary would be recorded

Alternative 2

	Total chips/tokens in service
minus	Total chips/tokens on hand
=	Total outstanding chips/tokens
minus	75% of non-souvenir chips/tokens of $10-$100 denominations
minus	35% of non-souvenir chips/tokens of $5-$10 denominations
minus	10% of non-souvenir chips/tokens of less than $5 denominations
=	Result

This result would then be compared to the income from outstanding chips already recognized and any adjustment necessary would be recorded

Required Treatment for Prior Years

For each of the prior years in question:

1. Select the period with the lowest total outstanding chip/tokens count
2. Subtract total chips/tokens of $100 + denominations
3. Multiply result by 70%
4. Include this amount in income or spread effect over a period of no more than three consecutive years

Source: Outstanding Chip Liability: Formula for Settlement; IRS 1996.

the IRS agrees that Section 274(n) does not apply, but indicates that the value of the meals will be taxable and employers will have to pay FICA as well.

This issue is being pursued by Boyd Gaming, and some resolution is expected in 1998. In defense of Boyd Gaming's position on the employee meal issue, Rick Darnold, Vice President of Tax and Financial Administration at Boyd Gaming, states that the real test of whether employee meals are Section 119 meals is whether or not the meals are provided for substantial noncompensatory business reasons. He disagrees with the Fewkes' viewpoint that such meals must be a business necessity, and that such meals are really compensatory. Furthermore, Darnold indicates that if the IRS does try to collect FICA on employee meals, it can only do so prospectively, since if the employer reasonably believed that meals were Section 119 meals, then FICA cannot be charged. Therefore, this issue will also not reach resolution until the Boyd court case is over.

Outstanding Chips and Tokens

At the time the Ivancevich and Fried (1995) article was written the IRS and the industry were hotly debating the treatment of outstanding chips and tokens. The IRS held that all outstanding chips and tokens should be accounted for as income, since casinos theoretically sell chips and token and thereby prepay any gaming win associated with these items. The industry maintained, however, that revenue is generated in gaming transactions rather than through the sale of chips and the chips are purely a means of simplifying gaming transactions. While some companies in the gaming industry have taken a portion of the liability into income that was deemed to relate to chips that may have been permanently taken from the premises as souvenirs or lost, the industry holds that a liability exists for outstanding chips and this liability should not be recognized as income until the chip series is retired. Clearly, the industry does not believe that all outstanding tokens should be treated as revenue.

As of Ivancevich and Fried (1995) the IRS was offering two settlement options. On one hand, the company could recognize 100 percent of the outstanding chip liability as revenue with no closing agreement. Alternatively, the casino could recognize 70 percent of the liability as income with a closing agreement. This issue has now been settled without having to go to trial based on a formula of the amount of chips estimated to have left the casino permanently. Both sides in the argument appear satisfied with the settlement. The formula for calculating the amount of the outstanding chip liability that now must be recorded as income is shown in Table 2.

The industry argues that the write-down of markers should be viewed as promotional expenses and should not be taxable to the casino patron.

Under Alternative 1, the company would start with total outstanding chips and tokens and then subtract outstanding chips and tokens in denominations of $100 or more. The rationale behind this subtraction is that it is quite unlikely that chips of such high denominations will be kept as souvenirs. Next, chips and tokens in players' hands of denominations less than $100 would be subtracted. Then, the amount would be adjusted to reflect the effects of foreign chips and tokens. Finally, the resulting figure would be compared with cumulative amounts previously recorded as income to decide what adjustment is necessary.

Under Alternative 2, the company would again start with total outstanding chips and tokens and then subtract outstanding chips and tokens of denominations of $100 or more. Then, the company would subtract IRS mandated percentages for chips less than $100, based on denomination categories. Lastly, this result would be compared with cumulative amounts previously recorded as income to decide what adjustment is necessary.

For any outstanding chips and tokens issues related to prior years, the settlement agreement stipulates different treatment. In these cases, companies can select the period where the outstanding chips and tokens count was the lowest and then subtract out outstanding chips and tokens of denomination greater or equal to $100. This figure is then multiplied by 70 percent to determine the amount that should be included in income. The income adjustment can be made over a period of time not to exceed three consecutive years, if these years are open for adjustment.

Marker Discounts

The controversy with respect to marker discounts, as discussed in Ivancevich and Fried (1995), centers on whether or not uncollected markers should qualify as bad debts for tax purposes. Fewkes argues that payoff amounts are often prenegotiated and that normal collection procedures are not followed for markers (T. Fewkes, personal communication, February 1997). Furthermore, if the payoff amount is negotiated at an amount less than the face value of the marker, Fewkes believes that the write-down should be treated as a forgiveness of debt and thereby be taxable to the casino patron. The industry argues that the write-down of markers should be viewed as promotional expenses and should not be taxable to the casino patron. Additionally, the industry argues that appropriate collection procedures are applied to the collection of markers. No significant changes with respect to marker discounts have occurred since the last paper. However, according to Fewkes, it does appear that it is now questionable whether the IRS will in fact pursue the foreign withholding portion of the debate. In other words, the IRS will not attempt to withhold taxes from foreign players who are granted write-downs on their markers.

High Denomination Slot Machine Win Reporting

As discussed in Ivancevich and Fried (1995), the IRS sometimes pursues issues that would benefit the industry and not result in higher taxes. While most of these issues are in response to requests from industry, the IRS has shown that it is willing to follow through with proposals that would decrease reporting burdens on the industry. An example of this was when the Las Vegas District Office afforded companies the alternative to aggregate all jackpots more than $1,200 onto one W2-G, if prior approval has been received from the IRS. The Las Vegas District IRS Office had also proposed that the reporting threshold be raised from $1,200 to $5,000 to reduce unneeded paperwork associated with the filing of thousands of W2-Gs between these two thresholds when studies have shown that most W2-Gs between $1,200 and $5,000 are offset by gambling losses and never result in additional tax collections. Presently, no significant changes have occurred in high denomination slot machine win reporting since 1995. Casinos are still permitted to aggregate a patron's wins in excess of $1,200 and report them on one W2-G. Furthermore, the proposed change to increase the reporting threshold from $1,200 to $5,000 has not yet become a reality. Although it is estimated that increasing the threshold to $5,000 would eliminate 87 percent of the paperwork relating to slot win reporting, the national office of the IRS has not yet acted on the suggestion to increase the reporting threshold. (It is important to note that such winnings are still subject to currency transaction reporting requirements even though the tax reporting threshold may be raised.) Whether the national office will choose to act is also still unknown. For the record, the industry is still trying to get this threshold raised (R. Darnold, personal communication, April 1997).

Conclusions

The Federal Government continues to show great interest in the gaming industry. This paper has discussed several developments in gaming taxation and regulation. With the ongoing interest of the Federal Government, the industry must be prepared for continued refinements in gaming taxation and regulation.

References

Ivancevich, S. & Fried, B. (1995). Contemporary tax issues in the gaming industry. *Gaming Research and Review Journal,* 2 (1), 31--42.

Endnotes

[1]This nine-member federal commission, with members appointed by President Clinton and congressional leaders, has been authorized to conduct a two-year study of gambling. In response to such attention, the American Gaming Association was formed to serve as the industry's advocate on Capital Hill in an attempt to protect the interests of gaming.