RALPH H. & MARY N. SCARBROUGH 101 Wren Drive Enterprise, AL 36330,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayers,	§	DOCKET NO. INC. 01-178
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Ralph H. and Mary N. Scarbrough (together "Taxpayers") for 1999 Alabama income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on January 30, 2002. Ralph H. Scarbrough (individually "Taxpayer") and accountant Robert L. Wills attended the hearing. Assistant Counsel Keith Maddox represented the Department.

ISSUE

The Taxpayer reported gambling winnings on his 1999 Alabama return, and offset those winnings with a corresponding amount of gambling losses. The issue in this case is whether all or a part of the gambling losses should be allowed.

FACTS

The Taxpayer is 62 years old and resides just south of Enterprise, Alabama. He has worked for the federal government at Fort Rucker in Coffee County, Alabama for over 36 years.

The Taxpayer began betting at various racetracks throughout the United States in the early 1960's. During 1999, he generally gambled two or three times a week at either the track in Ebro, outside of Pensacola, Florida, or at Victoryland in Macon County, Alabama. He primarily bet on horse races simulcasted at those tracks, but also on dogs and jai alai.

The Taxpayer reported gambling income of $27,402 on his 1999 Alabama return. He concedes that he only reported winning payouts of over $600 because he was told that payouts less than $600 were not taxable. He offset the gambling income by a corresponding amount of gambling losses. The Department audited the return and disallowed the losses. The Taxpayer appealed.

H&R Block prepared the Taxpayers' income tax returns in 1999 and prior years. The Taxpayer inquired with an H&R Block representative before 1999 as to how he should verify his gambling losses. The H&R Block representative told him to maintain his racing booklets and losing ticket stubs, and also keep a daily diary of his gambling trips, winnings and losses, etc. The Taxpayer claims he maintained the above documentary evidence during 1999. He submitted dozens of racing booklets, hundreds of ticket stubs, and a diary into evidence at the January 30 hearing.

The Taxpayer also testified extensively at the hearing concerning his betting habits, how long he has gambled, where he gambles, how he bets, etc. He bets primarily on large payout trifectas and superfectas. Consequently, he claims that when he wins a race, the payout is almost always over $600. He concedes that he did receive some payouts under $600, but that the total was insubstantial, and that his losses of over $42,000 in 1999 far exceeded his total winnings in that year, including those payouts under $600.

ANALYSIS

The deductibility of gambling losses was addressed in *Winston Shirley v. State of Alabama*, Inc. 96-153 (Admin. Law Div. 5/9/96), as follows:

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

> As with all deductions, the burden is on the taxpayer to prove gambling losses. Donovan v. Commissioner, 359 F.2d 64 (1966); Betson v. Commissioner, 802 F.2d 365 (9th Cir. 1986). Whether a taxpayer has adequately established his gambling losses is a question of fact in each case. As stated in Norgaard v. Commissioner, 939 F.2d 874 (9th Cir. 1991):
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> > The question of the amount of losses sustained by a taxpayer is a question of fact to be determined from the facts of each case, established by the taxpayer's evidence, and the credibility of the taxpayer and supporting witnesses. *Green v. Commissioner*, 66 T.C. 538, 545-46 (1976) *acq.* 1980-2 C.B. 1. The credibility of the taxpayer is a crucial factor. *See Mack v. Commissioner*, 429 F.2d 182, 184 (6th Cir. 1970) (that the tax court allowed some deduction based on the taxpayer's net worth method of proof "was a testament to the persuasiveness and seeming integrity of these taxpayers"). In some cases, courts have found losing tickets or other records and corroborating testimony by the taxpayer insufficient to establish that the taxpayer suffered deductible losses. However, in other cases, the tax court has allowed the taxpayer to deduct some or all of their losses on the basis of their losing tickets and credible corroboration by the taxpayer.
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> Norgaard, at page 878.
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> Losing tickets are in some cases sufficient to verify claimed losses, but only if the tickets are supported by the believable, direct testimony of the taxpayer. See generally, Norgaard, supra, footnote 3, at page 878. For example, in Wolkomir v. Commissioner (40 TCM 1078 (1980)), which is cited in the above footnote, the claimed losses were allowed based on the "forthright, credible, and candid testimony of the taxpayer."

Shirley, Inc. 96-153 at 3-5.

The Taxpayer in this case presented numerous racing booklets, losing ticket stubs, and a diary at the January 30 hearing. The records are not meticulous, but they do establish that the Taxpayer incurred some gambling losses in 1999. Importantly, the Taxpayer gave direct, credible, and detailed testimony at the

January 30 hearing concerning his gambling activities. As stated above, while losing ticket stubs are suspect and usually not sufficient to support gambling losses, such evidence together with the believable testimony of the taxpayer may be adequate.

Losses may also be estimated under the authority of *Cohan v. Commissioner*, 39 F.2d 540 (1930). The *Cohan* rule allows for the estimation of a deduction if the taxpayer has established some deductible expenditures, but kept less than adequate records to verify the exact amount.[1]

The Taxpayer's case is hurt by the fact that he admittedly failed to report winning payouts of less than $600. But based on the Taxpayer's records and his credible testimony at the January 30 hearing, some losses should be allowed.

The Department cited *Winston Shirley v. State of Alabama*, Inc. 96-153 (Admin. Law Div. 5/9/96) in support of its decision to disallow all of the Taxpayer's claimed losses. In that case, however, the taxpayer failed to provide any records or testify at the hearing before the Administrative Law Division. As indicated, in this case the Taxpayer provided records and offered credible testimony at the January 30 hearing.

In *State of Alabama v. Shirley Givens Johnson*, Inc. 90-126 (Admin. Law Div. 1/3/91), the taxpayer failed to report payouts under $500 (the W-2G limit at the time). The Department recognized that the taxpayer had some losses, and consequently allowed her 50 percent of her claimed losses. Under the

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[1]Congress has specifically rejected the *Cohan* rule for purposes of verifying entertainment expenses allowed under 26 U.S.C. §274. However, the rule may still be applied to establish gambling losses. "The tax court is permitted to make a reasonable estimate of both a taxpayer's unquantified, unreported winnings and his losses in order to determine the existence of deductible losses." *Norgaard*, 939 F.2d at 879.

circumstances, the Taxpayer in this case should also be allowed the same 50 percent of his claimed losses.[2]

The Department is directed to recompute the Taxpayer's 1999 liability as indicated above. A Final Order will then be entered.

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

Entered March 26, 2002.

[2]The Taxpayer is on notice that in the future, he must report all gambling winnings on his returns. He should also keep better records than those submitted in this case, including losing ticket stubs, matching racing booklets, and a daily log showing exact winnings and amounts bet on each race. Keeping such records is burdensome, but necessary.