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[4830-01-p]

DEPARTMENT OF TREASURY

Internal Revenue Service

26 CFR Part 31

[REG-123841-16]

RIN 1545-BN58

Withholding on Payments of Certain Gambling Winnings

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking

SUMMARY: This document contains proposed regulations under section 3402(q) with respect to withholding on certain payments of gambling winnings from horse races, dog races, and jai alai and on certain other payments of gambling winnings. The proposed regulations affect both payers and payees of the gambling winnings subject to withholding under section 3402(q).

DATES: Written or electronic comments and requests for a public hearing must be received by **INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-123841-16), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-123841-16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent

electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-123841-16).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Bergman, (202) 317-6845; concerning submissions of comments or to request a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been approved by the Office of Management and Budget through Form W-2G (OMB No. 1545-0238) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Notice and an opportunity to comment on the proposed changes to burden hours for the forms related to this proposed rule will be published in a separate notice in the Federal Register.

Background

This document contains proposed regulations to amend the Employment Tax Regulations (26 CFR 31) under section 3402 of the Internal Revenue Code relating to withholding from gambling winnings for horse races, dog races, and jai alai. The proposed regulations update and clarify other provisions of §31.3402(q)-1 and make conforming changes to §31.3406(g)-2.

Section 3402(q)(1) requires every person, including the United States government, a state, a political subdivision thereof, or any instrumentality of the foregoing, that makes any payment of gambling winnings to deduct and withhold tax on certain payments at the third-lowest tax rate applicable under section 1(c), which for the

2016 tax year is 25 percent. Section 3402(q)(2) provides an exemption from withholding under this section for payments of winnings to nonresident aliens and foreign corporations subject to withholding under sections 1441(a) or 1442(a). Section 3402(q)(3) describes the winnings subject to withholding as proceeds from a wager determined in accordance with the rules in that subsection.

Whether winnings are subject to withholding depends on the type of wagering transaction, the proceeds from a wager, and in some cases the odds associated with a wager. Under sections 3402(q)(3)(B) and (C)(i), payers generally must withhold if the proceeds from a wager exceed \$5,000 in a State-conducted lottery, other lottery, sweepstakes, or wagering pool. Under section 3402(q)(3)(A) and (C)(ii), in the case of a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai, the payer must withhold if the proceeds exceed \$5,000 and are at least 300 times as large as the amount wagered. Winnings from bingo, keno, and slot machines are exempted from withholding under section 3402(q)(1) by section 3402(q)(5).

Proceeds from a Wager and Identical Wagers

Section 3402(q)(4) provides that proceeds from a wager are determined by reducing the amount received by the amount of the wager, and proceeds which are not money are taken into account at fair market value. The current regulations provide rules for determining the amount of proceeds from a wager, including a special rule for “identical wagers.” The rule treats “identical wagers” as paid with respect to a single wager for purposes of calculating the proceeds from the wager. See §31.3402(q)-1(c)(ii).

Neither the statute nor the existing regulations explicitly define the terms “wager” or “identical wagers,” but the regulation text of §31.3402(q)-1(c)(ii), regarding rules for determining the amount of proceeds from a wager, and §31.3402(q)-1(d) provide examples of wagers that are and are not identical wagers. For example, amounts paid on two bets placed in a parimutuel pool on a particular horse to win a particular race are treated as paid with respect to the same wager. These two bets would not be identical, however, if one bet was for the horse to win and the other bet was for the horse to place (which are bets in two separate parimutuel pools, as explained below). Those two bets would also not be identical if one bet was placed in a pool conducted by the racetrack and the other bet was placed in a separate pool conducted by an off-track betting establishment and such wagers are not pooled with those placed at the racetrack. In addition, two bets on the same race are not identical where the bettor makes an exacta bet on horse M to win and horse N to place and a trifecta bet on horse M to win, horse N to place, and horse O to show. See §31.3402(q)-1(d), Example 11. The preamble to the current regulations provides the following definition for identical bets: “Identical bets are those in which winning depends on the occurrence (or non-occurrence) of the same event or events.” T.D. 7919 (48 FR 46296) (Oct. 12, 1983).

The statute does not explicitly address how to determine the amount of the wager in the case of exotic wagers. Exotic wagers are those other than straight wagers. Straight wagers include bets to win (selecting the first-place finisher), place (selecting a finisher to place first or second), and show (selecting a finisher to place first, second, or third). Examples of exotic bets include multi-contestant bets, such as an exacta (selecting the first and second-place finishers in a single contest, in the correct order)

and a trifecta (selecting the first, second, and third-place finishers in a single contest, in the correct order). Other examples include multi-contest bets such as a Pick 6 (selecting the first-place finisher in six consecutive contests).

The instructions to Form W-2G provide the rule for multiple wagers reflected on a single ticket as follows: “For multiple wagers sold on one ticket, such as the \$12 box bet on a Big Triple or Trifecta, the wager is considered as six \$2 bets and not one \$12 bet for purposes of computing the amount to be reported or withheld.” See, e.g., 2016 Instructions to Forms W-2G and 5754, at 2, available at <https://www.irs.gov/pub/irs-pdf/iw2g.pdf>. Thus, according to the instructions, the bettor may only consider the cost of a single winning combination when determining the amount wagered for purposes of determining whether proceeds from a wager meets the threshold for withholding in section 3402(q)(3)(C)(ii).

2015 Request for Comments

The Treasury Department and the IRS requested comments from the public on the treatment of wagers in parimutuel gambling on March 4, 2015, in a notice of proposed rulemaking (REG-132253-11) under section 6041 regarding information returns to report winnings from bingo, keno, and slot machine play. The notice of proposed rulemaking stated that taxpayers required to report winnings from parimutuel gambling may have concerns relating to when wagers with respect to horse races, dog races, and jai alai may be treated as identical and that the Treasury Department and the IRS intend to amend the regulations under §31.3402(q)-1.

Multiple commentators requested a rule that would take into account all money wagered in a particular parimutuel pool when determining proceeds from a wager for

purposes of determining whether withholding under section 3402(q) was required. In particular, some commentators requested that the Treasury Department and the IRS revise the regulations to provide a definition of the “amount of the wager” when multiple bets are placed in the same pool to include the total amount wagered by a bettor into a specific parimutuel pool for purposes of determining whether wagering proceeds are subject to withholding and reporting. The commentators stated that this change would reflect innovations and changes to today’s modern parimutuel wagering strategies.

Reporting Rules

Section 3402(q)(6) provides that recipients of gambling winnings subject to withholding must furnish a statement to the payer, under penalties of perjury, containing the name, address, and taxpayer identification number of the recipient and each person entitled to any portion of the payment. The current regulations provide that the statement, furnished on a Form W-2G, Certain Gambling Winnings, or Form 5754, Statement by Person(s) Receiving Gambling Winnings, also must indicate if the payee and any other persons entitled to payment are entitled to winnings from identical wagers. §§1.6011-3, 31.3402(q)-1(c)(ii). The payer may rely on this statement in determining the amount of proceeds from the wager. §31.3402(q)-1(c)(ii).

On or before February 28 (March 31 if filed electronically) of the calendar year following the calendar year in which the payment is made, the payer must file a return on Form W-2G with the Internal Revenue Service reporting the gambling winnings subject to withholding. §31.3402(q)-1(f). Section 6041(d) and the instructions to Form W-2G require that the payer filing a Form W-2G also furnish a statement to the payee

on or before January 31 of the calendar year following the calendar year in which the payment is made.

Explanation of Provisions

The current regulations for withholding from gambling winnings under section 3402(q) were last substantively amended in 1983. According to commentators, since that time, exotic bets on horse races, dog races, and jai alai have accounted for an increasing percentage of total bets placed on horse races, dog races, and jai alai. The increase in exotic betting, and in particular the use of certain methods of exotic betting, has resulted in scenarios where the current rules may result in withholding that significantly exceeds the individual gambler's ultimate income tax liability. In light of this, the proposed regulations amend the rules regarding how payers determine the amount of the wager in parimutuel wagering transactions with respect to horse races, dog races, and jai alai. Specifically, these proposed regulations address exotic bets on horse races, dog races, and jai alai by providing a new rule to determine the amount of the wager when wagers are placed in a single parimutuel pool and are reflected on a single ticket. In addition, the current regulations under section 3402(q) are updated to reflect current law regarding the withholding thresholds and certain information reporting requirements.

I. Wagers in the Case of Horse Races, Dog Races, and Jai Alai

A. Parimutuel Betting

In parimutuel betting, which translates to betting "amongst ourselves," the bettors themselves establish the odds and payouts, as opposed to having fixed odds. Each type of bet on a contest or series of contests goes into its own parimutuel pool. For

example, each win bet goes into the win pool for that contest, regardless of the finisher selected to win. As amounts are wagered in the pool, the odds and payouts adjust accordingly. Following the contest or contests determinative of a particular pool, all bettors who placed a winning bet share the money placed in that particular pool, less the applicable takeout. Parimutuel betting in the United States is used in betting on horse races, dog races, and jai alai.

Parimutuel betting involves both straight and exotic bets. Each type of straight or exotic bet is placed in its own parimutuel pool. For example, a trifecta bet on a particular contest goes into that contest's trifecta pool, regardless of the finishers or order of finish selected, and the trifecta pool is separate from the win pool, the exacta pool, and all other pools associated with that particular contest. Exotic bets provide greater odds and bigger pay-offs than straight bets.

Multiple combinations of exotic bets may be placed on a single ticket, making it easier for bettors to place wagers on the various possible outcomes. For example in horse racing, bettors often use box, key, and wheel bets to place the same type of exotic bet (e.g., exacta or trifecta) on multiple combinations of outcomes. Box bets involve betting on all possible outcomes of a specific group of horses in the same race; for example, a three-horse exacta box is a bet in which three specific horses are selected to place first or second in any combination or order of finish. A bettor wins a three-horse exacta box bet if any combination of the bettor's three horses finishes first and second. Key bets involve betting a single horse in one position with all possible combinations of the other selected horses; for example, a trifecta key is a bet where a single horse is selected to win and the other horses included in the bet are selected to

place second or third in any combination or order of finish. Finally, a wheel bet involves multiple horses in multiple combinations in multiple races; for example, a Daily Double wheel is a bet where a single horse is selected to win the first race and every horse is selected in the second race.

B. Comments Regarding Current Treatment of Parimutuel Betting

Commentators stated that since the regulations were last substantively amended, the rise in the number of exotic bets available at certain racetracks and the popularity of exotic betting has altered parimutuel betting practices. Commentators stated that, for example, in the 1978 Kentucky Derby, there were three types of bets available to be placed at Churchill Downs racetrack, where the Kentucky Derby is run. Those bets were bets to win, place, or show. By contrast, in the 2015 Kentucky Derby, there were twenty-three types of bets available to be placed at Churchill Downs racetrack, including the superfecta, super high five, and pick 7 jackpot. Furthermore, commentators stated that today approximately 67% of all parimutuel wagering occurs on exotic wagers (versus straight wagers), as compared to the 1970s when approximately 10% of parimutuel wagering occurred on exotic wagers.

Further, commentators stated that the increase in availability of exotic betting has caused bettors to substantially increase their amounts wagered, often by placing box, key, and wheel bets, in a particular parimutuel pool to increase their chances of winning and increase the potential payout. In addition, commentators attributed the rise in popularity of exotic bets to the fact that exotic bets offer significantly higher odds. As a result, commentators stated that modern bettors are putting more money towards bets with greater potential payouts in anticipation of significant winnings.

Commentators also stated that payouts from straight bets were rarely subject to withholding because they virtually never came close to exceeding the 300 to 1 ratio of proceeds to the amount of the wager. On the other hand, exotic bets do result in proceeds exceeding the amount of the wager by a 300 to 1 ratio; for example, seven different exotic bets at the 2015 Kentucky Derby produced payouts exceeding the 300 to 1 ratio. However, given the vast number of potential outcomes possible with exotic bets, the commentators stated that bettors are using techniques such as box, key, or wheel bets to increase their odds. As a result, it is undoubtedly the case that the winners wagered far more into the pool than the cost of the winning bet.

Commentators stated that the tax treatment under the current rules ignores the actual investment in a single parimutuel pool and may result in withholding that significantly exceeds the amount necessary to cover the individual gambler's ultimate income tax liability and suggested changing the rule to take into account all wagers in the same parimutuel pool. The commentators provided the following example to illustrate this. A bettor makes a seven-horse trifecta box wager, which involves selecting a group of seven horses to place first, second, and third, in any order. This bet has 210 unique possible results. Assuming the bettor bets \$20 on each combination, the total amount wagered is \$4,200. At race time the winning combination carries 304 to 1 odds. After the race, the bettor holds a winning ticket that pays \$6,100 ($\$304 \times \20 wagered + \$20 return of bet). Under the current rules, the racetrack would withhold \$1,520 ($(\$6,100 - 20) \times 25\%$) and report \$6,080 in winnings ($\$6,100 - \20) because the rules treat only the \$20 paid for the single winning combination as the amount wagered. However, the commentators stated that the individual has netted only

\$1,900 (\$6,100 winnings less \$4,200 wagered), and is left with \$380 (\$1,900 - \$1,520) once withholding taxes are taken out, which makes the withholding rate 80% of net winnings.

Under the commentators' proposed change, the amount of the wager would be considered to be \$4,200. Thus the racetrack would not withhold because the proceeds from the wager (\$1,900) are less than the \$5,000 withholding threshold and are also less than \$1,260,000 (300 times the amount wagered). Similarly, the racetrack would not report the proceeds because they are not at least 300 times the amount wagered.

The commentators noted that although the bettor may be able to deduct the losing wagers on the bettor's tax return at the end of the year as a miscellaneous itemized deduction, there would be other consequences. For example, the \$1,520 withholding lowers the amount of money in circulation at the racetrack that day and reduces the bettor's cash on hand, whereas the commentators' proposed change would result in additional cash on hand to be bet in subsequent races.

In addition, the commentators stated that the deduction for losing wagers results in reporting of higher adjusted gross income than would result under the commentator's proposed change. Commentators further stated that a higher adjusted gross income can cause the bettor to lose unrelated tax benefits. In addition, the deduction is only available if the bettor itemizes deductions and is not subject to the alternative minimum tax. Finally the commentators noted that many states limit itemized deductions for state tax purposes.

C. Proposed Rule for the Amount of the Wager in the Case of Horse Races, Dog Races, and Jai Alai

Proposed §31.3402(q)-1(c)(ii) provides a new rule for purposes of determining the amount of the wager for wagering transactions in horse races, dog races, and jai alai. The proposed rule allows all wagers placed in a single parimutuel pool and represented on a single ticket to be aggregated and treated as a single wager for purposes of determining the amount of the wager. The proposed rule allows a payer to take into account the total amount wagered in a particular pool as reflected on a single ticket to determine whether the winnings are subject to withholding and reporting. This treatment better reflects the full cost of exotic bets. In addition, straight wagers are unlikely to have odds and produce payouts of at least 300 to 1, so they generally are not subject to withholding, regardless of the application of the proposed rule. The proposed regulations contain examples to illustrate the proposed rule for wagering transactions in the case of horse races, dog races, and jai alai.

The proposed rule for determining the amount of the wager addresses the fact that the current rules may result in withholding that significantly exceeds the amount necessary to cover the individual gambler's ultimate income tax liability, and that creates an unnecessary burden on the bettor and the horse racing, dog racing, and jai alai industries. As described in the commentators' example, current rules for exotic bets placed as box, key, or wheel bets can result in an 80% withholding rate on net winnings from wagers placed in the same pool. This result has become more common in the decades since the regulations were last amended because the number of exotic bet types and the popularity of exotic bets have increased substantially, and various combinations of these exotic bets are often placed together on a single ticket as part of the same transaction.

By limiting the amount of the wager in a wagering transaction with respect to horse races, dog races, and jai alai to the wagers represented on a single ticket, the proposed rule limits the potential for fraud and creates an administrable system for payers. The rule is administrable because it does not require payers to collect information regarding winning wagers where additional wagers placed in the same pool are reflected on multiple tickets. If bettors want to place additional wagers in the same parimutuel pool after already having purchased a ticket, commentators stated that bettors may be able to cancel the first ticket and place the original and additional wagers for that pool on a new ticket.

The proposed regulations maintain the current rule regarding identical wagers. To clarify the meaning of the term, however, the proposed regulations provide a definition of identical wagers taken from the preamble of the current regulations. T.D. 7919 (48 FR 46296). The proposed regulations also move examples of identical wagers from the regulatory text to the examples section.

The Treasury Department and the IRS request comments regarding whether the proposed rule addressing the amount of the wager in a wagering transaction in the case of horse races, dog races, and jai alai should apply to other types of gambling subject to withholding under section 3402(q), such as lotteries.

II. Ministerial Updates to Current Regulations

In addition to the proposed rule for wagers in horse races, dog races, and jai alai, the proposed regulations make ministerial updates to the current regulations to reflect current law.

Proposed regulations §31.3402(q)-1(a) and (b) are amended to reflect the current statutory tax rate for withholding (the third-lowest tax rate under section 1(c)) and the current statutory thresholds for withholding for all types of gambling covered by this regulation (\$5,000). In 1992 and again in 2001, Congress amended section 3402(q)(1) to change the withholding rate first from 20 percent to 28 percent and then to its current level of “the third lowest rate of tax applicable under section 1(c),” but the current regulations do not reflect either of these statutory amendments. See Economic Growth and Tax Relief Reconciliation Act of 2001, Pub.L. 107-16, § 101(c)(8); Energy Policy Act of 1992, Pub.L. 102-486, § 1934(a). In 1992, Congress also amended sections 3402(q)(3)(A) and (C) to change the withholding threshold for certain types of gambling from \$1,000 to \$5,000, which the current regulations do not reflect. Energy Policy Act, § 1942(a). In addition, the proposed regulations remove certain dates reflecting transition periods, which are no longer necessary.

In addition, proposed regulation §31.3402(q)-1(c)(4) updates the rule regarding payments to nonresident aliens or foreign corporations.

III. Information Reporting for Gambling Winnings Subject to Withholding Under Section 3402(q)

Proposed regulations §31.3402(q)-1(d) and (e) update and clarify the reporting rules for gambling winnings subject to withholding under section 3402(q). The amendments to §31.3402(q)-1(d), regarding the statement by the payee of gambling winnings subject to withholding under section 3402(q), reorganize the current regulations into new sub-sections. Proposed §31.3402(q)-1(d)(1) provides the general rule that each payer of gambling winnings subject to withholding under section 3402(q)

must obtain a payee statement. Proposed §31.3402(q)-1(d)(2) describes the content of the payee statement. Proposed §31.3402(q)-1(d)(3) states the reliance rule currently described in §31.3402(q)-1(c)(1)(ii) that where a payee furnishes the required payee statement and, as required by §1.6011-3, indicates that he or she is entitled to winnings from identical wagers, the payer may rely on the statement in determining the total amount of proceeds from the wager.

The amendments to proposed §31.3402(q)-1(e), regarding the information return filed by the payer on Form W-2G, modernize the current reporting rules. First, the proposed regulations replace outdated references to the place of filing with a requirement that the return be filed with the appropriate Internal Revenue Service location designated in the instructions to the form.

Second, the proposed regulations require the payer to report the taxpayer identification number of the winner in lieu of the social security number to allow for a broader range of taxpayer identification numbers, including individual taxpayer identification numbers (ITINs) and adoption taxpayer identification numbers (ATINs). This amendment allows truncation of the taxpayer identification number on the statement furnished by the payer to the payee because the regulation no longer requires a social security number. For provisions relating to the use of truncated taxpayer identification numbers, see §31.6109-4 of this chapter.

Third, the proposed regulations update the payee identification provisions. Section 31.3402(q)-1(f)(1)(v) of the current regulations provides that the identification verifying the payee's identity must include the payee's social security number. According to the current regulations, examples of acceptable identification include a

driver's license, a social security card, or a voter registration card. However, today most forms of identification do not include a person's social security number. Therefore, many payees do not have identification that contains the payee's social security number and, even if they do, they may not have this identification with them at the time that they receive a payment of gambling winnings subject to withholding under section 3402(q).

To address this issue, proposed §§31.3402(q)-1(e)(1)(v) and (e)(2) provide that, in addition to government-issued identification, a properly completed Form W-9 signed by the payee is an acceptable form of identification to verify the payee's identifying information. Payers who verify payee information using identification set forth in proposed §§31.3402(q)-1(e)(1)(v) and (e)(2) before the date that final regulations implementing these provisions are published in the Federal Register will be treated as meeting the requirements of §31.3402(q)-1(f)(1)(v) of the current regulations.

Fourth, the proposed regulations contain a special rule in §31.3402(q)-1(e)(3) that tribal member identification cards need not contain the payee's photograph to meet the identification requirements in §31.3402(q)-1(e)(1)(v) of the proposed regulations, provided specific criteria are met. This special rule responds to comments raised by Indian tribes in response to the notice of proposed rulemaking (REG-132253-11) under section 6041 regarding information returns to report winnings from bingo, keno, and slot machine play that many tribal identification cards do not contain photographs.

Fifth, the proposed regulations update the obsolete reference to Form W-3G to reflect that payers should use Form 1096 to transmit Forms W-2G to the Internal Revenue Service.

Finally, the proposed regulations in §31.3402(q)-1(e)(5) provides that a payer filing an information return with the Internal Revenue Service must furnish a statement to the payee containing the same information on or before January 31st of the year following the calendar year in which payment of the winnings subject to withholding is made. See section 6041(d).

Proposed amendments to the regulations under section 3406 update the reporting requirements to address horse races, dog races, and jai alai. Proposed §31.3406(g)-2(d) is amended to clarify the definition of a reportable gambling winning and to add a cross-reference to §31.3402(q)-1(c) for determining the amount of the wager in a wagering transaction with respect to horse races, dog races, and jai alai, or amounts paid with respect to identical wagers.

Proposed Effective/Applicability Date

These regulations are proposed to apply to payments made after the date of publication of the Treasury Decision adopting these rules as final regulations in the **Federal Register**.

Statement of Availability of IRS Documents

IRS published guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order

13563. Therefore, a regulatory assessment is not required. It is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that this rule merely provides guidance regarding withholding and reporting requirements for payers of certain gambling winnings. The requirement for payers to withhold and make information returns is imposed by statute and not these regulations. In addition, this rule reduces the existing burden on payers to comply with the statutory requirement by decreasing the number of payments subject to withholding and reporting. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. In addition to the requests for comments noted in the Background Section, Treasury and the IRS request comments on any other aspects of the proposed rules, and any other issues relating to the payment of gambling winnings that are not addressed in the proposed regulations. All comments will be available at www.regulations.gov for public inspection or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is David Bergman of the Office of the Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 31

Employment Taxes and Collection of Income Tax at Source.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAXES AT THE SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 31.3402(q)-1 is amended:

1. By revising paragraphs (a)(1), (b), and (c)(1) and (4).
2. By redesignating paragraph (d) as paragraph (f), paragraph (e) as paragraph (d), and paragraph (f) as paragraph (e).
3. By revising newly designated paragraphs (d) and (e).
4. In paragraph (f), removing Example 3 and Example 11, by redesignating Examples 4 through 10 as Examples 3 through 9, and adding examples 10 through 16.

5. In paragraph (f), in newly redesignated Example 4 by removing the language “Example 4” and adding in its place the language “Example 3” and in newly redesignated Example 6 by removing the language “Example 6” and adding in its place the language “Example 5” wherever it appears.

6. By adding paragraph (g).

The revisions and additions read as follows:

§ 31.3402(g)–1 Extension of withholding to certain gambling winnings.

(a) Withholding obligation--(1) General rule. Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentality of any of the foregoing making any payment of “winnings subject to withholding” (defined in paragraph (b) of the section) shall deduct and withhold a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment. The tax shall be deducted and withheld upon payment of the winnings by the person making such payment (“payer”). See paragraph (c)(5)(ii) of this section for a special rule relating to the time for making deposits of withheld amounts and filing the return with respect to those amounts. Any person receiving a payment of winnings subject to withholding must furnish the payer a statement as required in paragraph (d) of this section. Payers of winnings subject to withholding must file a return with the Internal Revenue Service and furnish a statement to the payee as required in paragraph (e) of this section. With respect to reporting requirements for certain payments of gambling winnings not subject to withholding, see section 6041 and the regulations thereunder.

* * * * *

(b) Winnings subject to withholding. (1) In general. Winnings subject to withholding means any payment from--

(i) A wager placed in a State-conducted lottery (defined in paragraph (c)(2) of this section) but only if the proceeds from the wager exceed \$5,000;

(ii) A wager placed in a sweepstakes, wagering pool, or lottery other than a State-conducted lottery but only if the proceeds from the wager exceed \$5,000; or

(iii) Any other wagering transaction (as defined in paragraph (c)(3) of this section) but only if the proceeds from the wager (A) exceed \$5,000 and (B) are at least 300 times as large as the amount of the wager.

(2) Total proceeds subject to withholding. If proceeds from the wager qualify as winnings subject to withholding, then the total proceeds from the wager, and not merely amounts in excess of \$5,000, are subject to withholding.

(c) Definitions; special rules—(1) Rules for determining amount of proceeds from a wager—(i) In general. The amount of “proceeds from a wager” is the amount paid with respect to the wager, less the amount of the wager.

(ii) Amount of the wager in the case of horse races, dog races, and jai alai. In the case of a wagering transaction with respect to horse races, dog races, or jai alai, all wagers placed in a single parimutuel pool and represented on a single ticket are aggregated and treated as a single wager for purposes of determining the amount of the wager. A ticket in the case of horse races, dog races, or jai alai is a written or electronic record that the payee must present to collect proceeds from a wager or wagers.

(iii) Amount paid with respect to a wager—(A) Identical wagers. Amounts paid with respect to identical wagers are treated as paid with respect to a single wager for

purposes of calculating the amount of proceeds from a wager. Two or more wagers are identical wagers if winning depends on the occurrence (or non-occurrence) of the same event or events; the wagers are placed with the same payer; and, in the case of horse races, dog races, or jai alai, the wagers are placed in the same parimutuel pool.

Wagers may be identical wagers even if the amounts wagered differ as long as the wagers are otherwise treated as identical wagers under this paragraph (c)(1)(iii)(A).

Tickets purchased in a lottery generally are not identical wagers, because the designation of each ticket as a winner generally would not be based on the occurrence of the same event, e.g., the drawing of a particular number.

(B) Non-monetary proceeds. In determining the amount paid with respect to a wager, proceeds which are not money are taken into account at the fair market value.

(C) Periodic payments. Periodic payments, including installment payments or payments which are to be made periodically for the life of a person, are aggregated for purposes of determining the amount paid with respect to the wager. The aggregate amount of periodic payments to be made for a person's life is based on that person's life expectancy. See §§ 1.72-5 and 1.72-9 of this chapter for rules used in computing the expected return on annuities. For purposes of determining the amount subject to withholding, the first periodic payment shall be reduced by the amount of the wager.

* * * * *

(4) Certain payments to nonresident aliens or foreign corporations. A payment of winnings that is subject to withholding tax under section 1441(a) (relating to withholding on nonresident aliens) or 1442(a) (relating to withholding on foreign corporations) is not subject to the tax imposed by section 3402(q) and this section if the payer complies with

the requirements of withholding, documentation, and information reporting rules of section 1441(a) or 1442(a) and the regulations thereunder. A payment is treated as being subject to withholding tax under section 1441(a) or 1442(a) notwithstanding that the rate of such tax is reduced (even to zero) as may be provided by an applicable treaty with another country. However, a reduced or zero rate of withholding of tax shall not be applied by the payer in lieu of the rate imposed by sections 1441 and 1442 unless the person receiving the winnings has provided to the payer the documentation required by §1.1441-6 of this chapter to establish entitlement to treaty benefits.

* * * * *

(d) Statement furnished by payee—(1) In general. Each person who is making a payment subject to withholding under this section must obtain from the payee a statement described in paragraph (d)(2) of this section.

(2) Contents of statement. (i) Each person who is to receive a payment of winnings subject to withholding under this section must furnish the payer a statement on Form W-2G or 5754 (whichever is applicable) made under the penalties of perjury containing--

(A) The name, address, and taxpayer identification number of the winner accompanied by a declaration that no other person is entitled to any portion of such payment, or

(B) The name, address, and taxpayer identification number of the payee and of every person entitled to any portion of such payment.

(3) If more than one payment of winnings subject to withholding is to be made with respect to a single wager, for example in the case of an annuity, the payee is

required to furnish the payer a statement with respect to the first such payment only, provided that such other payments are taken into account in a return required by paragraph (e) of this section.

(4) Reliance on statement for identical wagers. If the payee furnishes the statement which may be required pursuant to § 1.6011-3 of this chapter (regarding the requirement of a statement from payees of certain gambling winnings), indicating that the payee (and any other persons entitled to a portion of the winnings) is entitled to winnings from identical wagers, as defined in paragraph (c)(1)(iii)(A) of this section, and indicating the amount of such winnings, if any, then the payer may rely upon such statement in determining the total amount of proceeds from the wager under paragraph (c)(1) of this section.

(e) Return of payer—(1) In general. Every person making payment of winnings for which a statement is required under paragraph (d) of this section shall file a return on Form W-2G with the Internal Revenue Service location designated in the instructions to the form on or before February 28 (March 31 if filed electronically) of the calendar year following the calendar year in which the payment of winnings is made. The return required by this paragraph (e) need not include the statement by the payee required by paragraph (d) of this section and, therefore, need not be signed by the payee, provided such statement is retained by the payer as long as the contents thereof may become material in the administration of any internal revenue law. In addition, the return required by this paragraph (e) need not contain the information required by paragraph (e)(1)(v) of this section provided such information is obtained with respect to the payee and retained by the payer as long as the contents thereof may become

material in the administration of any internal revenue law. For payments to more than one winner, a separate Form W-2G, which in no event need be signed by the winner, shall be filed with respect to each such winner. Each Form W-2G shall contain the following:

- (i) The name, address, and employer identification number of the payer;
- (ii) The name, address, and taxpayer identification number of the winner;
- (iii) The date, amount of the payment, and amount withheld;
- (iv) The type of wagering transaction;
- (v) Except with respect to winnings from a wager placed in a State-conducted lottery, a general description of the two types of identification (as described in paragraph (e)(2) of this section), one of which must have the payee's photograph on it (except in the case of tribal member identification cards in certain circumstances as described in paragraph (e)(3) of this section), that the payer relied on to verify the payee's name, address, and taxpayer identification number;
- (vi) The amount of winnings from identical wagers; and
- (vii) Any other information required by the form, instructions, or other applicable guidance published in the Internal Revenue Bulletin.

(2) Identification. The following items are treated as identification for purposes of paragraph (e)(1)(v) of this section--

- (i) Government-issued identification (for example, a driver's license, passport, social security card, military identification card, tribal member identification card issued by a federally-recognized Indian tribe, or voter registration card) in the name of the payee; and

(ii) A Form W-9, "Request for Taxpayer Identification Number and Certification," signed by the payee that includes the payee's name, address, taxpayer identification number, and other information required by the form. A Form W-9 is not acceptable for this purpose if the payee has modified the form (other than pursuant to instructions to the form) or if the payee has deleted the jurat or other similar provisions by which the payee certifies or affirms the correctness of the statements contained on the form.

(3) Special rule for tribal member identification cards. A tribal member identification card need not contain the payee's photograph to meet the identification requirement described in paragraph (e)(1)(v) of this section if--

(i) The payee is a member of a federally-recognized Indian tribe;

(ii) The payee presents the payer with a tribal member identification card issued by a federally-recognized Indian tribe stating that the payee is a member of such tribe; and

(iii) The payer is a gaming establishment (as described in §1.6041-10(b)(2)(iv) of this chapter) owned or licensed (in accordance with 25 U.S.C. 2710) by the tribal government that issued the tribal member identification card referred to in paragraph (e)(3)(ii) of this section.

(4) Transmittal form. Persons making payments of winnings subject to withholding shall use Form 1096 to transmit Forms W-2G to the Internal Revenue Service.

(5) Furnishing a statement to the payee. Every payer required to make a return under paragraph (e)(1) of this section must also make and furnish to each payee, with respect to each payment of winnings subject to withholding, a written statement that

contains the information that is required to be included on the return under paragraph (e)(1) of this section. The payer must furnish the statement to the payee on or before January 31st of the year following the calendar year in which payment of the winnings subject to withholding is made. The statement will be considered furnished to the payee if it is provided to the payee at the time of payment or if it is mailed to the payee on or before January 31st of the year following the calendar year in which payment was made.

(f) Examples. * * *

Example 10. B places a \$15 bet at the cashier window at the racetrack for horse A to win the fifth race at the racetrack that day. After placing the first bet, B gains confidence in horse A's prospects to win and places an additional \$40 bet at the cashier window at the racetrack for horse A to win the fifth race, receiving a second ticket for this second bet. Horse A wins the fifth race, and B wins a total of \$5,500 (100 to 1 odds) on those bets. The \$15 bet and the \$40 bet are identical wagers under paragraph (c)(1)(iii)(A) of this section because winning on both bets depended on the occurrence of the same event and the bets are placed in the same parimutuel pool with the same payer. This is true regardless of the fact that the amount of the wager differs in each case.

B cashes the tickets at different cashier windows. Pursuant to paragraph (d) of this section and §1.6011-3, B completes a Form W-2G indicating that the amount of winnings is from identical wagers and provides the form to each cashier. The payments by each cashier of \$1,500 and \$4,000 are less than the \$5,000 threshold for withholding, but under paragraph (c)(1)(iii)(A) of this section, identical wagers are treated as paid with respect to a single wager for purposes of determining the proceeds from a wager. The payment is not subject to withholding or reporting because although the proceeds from the wager are \$5,445 ($\$1,500 + \$4,000 - \55), the proceeds from the wager are not at least 300 times as great as the amount wagered ($\$55 \times 300 = \$16,500$).

Example 11. B makes two \$1,000 bets in a single "show" pool for the same jai alai game, one bet on Player X to show and one bet on Player Y to show. A show bet is a winning bet if the player comes in first, second, or third in a single game. The bets are placed at the same time at the same cashier window, and B receives a single ticket showing both bets. Player X places second in the game, and Player Y does not place first, second, or third in the game. B wins \$8,000 from his bet on Player X. Because winning on both bets does not depend on the occurrence of the same event, the bets are not identical bets under paragraph (c)(1)(iii)(A) of this section. However, pursuant to the rule in paragraph (c)(1)(ii) of this section, the amount of the wager is the aggregate

amount of both wagers (\$2,000) because the bets were placed in a single parimutuel pool and reflected on a single ticket. The payment is not subject to withholding or reporting because although the proceeds from the wager are \$6,000 (\$8,000 - \$2,000), the proceeds from the wager are not at least 300 times as great as the amount wagered ($\$2,000 \times 300 = \$600,000$).

Example 12. B bets a total of \$120 on a three-dog exacta box bet (\$20 for each one of the six combinations played) at the dog racetrack and receives a single ticket reflecting the bet from the cashier. B wins \$5,040 from one of the selected combinations. Pursuant to the rule in paragraph (c)(1)(ii) of this section, the amount of the wager is \$120, not \$20 for the single winning combination of the six combinations played. The payment is not subject to withholding under section 3402(q) because the proceeds from the wager are \$4,920 ($\$5,040 - \120), which is below the section 3402(q) withholding threshold.

Example 13. B makes two \$12 Pick 6 bets at the horse racetrack at two different cashier windows and receives two different tickets each representing a single \$12 Pick 6 bet. In his two Pick 6 bets, B selects the same horses to win races 1-5 but selects different horses to win race 6. All Pick 6 bets on those races at that racetrack are part of a single parimutuel pool from which Pick 6 winning bets are paid. B wins \$5,020 from one of his Pick 6 bets. Pursuant to the rule in paragraph (c)(1)(ii) of this section, the bets are not aggregated for purposes of determining the amount of the wager because the bets are reflected on separate tickets. Assuming that the applicable rate is 25%, the racetrack must deduct and withhold \$1,252 ($(\$5,020 - \$12) \times 25\%$) because the amounts of the proceeds of \$5,008 ($\$5,020 - \12) is greater than \$5,000 and is at least 300 times as great as the amount wagered ($\$12 \times 300 = \$3,600$). The racetrack also must report B's winnings on Form W-2G pursuant to paragraph (e) of this section and furnish a copy of the Form W-2G to B.

Example 14. C makes two \$50 bets in two different parimutuel pools for the same jai alai game. One bet is an "exacta" in which C bets on player M to win and player N to "place". The other bet is a "trifecta" in which C bets on player M to win, player N to "place," and player O to "show." C wins both bets and is paid \$2,000 with respect to the bet in the "exacta" pool and \$3,100 with respect to the bet in the "trifecta" pool. Under paragraph (c)(1)(iii)(A) of this section, the bets are not identical bets. Under paragraph (c)(1)(ii) of this section, the bets are not aggregated for purposes of determining the amount of the wager for either payment because they are not wagers in the same parimutuel pool. No section 3402(q) withholding is required on either payment because neither payment separately exceeds the \$5,000 withholding threshold.

Example 15. C makes two \$100 bets for the same dog to win a particular race. C places one bet at the racetrack and one bet at an off-track betting establishment, but the two pools constitute a single pool. C receives separate tickets for each bet. C wins both bets and is paid \$4,000 from the racetrack and \$4,000 from the off-track betting establishment. Under paragraph (c)(1)(ii) of this section, the bets are not aggregated

for purposes of determining the amount of the wager because the wager placed at the racetrack and the wager placed at the off-track betting establishment are reflected on separate tickets, despite being placed in the same parimutuel pool. No section 3402(q) withholding is required because neither payment separately exceeds the \$5,000 withholding threshold.

Example 16. C places a \$200 Pick 6 bet for a series of races at the racetrack on a particular day and receives a single ticket for the bet. No wager correctly picks all six races that day, so that portion of the pool carries over to the following day. On the following day, C places an additional \$200 Pick 6 bet for that day's series of races and receives a new ticket for that bet. C wins \$100,000 on the second day. Pursuant to the rule in paragraph (c)(1)(ii) of this section, the bets are on two separate tickets, so C's two Pick 6 bets are not aggregated for purposes of determining the amount of the wager. Assuming that the applicable rate is 25%, the racetrack must deduct and withhold \$24,950 $((\$100,000 - \$200) \times 25\%)$ because the amount of the proceeds of \$99,800 $(\$100,000 - \$200)$ is greater than \$5,000, and is at least 300 times as great as the amount wagered $(\$200 \times 300 = \$60,000)$. The racetrack also must report C's winnings on Form W-2G pursuant to paragraph (e) of this section and furnish a copy of the Form W-2G to C.

(g) Applicability date. These rules apply to payments made after [the date of publication of the Treasury decision adopting these rules as final regulations in the Federal Register]. For rules that apply to payments made before that date, see 26 CFR 31.3402(q)-1 (revised April 2015).

Par. 3. Section 31.3406-0 is amended by adding an entry for paragraph (h) to §31.3406(g)-2 to read as follows:

§31.3406-0 Outline of the backup withholding regulations.

* * * * *

§31.3406(g)-2 Exception for reportable payments for which backup withholding is otherwise required.

* * * * *

(h) Effective/applicability date.

* * * * *

Par. 4. Section 31.3406(g)-2 is amended by revising paragraphs (d)(2) and (3) and adding paragraph (h) to read as follows:

§ 31.3406(g)-2 Exception for reportable payment for which withholding is otherwise required.

* * * * *

(d) * * *

(2) Definition of a reportable gambling winning and determination of amount subject to backup withholding. For purposes of withholding under section 3406, a reportable gambling winning is any gambling winning subject to information reporting under section 6041. A gambling winning (other than a winning from bingo, keno, or slot machines) is a reportable gambling winning only if the amount paid with respect to the wager is \$600 or more and if the proceeds are at least 300 times as large as the amount wagered. See § 1.6041-10 of this chapter to determine whether a winning from bingo, keno, or slot machines is a reportable gambling winning and thus subject to withholding under section 3406. The amount of a reportable gambling winning is--

(i) The amount paid with respect to the amount of the wager reduced, at the option of the payer; by

(ii) The amount of the wager.

(3) Special rules. For special rules for determining the amount of the wager in a wagering transaction with respect to horse racing, dog racing, and jai alai, or amounts paid with respect to identical wagers, see § 31.3402(q)-1(c).

* * * * *

(h) Applicability date. The rules apply to reportable gambling winnings paid after [the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**]. For reportable gambling winnings paid on or before [the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**], §31.3406(g)-2 (as contained in 26 CFR part 31, revised April 2015) applies.

John Dalrymple

Deputy Commissioner for Services and Enforcement.

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