Legislative Analysis

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WITHHOLDING OF WINNINGS AT DETROIT CASINOS

House Bill 5845 as introduced
Sponsor: Rep. Larry Julian
Committee: Government Operations
First Analysis (5-19-04)

BRIEF SUMMARY: The bill would amend the Income Tax Act to require the Detroit casinos to withhold a tax on the winnings of all taxpayers (residents and non-residents alike) if the winnings meet the threshold for withholding under the federal Internal Revenue Code. It would also reduce the level of withholding for nonresidents to conform to federal withholding levels.

FISCAL IMPACT: A fiscal analysis is in progress.

THE APPARENT PROBLEM:

The state's Income Tax Act was amended by Public Act 22 of 2003 to require the three Detroit casinos to withhold taxes on the winnings of nonresidents that are reportable by the casino under the federal Internal Revenue Code. The amendment was part of the Granholm administration's revenue enhancement package that accompanied the executive budget for the 2003-2004 fiscal year. Public Act 21 of 2003 amended the Income Tax Act to include, casino winnings from the Detroit casinos and tribal casinos, as well as winnings at state horse racetracks in the taxable income of nonresidents. Public Act 22 was necessary to enforce Public Act 21.

However, in the short time that Public Act 22 has been effective a problem has emerged. The act requires the Detroit casinos to withhold the appropriate amount of state income tax based on any winnings by nonresidents that are reportable under the federal Internal Revenue Code. The problem is that the federal IRC requires the casinos to withhold federal income tax on a different amount of winnings (not on the reportable amount).

Section 3402(q) of the IRC generally requires that gaming establishments withhold a tax of 25 percent on the winnings (less the amount wagered) if the winnings exceed $5,000 and are from sweepstakes, wagering pools, lotteries, or certain other wagering transactions and only if the winnings are at least 300 times the amount wagered. The withholding requirements do not apply to winnings from slot machines, keno, or bingo, although winnings from those gaming activities may be subject to a 28 percent "backup withholding" under section 3406 of the federal IRC if certain criteria are met. However, gambling winnings are generally reportable on IRS form W-2G if the amount paid (less the wager) is at least $600 and at least 300 times the amount of the wager. Keno winnings (less the wager) of at least $1,500, and bingo and slot machine winnings (not less the wager) of at least $1,200 are reportable.

As a result, state and federal law do not treat patrons of the Detroit casinos equally. State law sets a lower withholding threshold than required under federal law and only applies to nonresidents. Legislation has been introduced that would bring some consistency between the state and federal taxation of gambling winnings.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to require the Detroit casinos to withhold a tax on the winnings of all individuals at the casino (both residents and nonresidents of Michigan). The bill would define "winnings" to mean proceeds from a wagering transaction that would be subject to withholding under Section 3402(q) under the federal Internal Revenue Code, if the winnings met the threshold amount in that section. (See above for a description of section 3402.)

MCL 206.351

BACKGROUND INFORMATION:

Gambling winnings of Michigan residents are subject to the state income tax to the extent that they are included in the federal adjusted gross income (AGI), which serves as the starting point for the calculation of Michigan income tax liability. The Income Tax Act (MCL 206.510) specifically excludes the first $300 of awards, prizes, lottery, bingo or other gambling winnings from the calculation of income for the purposes of determining the homestead credit.

Gambling losses can be deducted on an itemized federal return (Form 1040, Schedule A), but only up to the amount of any winnings. Losses cannot be deducted on a Michigan return.

ARGUMENTS:

For:

The bill brings some consistency between state and federal tax withholding requirements on gambling winnings at the Detroit casinos. State law requires the Detroit casinos to withhold a tax on a lower amount and on different types of winnings than is required under the federal Internal Revenue Code. In general, the federal withholding requirement applies to winnings of at least $5,000 if those winnings are least 300 times the amount wagered. The withholding requirement does not even apply to winnings from slot machines, bingo, or keno games (though it does in certain instances). The state withholding threshold is generally winnings of at least $600 that are at least 300 times the wager. In addition, the state withholding requirement does apply to winnings from slot machines, bingo, and keno games. Moreover, the federal withholding requirement applies to both residents and nonresidents alike, whereas the state withholding requirements applies only to nonresidents. This can be problematic for the casinos. For instance, if a non-resident wins $2,000 from a slot machine at a Detroit casino, the casino would not have to withhold a federal tax on those winnings, but would have to withhold a state tax.

In addition, the bill applies a withholding requirement to the winnings of state residents. Now, residents pay income tax on gambling winnings only to the extent they are included in the calculation of the federal adjusted gross income. If a taxpayer does not include these winnings in the federal return, they won't be included in the state return either, and the state receives no income tax revenue. By adding a withholding requirement, the bill collects the income tax at the casino.

Against:

The bill raises the withholding threshold on the winnings of nonresidents. Winnings from slot machines, bingo, and keno would no longer be withheld, nor would smaller winnings from other types of gaming activities. While the nonresidents would still be liable for all of their gaming winnings, collection becomes more difficult as this bill would negatively impact the chief means of enforcement. The withholding requirement was added to ensure that nonresidents would pay at least a portion of their Michigan tax liability. This bill requires them to pay a smaller amount of income tax to the state. Thus the bill has the potential to reduce state tax revenue.

POSITIONS:

The Department of Treasury opposes the bill. (5-18-04)

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