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BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment of)	
)	No. 96-151
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. . .)	Registration No. . . .
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RULE 131: SERVICE B&O TAX -- GAME OF CHANCE -- PULLTAB GAME -- TAXABLE INCOME MEASURED BY INCREASES -- DEDUCTIONS -- PAY OUTS -- COST OF GAME NOT DEDUCTIBLE. The business activity of operating nonmerchandising pulltab games, a game of chance, is subject to the Service B&O tax. The taxable income is measured by the "increases" defined as "the winnings, gains, or accumulations accruing from any one game over and above the amount put into the game by the operator." Deductions from the increases are allowed only for pay outs to winners. "The amount put into the game" does not include the cost of the game or any other expense of the operator.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Petition protesting the disallowance of the deduction of the cost of pulltab games from the gross receipts subject to tax.¹

FACTS:

Krebs, A.L.J. -- The taxpayer is engaged in the business of operating a restaurant, gift shop, golf course and tavern.

The Department of Revenue (Department) examined the taxpayer's business records for the period from January 1, 1990 through March 31, 1994. As a result of this audit, the Department issued the above-captioned tax assessment on October 26, 1994, asserting excise taxes due plus interest.

The taxpayer's protest involves Schedule III of the audit report where Service business and occupation (B&O) tax was assessed on disallowed deductions taken by the taxpayer from its pulltab (also spelled as

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

"pull tab" and "pull-tab") gambling income increases. The Department's Audit Division found that the taxpayer had deducted the entire cost of the pulltab games from its pulltab income, rather than only the allowed cash prize pay outs.

The taxpayer's protest is based on the following reasons and/or contentions:

(1) The cost of the pulltab game is an integral part of "the amount put into the game" per WAC 458-20-131 (Rule 131). Rule 131 gives two definitions for "increases," when only one would be necessary if pay outs, in whatever form, were the only deduction. This implies that there are other allowable deductions, as supported by the Tax Topics publication dated June 1992.

(2) Rule 131 provides for taxation on games of chance under which pulltabs clearly fall. However, for such taxation on games of chance, Rule 131 allows for deductions of "the amount put into the game by the operator."

(3) Gambling in the form of pulltabs is a unique type of business activity. As such, it does not fit into even the broad definitions of the statutes for imposition of the B&O tax and Service B&O tax activity (RCW 82.04.290); and does not fit into the definitions of "sales" or "income."

(4) Business activity is typically for profit, and the amounts received for products and services provided are controlled only by what the market will bear. Whether a profit or loss is realized from the business activity, the business owner/operator has control on what he/she charges for the product or service; and he/she can take into consideration any costs, taxes, or any expense that may be a part of the business activity. In the case of pulltabs, the taxpayer claims it is restricted by law as to what can be charged for a chance and how much can be derived from such activity.

ISSUES:

(1) With respect to pulltab games, are pay outs the only deductions allowed in computing the taxable "increases"?

(2) Does "the amount put into a game" include the cost of the game so as, in effect, to be a deduction from the taxable "increases"?

(3) Are gambling/pulltab game receipts within the definition of "sales" or "income" so as to be subject to the B&O tax?

(4) Where the taxpayer is restricted by law as to what it can charge for services and derive from his business activity, can it deduct costs, taxes or any other expense related to that business activity?

DISCUSSION:

Chapter 9.46 RCW, titled "Gambling - 1973 Act", has the following provisions which are pertinent to the discussion of the taxpayer's protest.

"Punch boards" and "pull-tabs" as used in this chapter shall have their usual and ordinary meaning and such definition may be revised by the Gambling Commission pursuant to rules and regulations promulgated pursuant to this chapter. RCW 9.46.0273.

The legislature hereby authorizes any person . . . or organization operating an established business primarily engaged in the selling of food or drink for consumption on the premises . . . to utilize punch boards and pull-tabs as a commercial stimulant to such business when licensed and operated pursuant to this chapter. RCW 9.46.0325.

The legislative authority of any locality may provide for the taxing of any gambling activity authorized by this chapter within its jurisdiction, provided that punch boards and pull-tabs shall have a fifty cent limit on a single chance thereon, and "shall be taxed on a basis which shall reflect only the gross receipts from such punch boards and pull-tabs." Taxation of punch boards and pull-tabs shall not exceed five percent of gross receipts. RCW 9.46.110.

Chapter 230-02 WAC has the following provisions which are pertinent to the taxpayer's protest.

"Gross gambling receipts" means the monetary value that would be due to any operator of a gambling activity for any chance taken. The value shall be stated before any deductions for prizes or any other expenses. WAC 230-02-110.

"Net gambling receipts" means all gross gambling receipts from any gambling activity less the monetary value or, in case of merchandise, the actual cost, of any prizes that were awarded. WAC 230-02-120.

An "operator" is any person who purchases or receives equipment for use in authorized gambling activities, including but not limited to punch boards or pull tabs. WAC 230-02-200.

A "pull tab" is defined as a single folded or banded ticket or is a card, the face of which is initially covered or otherwise hidden from view to conceal a number, symbol or set of symbols, a few of which numbers or symbols out of every set, have been designated in advance and at random as prize winners. A person pays some consideration to an operator for the opportunity to obtain a ticket or card and possibly obtain a prize winning pull tab. WAC 230-02-260.

Rule 131, in pertinent part, provides:

Games of chance other than merchandising games. Persons conducting dice games, card games, . . . or similar games of chance wherein players participate in such games with the opportunity of winning a certain sum of money, . . . are taxable under the service and other business activities classification upon all "increases" arising from the conduct of such games. The word "increases" as used herein means the winnings, gains, or accumulations accruing from any one game over and above the amount put into the game by the operator" . . . and, where redeemable scrip, trade checks, or hickies are issued to winning players, the word "increases" means the excess of the operator's cash income from the game over the amount of redeemable scrip, . . . issued.

. . .

Punchboards which offer cash prizes are games of chance . . . and the "increases" (as defined above) therefrom should be reported under the service and other business activities classification.

(Emphasis supplied.)

The issues will be discussed in the order presented.

(1) and (2) Definitions, increases, pay outs, and allowable deductions.

The operation of punchboards and pulltab games are gambling activities; that is, games of chance. RCW 9.46.110. WAC 230-02-110.

The taxpayer operated pulltab games -- a game of chance -- where the participating players had the opportunity/chance to win certain sums of money. The "increases" from the operation of such games of chance are subject to the Service B&O tax. Rule 131 gives two definitions for the "increases" from such non-merchandising games; that is, "the winnings, gains, or accumulations accruing from any one game over and above the amount put into the game by the operator," and "the excess of the operator's cash income from the game over the amount of redeemable scrip, trade checks or hickies issued" to winning players.

In this case, the taxpayer had deducted the entire cost of the pulltab games, and contends that such cost was part of the "amount put into the game" per Rule 131. We disagree. The "amount put into the game" is preceded by the words "winnings, gains," signifying that they are pay outs on amounts wagered. We find that the intended meaning of the term "increases" is not to take into account the cost amount of the game to the taxpayer, but rather to take into account solely what was paid out to winning players in the form of cash or cash equivalents. This is buttressed by the definition of "net gambling receipts" which allows only a deduction from gross gambling receipts for the monetary value or cost of prizes awarded. WAC 230-02-120. Accordingly, we conclude that the cost of the pulltab game is not deductible from the taxable "increases."

The Department's Tax Topics publication dated June 1992, in pertinent part, stated:

Punchboards and pulltabs which offer cash prizes are "games of chance." Persons operating games of chance are subject [to] the service . . . (B&O) tax on the "increases" derived from their games. "Increases" means the gross amount received from the game, less the cost of the game and the prizes distributed.

(Bracketed word and emphasis supplied.)

The foregoing article was corrected in the next Tax Topics publication dated September 1992 and headlined "Correction!!". The correction article, in pertinent part, stated:

The cost of punchboards and pulltabs games is not deductible

The . . . June 1992 issue of Tax Topics contains an article on page 2 which discusses the taxability of income derived from punchboards and pulltabs. The article states that tax is due on the "increases" and that the term "increases" means the gross amount received from the game, less the cost of the game and the prizes distributed. This definition is incorrect. The term "increases" means the gross amount received from the game, less only the prizes distributed. The cost of the game is not deductible from taxable income.

Contrary to the taxpayer's assertion, neither Rule 131 nor the corrected Tax Topics article implies that there are other allowable deductions from the increases.

(3) Gambling/pulltab game receipts within definition of "sales" or income; subject to B&O tax.

The taxpayer contends that gambling in the form of pulltab games, as a unique type of business, does not fit into the definitions of "sales" or "income." The taxpayer further contends that, as such, it is not subject to the Service B&O tax.

The B&O tax is a classic excise tax, intended to allow the government to "excise" its little bit of the coin of the domain each time it changes hands in a business transaction.

"Business" includes all activities engaged in with the object of gain, benefit or advantage to the taxpayer or to another person or class, directly or indirectly. RCW 82.04.150.

RCW 82.04.220 provides:

Business and occupation tax imposed. There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business.

With respect to the gambling/pulltab game activity, the taxpayer is clearly engaged in a business activity with the object of gain, benefit or advantage to itself. Consequently, the taxpayer is subject to the B&O tax. RCW 82.04.150 and RCW 82.04.220.

Because the gambling activity is not one for which there is a statute specifically designating the business activity and the measure of the tax, it is subject to the "catch-all" activity statute of "service and other business activities". RCW 82.04.290. The amount of tax on account of such activities is equal to the "gross income of the business" multiplied by the tax rate.

"Gross income of the business" is defined by RCW 82.04.080, in pertinent part, to mean:

. . . the value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . gains realized from trading in stocks, bonds, or other evidences of indebtedness, . . . fees, . . . and other emoluments however designated, all without any deduction on account of . . . the cost of materials used, labor costs, . . . taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

(Emphasis supplied.)

"Value proceeding or accruing" is defined by RCW 82.04.090 to mean "the consideration, whether money, credits, rights, or other property expressed in terms of money actually received or accrued."

In this case, the taxpayer receives money from its customer participating in the taxpayer's gambling/pulltab game business activity. The money received is "value proceeding" and becomes the "gross income" of the business activity subject to the Service B&O tax. We reject the taxpayer's contentions that its gambling income does not fit within the definition of income and is not subject to Service B&O tax.

(4) Punch boards and pulltab games have a fifty cent limit per single chance thereon. RCW 9.46.110. Because it is restricted by law as to what it can charge for a pulltab chance rather than what the

market will bear, the taxpayer believes it should not be restricted from deducting its costs, taxes or any other expense that may be a part of the business activity.

Whether or not the taxpayer makes a profit on the operation of pulltab games is immaterial to whether the taxpayer is engaged in business activities or is entitled to deductions from its gross income. The B&O tax is imposed on gross income regardless of profit or profit motive.

The Washington Supreme Court has never countenanced any deductions other than those expressly allowed by statute. Engine Rebuilders v. State, 66 Wn.2d 147, 401 P.2d 628 (1965). Canteen Service v. State, 83 Wn.2d 761, 522 P.2d 847 (1974). RCW 82.04.080 specifically does not allow deductions from the gross income of the business for costs of materials used (the pulltab game), taxes, any other expense or on account of losses. The Department lacks authority to grant those deductions even if the taxpayer's business is adversely affected by legal restrictions.

Not to be ignored is that the taxpayer, because it is engaged in the selling of food or drink for consumption on its premises, receives authority from the legislature to use punch boards and pulltab games as a "commercial stimulant" to such business of selling food or drink. RCW 9.46.0325. The negative of the restricted charge for a pulltab charge is balanced by or favored by increased sales of food or drink.

For the facts, reasons, and applicable law stated, we conclude that the tax assessment in question was proper and must be sustained.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 30th day of August 1996.