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memorandum

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subject: Discounted Casino Markers

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Casino =

ISSUE

How much income does Casino realize when a customer gambles, and loses, using a prenegotiated discounted marker?

CONCLUSIONS

The discounted amount of the marker, or net sales price, is the actual price paid by the customer for Casino's services, and Casino realizes only the discounted amount in income.

FACTS

Casino owns and operates a licensed gambling casino and, for federal income tax purposes, computes its income using an overall accrual method of accounting. In connection with its gambling operations, Casino routinely extends lines of credit to its premium players (hereinafter "customers") to encourage their continued patronage and to promote gambling at its facilities. Before extending credit, Casino reviews a customer's credit worthiness. At the time the credit is extended, the customer signs a promissory note payable to Casino, commonly referred to as a "marker." The marker generally is dated; states the customer's name, his bank's name, location, and account number; and contains the customer's instruction to its bank to pay Casino the amount of the credit extended to the customer. After the customer signs the marker, he may exchange it for gaming chips to gamble at Casino. When the customer finishes gambling, he is expected to settle (pay, as explained below) the discounted amount of his marker.

Most casinos compete with each other to obtain customers' business. One method Casino uses to attract customers' business is a "marker discount." A marker discount is a prearranged agreement between Casino and a customer, whereby Casino agrees to accept less than the face amount of the marker if the customer loses. The amount of the discount is a fixed percentage of the customer's losses. Customers know the amount of the discount they will receive before they begin gambling. However, Casino does not provide its customers with a formal written agreement acknowledging the discount. If the customer wins, the customer must pay the full face amount of the marker.

The customer's account will reflect the total amount of any markers signed by the customer until the markers are settled. The discounts given to a customer are computed on a daily basis, based on the customer's winnings and losses for the day. Discounts are then reported in Casino's daily operating report. At the end of the month, the discounts for all customers are aggregated and recorded in the general ledger via a journal entry. Casino records the undiscounted amount of its gambling winnings in gross revenues. Casino then debits Customer Credit Discounts, a contra-revenue account, and credits Anticipated Credit Discounts, a contra-asset account.

In all cases where Casino extends credit to a customer, the customer must sign a marker for the full amount of such credit, despite the discount agreement. However, if the customer loses, he can settle the marker for the prearranged discounted amount. When a credit marker is settled for less than the full face amount, Casino prepares a Discount Authorization Form required by the Nevada Gaming Control Board. The form is used to authorize all discounts from the credit marker held by Casino and to document the reason for the discount.

Casino has the legal right to enforce the full face amount of the marker until the customer settles the marker. However, Casino honors a customer's discount until the customer's receivable balance is written off. Casino generally will exhaust all civil remedies before turning the marker over to the local district attorney's office for criminal prosecution.

LAW AND ANALYSIS

Section 61 provides that gross income includes all income from whatever source derived. In Pittsburgh Milk Co. v. Commissioner, 26 T.C. 707 (1956), acq. 1962-2 C.B. 5, the Tax Court found that allowances were part of the sales transaction and concluded that gross income must be computed on the net agreed price for which the milk was actually sold. Thus, under Pittsburgh Milk, where the purpose and intent of the parties is to reach an agreed net sales price, the allowance is properly viewed as an adjustment to the purchase price that reduces gross sales in determining gross income. See also Rev. Rul. 82-149, 1982-2 C.B. 56.

In the instant case, Casino agrees to the discount to provide an incentive for the customer to gamble at Casino and to retain the customer's business. The discount is negotiated before the customer commences play. As in Pittsburgh Milk, the purpose and intent of the parties is to reach an agreed net sales price. Therefore, the discounted amount (net sales price) is the actual agreed price for the gambling services, and Casino is required to include only the discounted amount in gross income.

The possibility that Casino may attempt to collect the full amount of the marker if the customer fails to pay the agreed, discounted price does not change the (discounted) net sales price. Casino's allowance of the discount depends merely upon the customer incurring a gambling loss and not some later event. If Casino later collects an amount greater than the discounted amount, Casino must include the difference in gross income.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Justin G. Meeks at (202) 622-5020 if you have any further questions.