

Slot player's biggest gamble, with the IRS, pays off big

by Onell R. Soto

Frank Gagliardi is a gambler.

Does it for hours at a stretch. For days. Played right through the 9/11 attacks. A former girlfriend says he was so busy at the slots it took him two or three days to notice she had left him.

IT'S A GAMBLE - Gamblers must pay taxes on winnings minus losses. That led to a battle between one man and the IRS about whether he had properly accounted for his losses, which he was sure were more than his winnings. CNS Photo by Eduardo Conteras. He admits there have been stretches when he has gambled "every day I was awake." He doesn't know how many millions of dollars he has won and lost.

If pressed, Gagliardi will say the root of all this might be his 1991 Lotto win, the one that paid \$26.7 million.

But set that aside for a minute. Gagliardi's biggest gamble was with the Internal Revenue Service. He took the feds to Tax Court after they rejected three years of his tax returns, saying he couldn't prove the nearly \$2.5 million in gambling losses he claimed.

The IRS wanted more than \$1 million in back taxes and penalties.

Gamblers must pay taxes on winnings minus losses. Gagliardi and the IRS disagreed on whether he had properly accounted for his losses, which he was sure were more than his winnings.

The case turned out to be another Gagliardi jackpot. In January, a judge found Gagliardi's report of his massive losses credible and ruled against the IRS, establishing what likely is a national tax-law precedent.

Because of Gagliardi, gamblers can now back up their claims of losses with receipts and records. That is a significant change from the IRS' advice, which is often ignored, that bettors keep a written log of all gambling activity, said Alvin Brown, who was among the tax lawyers across the nation who highlighted the case on the Internet.

The IRS still recommends the gambling diary.

"It might not be a bad idea to keep that log," said IRS spokesman Raphael Tulino. "Anything you put on a tax return, you want to have substantiation for."

Like Gagliardi's other wins, however, the tax decision is unlikely to change what has defined his life for years - his compulsion for the slots.

CATCHING THE FEVER

Gagliardi, 46, wasn't always a big gambler. The bug didn't bite until well after Gagliardi, who was living in Riverside County, Calif., at the time, won what was then the fourth biggest jackpot in California Lottery history. He opted to take his winnings in 20 yearly payments of \$1.3 million.

While drawing more than \$666,000 a year - his now-ex-wife gets the other half - he lived the high life for several years.

Summers in the tropics, winters on the ski slopes. After his marriage broke up, he moved home to San Diego County and bought a mansion.

Then, a dying friend visiting from out of town asked for a favor. Can we go to the casinos?

Gagliardi loved the slot machines.

Soon, he couldn't stop himself. He gambled \$10 or so per spin, five spins a minute.

If he won - and often he did - he would put the jackpot money right back into the machines and gamble it all.

"I hit jackpots all the time," he said. "It doesn't even make me smile anymore."

When the IRS eventually targeted him, his lottery stake gave Gagliardi the means to pay for high-priced lawyers and expert witnesses.

They were able to prove to a Tax Court judge that yes, Gagliardi is a pathological gambler and loses hundreds of thousands of dollars a year at the casinos.

"He had to spend a lot of money to substantiate his losses," said his lawyer, Eric Swenson, who tried the case with another lawyer, Allison Cato.

A judge examined Gagliardi's life to see whether it was true he gambled all the money he got at the casinos - millions withdrawn from ATMs, by cashed checks or received as slot machine jackpots.

It was a trial complete with a psychologist describing how out-of-control gamblers think, and a math expert giving the lousy odds that chronic gamblers face, plus testimony from the former girlfriend about romance foiled by the slots.

During his trial, Gagliardi described his gambling like it was a job. He would wake at his 6,000-square-foot home, pick up coffee at a 7-Eleven and hit the slot machines at tribal casinos for hours, sometimes days.

"To the casino and back, that's about it," he said of his life.

THE ROAD TO EASY STREET

Gagliardi grew up in the San Diego area. He dropped out of high school just short of graduation and worked a couple of years as a machine operator at Buck Knives.

By 29, when he hit the Lotto, he was married with a 21-month-old son and a daughter on the way, living in

Riverside County and driving a truck cross-country to military and trade shows.

The excitement of winning was such that he didn't know what to do. Gagliardi and his wife stayed at a hotel with the ticket in a closet safe, and didn't leave the room.

"We couldn't sleep," he told a reporter in 1995.

When the enormity of the win - \$1.3 million a year for 20 years - sank in, they bought a Mercedes-Benz and moved to Marin County north of San Francisco.

They got a financial planner, set up trust funds for the children.

"We pretty much saved most of it," he said.

But the money didn't solve long-standing marital troubles, and they split a couple of years later, each getting half of the lottery winnings.

Gagliardi moved back to San Diego County and moved into the a huge home he bought for \$850,000.

In 1995, when The San Diego Union-Tribune wrote a story about lottery winners, he described life on Easy Street.

"I can do whatever the hell I want," he said, chuckling. "And that's how it works out. If I want to go to the beach, I go to the beach. ... Right now, ski season is coming. When ski season comes up, I'm hardly ever here."

His life changed the next year when his friend asked to visit the casinos.

The trips to tropical places and ski slopes stopped.

"It's not like that now," Gagliardi said during his trial, describing how he takes out thousands of dollars from ATMs and plows winnings back into the slot machines.

"I never won - I mean, I might have won a bunch on paper, but I didn't ever walk out of there with the money," he testified. "I could wallpaper my bathrooms with just ATM receipts for millions of dollars."

In 2000, he gave those receipts to his accountant to file his 1999 taxes, along with the tax forms the casinos gave him every time he won more than \$1,200 on any given bet.

Then he waited to file his 2000 and 2001 taxes until 2003, figuring he would have a refund due from the IRS; he saw it as a "forced" savings account.

"Every time I got my check back from doing my taxes, I went straight to the casino with that money," he said during the trial.

Gagliardi claimed nearly \$2.5 million in gambling losses over three years, backed up, primarily, by his account that he gambled every dollar he obtained in a casino, whether from a jackpot, an ATM or a check.

"This is not the way the government can do business, simply relying on people's words," IRS lawyer Michael Hensley argued.

'UNTIL HE DIES'

But it wasn't simply Gagliardi's word that proved what happened, said Swenson, his lawyer.

Swenson had psychologist Suzanne Graupner Pike, who runs the San Diego Center for Pathological Gambling, examine Gagliardi.

Pike said Gagliardi has an impulse-control condition, akin to kleptomania or incessant hair pulling, in which people can't stop themselves from gambling.

Part of Gagliardi's dilemma is that, as with many problem gamblers, he's sure he's just a win away from erasing all his losses. That might be easier for him to believe because he has already won big.

"It's a mental illness," Pike testified.

Even though he hasn't lost all of his money and has money set aside to take care of his children and his bills, he is in trouble, Pike said.

Without treatment, she said, "Mr. Gagliardi will gamble until he dies or loses his last penny."

His former girlfriend, Susan Serum, testified that their "dates" often consisted of him taking her to the casinos, where he would give her money to gamble, but he would spend his time at the machines.

Eventually, Serum had enough.

"I didn't have a relationship with him," she told the judge. "I mean, he just was never there. I don't even think he knew I moved out for two or three days."

Through his incessant playing, Gagliardi has stacked the odds against himself, said Mark Nicely, who figures out the math behind slot machines.

While the math can be complicated, the concept isn't hard to grasp, said Nicely, who works for WagerWorks, a subsidiary of slot maker IGT.

Slot machines take in more money than they spit out. That's what makes them profitable.

The exact amount that machines keep isn't spelled out by local casinos, but Nicely cited estimates that slots pay out no more than 90 percent of what is bet in them.

On any single spin, the chances of hitting a jackpot are small, but it is possible to win big. An occasional gambler can come out ahead. But the more you gamble, the less likely you are to do that or even break even.

"If you play long enough, even on a 98 percent game, your chance - your probability of being ahead - tends to zero," Nicely testified.

Someone gambling as Gagliardi does - more than 400,000 spins a year - is sure to lose, he said, calling the probability of coming out ahead "infinitesimal" and "incalculable."

Gagliardi said recently that he knows he's in trouble.

"If I keep gambling I'm going to lose all my money," he said. "I'm just trying to stay away from that place as much as I can."

He said he works on his house to keep busy and is doing odd jobs, so he doesn't go to the casinos as much as he used to.

He hasn't signed up for programs designed to exclude problem gamblers from San Diego County casinos - he says they are ineffective anyway - and he isn't seeking treatment right now.

He knows the lottery checks will stop in a couple of years.

"If I don't go crazy gambling, I should be all right," he said.

The urge to bet isn't easy to overcome.

"I still go," Gagliardi said. "I went yesterday."

He couldn't explain why.

"I don't know what it is. It's an addiction I want to kick," he said. "It's not about the money."

Pressed further, he said he went when he was bored, and recalled that multimillion-dollar win.

"Maybe I'm trying to find that big hurrah again," he said. "But it's not going to happen again."

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