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THE EVOLUTION OF THE PHRASE "TRADE OR BUSINESS": FLINT V. STONE TRACY COMPANY TO COMMISSIONER V. GROETZINGER—AN ANALYSIS WITH RESPECT TO THE FULL-TIME GAMBLER AND THE INVESTOR*

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I. INTRODUCTION

The phrase "trade or business" appears a total of 1,138 times throughout the Internal Revenue Code, the Treasury Regulations and the Proposed Regulations.[1] Although it is undoubtedly one of the most commonly used terms in federal taxation,[2] it is not defined anywhere in the legislative history, the Internal Revenue Code or the Regulations.[3] Rather, the courts have been left with the task of formulating the proper definition.

The judicial development of a definition for the term "trade or business" has been slow to emerge. Although the courts were first presented with the phrase over seventy-five years ago[4] and have had several opportunities to define the term since that time, to date no precise definition has been developed.[5] Several reasons can be offered to explain why the judiciary has been unable to articulate an all encompassing definition for the phrase "trade or business."

This article analyzes the judicial development of the phrase

1. The phrase "trade or business" appears in the Internal Revenue Code (I.R.C.) 357 times; in the Treasury Regulations 706 times; and in the Proposed Regulations 75 times. This information was compiled pursuant to a key-word computer search using the Lexis Federal Taxation data base.

2. All references to Sections, unless otherwise indicated, are made with respect to the Internal Revenue Code of 1986 and the regulations promulgated by the Secretary of the Treasury thereunder.

3. *See, e.g.*, Groetzinger v. Commissioner, 107 S. Ct. 980, 983 (1987). As the Court recognized, the term has been defined for very limited purposes not relevant to our inquiry. *See* I.R.C. §§ 355(b)(2), 502(b), 513(b) and 7701(a)(6).

4. Flint v. Stone Tracy Co., 220 U.S. 107 (1911).

5. *See infra* Section II. Historical Analysis.

"trade or business" as it appears in the Internal Revenue Code ("Code") and Treasury Regulations ("Regulations"). In order to make coverage of this expansive topic manageable, all analysis has been devoted to the term as it is used in Section 162, its predecessor provisions and other sections which have adopted the phrase in the same context.[6] For purposes of illustrating each of the standards which have evolved, this author has chosen to concentrate on two different taxpayers: the full-time gambler and the full-time investor.

To facilitate an understanding of the current state of the law, special emphasis has been placed on the Supreme Court's recent decision in *Commissioner v. Groetzinger*.[7] Accordingly, an analysis of the holdings of the Tax Court, Seventh Circuit Court of Appeals and the Supreme Court in that case have been incorporated in this article. Moreover, a critical examination of the dissent of Justices White, Rehnquist, and Scalia has also been included in the discussion. The ultimate goal of this article is to accurately illustrate and critique the analysis which is currently employed by the judiciary to determine whether a taxpayer is engaged in carrying on a trade or business for the purposes of federal taxation.

The term "trade or business" in and of itself is extremely broad and arguably not subject to precise definitional parameters. Moreover, the phrase appears in several different contexts throughout the Code and Regulations, making it even more difficult for the courts to formulate any universal guidelines or definitional boundaries. For example, in order for expenses to be deductible under Section 162, they must have been incurred in "carrying on a trade or business." In addition, as a threshold to obtaining special-use valuation for purposes of computing the gross estate of a decedent under Section 2032A, the taxpayer's property must have been used in an "active trade or business." Finally, in order for research and development expenditures to be deductible under Section 174, they must have been incurred in "connection with a

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6. Although the phrase "trade or business" is used in several sections of the Code, for purposes of this article, unless otherwise indicated, all references to the phrase refer to the context in which it is used in I.R.C. §§ 62, 162, 165 and 1402. The courts have determined that the term should be given the same meaning in each of these sections. *See, e.g., Groetzinger*, 107 S. Ct. at 988 n.6.

7. *See supra* note 3.

trade or business."

With the foregoing contextual differences in mind, it is not difficult to understand why the judiciary has struggled to develop an all-purpose definition for the term "trade or business." The struggle has been further perpetuated by the Supreme Court's failure to provide the lower courts with any sufficiently clear guidelines by which they could determine whether a taxpayer is engaged in a trade or business. The Court's opinions have been somewhat vague and have never articulated in other than very general terms what constitutes a trade or business. Accordingly, because the lower courts have interpreted the Supreme Court's decisions in many different ways, relatively divergent standards have been developed.[8] The two prominent tests which have emerged are the "goods or services" approach first pronounced by Justice Frankfurter in *Deputy v. DuPont*,[9] and the "facts and circumstances" approach expressed by Justice Reed in *Higgins v. Commissioner*.[10]

Under the "facts and circumstances" test, the court is required to undertake an analysis of all the facts and circumstances of each case. Although no one fact is decisive, focus is placed on the taxpayer's intent to earn a livelihood, and the regularity, continuity, and substantiality of his activities. Other than these broad considerations, the test consists of virtually no parameters.

The courts which have adopted the "goods or services" test, like those adopting the "facts and circumstances" test, look at all the facts and circumstances of each case. Under this approach, however, if the taxpayer is not engaged in offering goods or services to others, he will automatically be denied trade or business status. Although this standard can be just as nebulous in application as the "facts and circumstances" test, the goods or services requirement is appealing because its all or nothing character can serve to simplify the trier of fact's job.

Ironically, these two different approaches create the same result in all but two situations. In the first of these scenarios, the case of the investor, it appears that no matter how extensive his activities, the investor will never be considered as carrying on a

8. *See infra* Section II. Historical Analysis.
9. 308 U.S. 488 (1940).
10. 312 U.S. 212 (1941).

trade or business. Thus, the investor is a carve-out under either test. The second of these scenarios, the case of the full-time gambler, however, receives drastically divergent treatment depending upon which test is utilized. Since the gambler does not generally offer goods or services to others, the courts which have adopted the "goods or services" test deny him trade or business status. On the other hand, those courts which have adopted the "facts and circumstances" approach accord the gambler trade or business status.

Due to the inconsistent treatment of the gambler, a vast amount of scholarly[11] and judicial[12] discourse has been devoted to the development of a universal definition for the phrase "trade or business." Nevertheless, no complete solution to this problem has been developed. Just recently, however, the Supreme Court was presented with the case of *Commissioner v. Groetzinger*.[13] The facts of this case afforded the Court an opportunity to clean the slate of any prior misconceptions and pronounce a precise definitional standard by which the lower courts will be able to consistently resolve the trade or business issue. The Court, however, failed to sieze the opportunity. Rather, while renouncing the "goods or services" test, the Court simply concluded that the "facts and circumstances" approach must be implemented on a case by case basis to determine trade or business status. By adopting the "facts and circumstances" test, the Court removed the possibility of future inconsistent treatment with respect to the gambler. It did not, however, attempt to formulate any universal guidelines for determining trade or business status. Thus, the judi-

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11. *See, e.g.*, Saunders, *"Trade or Business," Its Meaning Under the Internal Revenue Code*, 1960 So. CALIF. TAX INST. 693; Freed, *Factors That Will Establish That a Taxpayer's Activity Constitutes a Trade or Business*, 31 TAX'N FOR ACCTS. 90 (1983); Note, *On Deducing a Deductible Loss: The Continuing Search for an Appropriate Legal Standard in Dreicer v. Commissioner and Snyder v. United States*, 15 CONN. L. REV. 847 (1983); Callison, *Tax Aspects of Computer Software Development*, 13 COLO. LAW 959 (1984); Lopez, *Defining "Trade or Business" Under the Internal Revenue Code: A Survey of the Relevant Cases*, 11 FLA. ST. U.L. REV. 949 (1984); Note, *The Trade or Business Issue: Can A Gambling Loss be Considered a Business Loss?*, 19 SUFFOLK U.L. REV. 906 (1985); Haller, *The Business of Betting: Proposals for Reforming the Taxation of Business Gamblers*, 38 TAX LAW. 759 (1985); Comment, *Continuing Vitality of the "Goods or Services" Test*, 15 U. BALT. L. REV. 108 (1985); Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. CIN. L. REV. 1199 (1986); Boyle, *What is a Trade or Business?*, 39 TAX LAW. 737 (1986).

12. *See infra* Section II. Historical Analysis.

13. *See supra* note 3.

ciary's struggle to develop a definition continues to exist.

II. Historical Analysis

A. *United States Supreme Court*

The debate over what constitutes a "trade or business" for purposes of federal taxation is not contemporary in origin. In fact, the issue was addressed by the United States Supreme Court as early as 1911 in *Flint v. Stone Tracy Company*.[14] In *Flint*, the Court was asked for the first time to determine whether a taxpayer was engaged in "business" within the meaning of a federal tax statute.[15] The statute before the Court was the Corporation Tax Law of 1909.[16] After determining its constitutional validity,[17] the Court went on to examine whether Section 38 of the statute was applicable to the petitioning taxpayer. Section 38 of the Corporation Tax Law of 1909 utilized the language "carrying on or doing business."[18]

In order to resolve this issue and determine whether the law applied to the taxpayer, the Court recognized that it had to ascertain whether he was engaged in "business" within the meaning of the statute. Finding no definition of the term in the statute or the legislative history, and no guidance from prior judicial decisions, the Court was forced to formulate its own definition. It determined, as a matter of proper statutory construction, that the plain

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14. 220 U.S. 107 (1911).

15. *See* Von Baumbach v. Sargent Land Co., 242 U.S. 503, 515 (1917). The Court acknowledges that the issue was first addressed in Flint v. Stone Tracy Co., 220 U.S. 107 (1911).

16. 220 U.S. 107, 142 (1911).

17. *Id.* at 167.

18. *Id.* at 143-44. Section 38 of the Corporation Tax Law of 1909 provided in pertinent part:

> That every corporation, joint stock company or association for profit . . . and engaged in *business* . . . shall be subject to pay annually a special excise tax with respect to *the carrying on or doing business* by such corporation, joint stock company or association . . . equivalent to one per centum upon the entire net income over and above five thousand dollars. . . . (Emphasis added).

Although the tax was an excise tax imposed for doing business in corporate form, it was, for all practical purposes, simply an income tax. It was in no way different than successor corporate tax provisions in the Internal Revenue Code. *See* Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199, 1205-06 (1986).

meaning of the term should be adopted.[19] With this in mind, the Court looked to *Black's* and *Bouvier's* law dictionaries.[20] Justice Day, writing the majority opinion, concluded that " '[b]usiness is a very comprehensive term and [its ordinary meaning] embraces everything about which a person can be employed' . . . [it includes] '[t]hat which occupies time, attention, and labor of men for the purpose of a livelihood or profit.' "[21]

The Court's definition of the term "business" received continued acceptance for purposes of interpreting the Corporation Tax Law of 1909.[22] It was not, however, widely adopted for the purpose of defining the term as it was used in other federal tax statutes.[23]

In *Deputy v. DuPont*,[24] the Court was once again presented with the "trade or business" issue. This case, however, involved a different federal tax statue than the one presented in *Flint*.[25]

In 1919, a 10% shareholder of E.I. DuPont de Nemours & Company (DuPont) borrowed a block of Dupont stock from Christiana Securities Company (Christiana).[26] Under an agreement with Christiana, the taxpayer agreed to repay the stock in kind within ten years.[27] He also agreed to repay an amount equivalent to all dividends declared during the loan period.[28]

Just prior to the time when repayment was due, because the taxpayer still did not have a sufficient number of shares readily available to meet the pending obligation, he entered into an arrangement with another shareholder whereby he borrowed the exact amount of DuPont stock needed to repay Christiana.[29] Like the

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19. 220 U.S. at 144.
20. *Id.* at 171.
21. *Id.* (citing BLACK'S LAW DICTIONARY at 158 and BOUVIER'S LAW DICTIONARY at 273.)
22. See *supra* note 15, at 515-16.
23. *See infra* notes 109-83 and accompanying text.
24. 308 U.S. 488 (1940).
25. *Id.* at 490. The statute before the Court was Section 23 of the Revenue Act of 1928. Although the text of this statute differs from that of Section 38 of the Corporation Tax Law of 1909, there is no indication from a reading of both statutes that Congress intended to give the term "business" any different meaning than that which the term ordinarily receives in everyday speech. Moreover, there is nothing in the legislative history of either statute that would guide us to a different conclusion.
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.*

original loan arrangement, he agreed to repay the subsequent lender in kind within a specified period of time.[30] The taxpayer also agreed to pay the lender an amount equivalent to all dividends declared during the loan period and to reimburse the lender for all taxes accrued against it as a result of the agreement.[31]

The taxpayer sought to deduct a portion of the foregoing loan expenses pursuant to Section 23 of the Revenue Act of 1928, which limited deductibility to those items directly incurred by a taxpayer in "carrying on a trade or business."[32] Asserting that the taxpayer had not incurred the subject expenses while engaged in a trade or business, the Commissioner denied the deductions.[33] Thereafter, the taxpayer filed suit.[34]

Based upon the taxpayer's extensive financial interest in the company, the lower court concluded that his activities constituted the business of "conserving and enhancing" an estate.[35] Thus, the foregoing expenses were held to be deductible under Section 23 since they were incurred in carrying on the taxpayer's business.[36]

On certiorari, the Commissioner contended that the lower court had erred and again asserted that the taxpayer's activities did not constitute a trade or business.[37] Therefore, the Commissioner argued that the expenses were nondeductible.[38] The Court, however, provided no comment on the Commissioner's position. Rather, it found it unnecessary to analyze the trade or business

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30. *Id.*

31. *Id.*

32. *Id.* Note that Section 23(a) of the Revenue Act of 1928 limited the deductibility of items to those that were ordinary, necessary and directly connected with the taxpayer's trade or business. This is a predecessor of I.R.C. § 162. At that time, there was no equivalent of I.R.C. § 212. *See* Burnet v. Clark, 287 U.S. 410 (1932).

33. 408 U.S. at 493.

34. *Id.*

35. *Id.* The lower court relied on the dictionary's definition of "trade or business" and concluded that it means "that which busies or engages time, attention or labor as a principal serious concern or interest; any particular occupation . . . for livelihood or gain." Deputy v. Dupont, 103 F.2d 257 (3d Cir. 1939).

36. 308 U.S. at 493.

37. *Id.*

38. *Id.* The Court concluded that the items would not have been deductible even if the taxpayer had been engaged in a trade or business within the meaning of the statute. Its conclusions were based on two grounds: 1) The expenses were not incurred in the taxpayer's business; and 2) the expenses were not ordinary and necessary as specifically required by the statute. *Id.* at 494-95.

issue.[39] The Court concluded that the subject expenses would not have been deductible even if the taxpayer's activities had constituted a trade or business.[40] Therefore, the majority of the Court never reached the issue of what constitutes a trade or business within the meaning of Section 23 of the Revenue Act of 1928.[41]

In a concurring opinion, however, Justice Frankfurter decided to deal with the "trade or business" issue.[42] Without any reference to the Court's earlier decision in *Flint v. Stone Tracy Company.*,[43] he concluded that incurring expenses in the active management or conservation of one's own financial interests alone will never constitute carrying on a trade or business.[44] Moreover, without elaboration or citing any authority, Justice Frankfurter stated that carrying on a trade or business within the meaning of Section 23 requires the selling of goods or services to others.[45]

With the foregoing sweeping statement came the birth of what is commonly referred to as the "goods or services" test.[46] Although the test appears simple, its lack of legislative or judicial support has created conflict among the courts. Accordingly, the validity of Justice Frankfurter's statement has been a constant matter of judicial and scholarly debate.[47]

While the majority opinion in *DuPont* did not directly address the "trade or business" issue, it did acknowledge that as a matter of proper statutory construction, the Court should adopt the term's plain meaning.[48] In fact, the Court stated: "[W]hen it comes to construction of the statutory provision under which the deduction is sought, the general rule that 'popular or received impact of words furnishes the general rule for the interpretation of public

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39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 499.
43. *See supra* notes 14-21 and accompanying text.
44. 308 U.S. at 499. *See also* Snyder v. Commissioner, 295 U.S. 769 (1935). In *Snyder*, the Supreme Court concluded that an individual who dealt in securities for his own personal account was not a "trader" and therefore not engaged in "business" within the meaning of the federal tax statute.
45. 308 U.S. at 499.
46. *See infra* notes 109-138 and accompanying text.
47. *Id.*
48. 308 U.S. at 493.

laws.' "[49] Therefore, it is arguable that by this statement the majority affirmed the earlier holding in *Flint* and extended its application to the interpretation of Section 23 of the Revenue Act of 1928.

In *Higgins v. Commissioner*, decided one year after *DuPont*, the Court removed all doubt and made it clear that it was not their intention to extend the *Flint* decision beyond its application to the Corporation Tax Law of 1909.[50] Rather, the Court explained that it intended to adopt a much narrower definition of the term "trade or business" for purposes of the subject tax statute.[51]

Higgins involved a taxpayer who held extensive investments in real property, bonds and stocks.[52] He devoted considerable amounts of time to overseeing these interests.[53] In fact, the taxpayer even hired associates to assist him at this endeavor. Moreover, to carry on these operations, he maintained offices in both France and the United States.[54] Pursuant to Section 23 of the Revenue Act of 1932,[55] the taxpayer claimed deductions for the salary expenses and other costs incurred in carrying on his investment activities.[56]

The Commissioner did not dispute that the expenses incurred with respect to the taxpayer's investment activities were "ordinary and necessary" and did not question the deductibility of the items solely attributable to the real estate activities.[57] He did, however, contest the deductibility of those expenses attributable to the taxpayers portfolio investments.[58] The Commissioner asserted that the activities relating to Mr. Higgin's stock portfolio were personal and no matter how extensive, could never constitute a trade or

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49. *Id.*

50. 312 U.S. 212, 217 (1941), *reh'g denied*, 312 U.S. 714 (1941).

51. *Id.* This case involved Section 23(a) of the Revenue Act of 1932 which provided for the deductibility of all ordinary and necessary expenses incurred in carrying on any trade or business. *See infra* note 55.

52. 312 U.S. at 213.

53. *Id.*

54. *Id.* at 213-14.

55. Section 23(a) of the Revenue Acts of 1928 and 1932 are identical. *See* BARTON, FEDERAL INCOME, ESTATE & GIFT TAX LAWS 35 (1938).

56. 312 U.S. at 213.

57. *Id.* at 214.

58. *Id.* at 214-15.

business.[59] Thus, it was the Service's contention that the expenses were nondeductible.[60] The Board of Tax Appeals upheld this position and the Second Circuit affirmed.[61]

On certiorari, the Supreme Court acknowledged that the term "trade or business" was not defined anywhere in the statute and therefore sought to resolve the issue.[62] The taxpayer, relying on *Flint*, argued that the term should be defined by its ordinary meaning—that of an occupation—an attempt to earn a livelihood.[63] The Court, however, refused to apply the earlier definition because it was formulated for a different statute. The Higgins Court stated that: "A definition given for such an issue is not controlling . . . [a] dissimilar inquiry."[64] Yet, the Court never explained how the inquiry in the two cases differed.[65] Moreover, no authority was cited to support the Court's implicit conclusion that Congress intended the term "business" to take on a different meaning in each of the subject statutes.[66] Furthermore, it never actually formulated a specific definition for the term.

Without any reference to Justice Frankfurter's concurring opinion in *DuPont*, the Court concluded that in order "[t]o determine whether activities of a taxpayer are 'carrying on a business' requires an examination of the facts of each case."[67] Analyzing the facts of the instant case, the Court emphasized that the taxpayer merely kept records and collected the return accruing from his in-

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59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.* at 217.
64. *Id.* The Court's reasoning is not logical. In both statutes, the term "business" is used in the same context. In both cases, the Treasury had not promulgated Regulations and the Statute did not define the term. Thus, it is arguable that the ordinary meaning should have been adopted in *Higgins* as it was in *Flint*.
65. *Id.*
66. *Id.*
67. *Id.* This case was decided less than one year after *DuPont*, yet there is no reference to Justice Frankfurter's concurrence. In fact, Justice Frankfurter joined the majority in *Higgins* and still there is no reference to the "goods or services" test. One could argue that this oversight was intentional and constituted a movement to reject the earlier position. However, it is equally tenable, because the taxpayer in *Higgins* was not engaged in offering goods or services to others, that the Court impliedly upheld the "goods or services" test when it emphasized that the facts presented cannot, as a matter of law, constitute a trade or business.

vestments.[68] No matter how large the estate or how expansive the operations, as long as the taxpayer is merely caring for his own investments, the Court concluded that, as a matter of law, such activities will not constitute a trade or business.[69] Beyond this, however, the Court did not provide any real guidance as to what actually constitutes a trade or business within the meaning of the subject federal tax statute.

Less that two months after deciding *Higgins*, the Court was presented with the companion cases of *City Bank Trust Company v. Helvering*[70] and *United States v. Pyne*.[71] The issue in both of these cases once again was whether the taxpayer was engaged in a trade or business within the meaning of a federal tax statute. With these cases, the Court firmly entrenched its conclusion that an investor, no matter how extensive his activities, is not engaged in carrying on a trade or business.

In *City Bank Farmers Trust Company*, the petitioner was the trustee of two testamentary trusts.[72] He actively managed the investments of the trusts which were created primarily for the support and education of the grantor's family.[73] The ultimate question before the Court was whether the petitioner's activities as trustee were sufficient to place the trust within the realm of carrying on a trade or business for purposes of Section 23 of the Revenue Act of 1928.[74] Without any elaboration, the Court concluded that the trustee's activities were virtually identical to those of the taxpayer in *Higgins*. Thus, it held that the trust was not engaged in a trade or business and therefore was not entitled to deduct its expenses pursuant to Section 23 of the subject tax statute.[75]

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68. *Id.* at 218.

69. *Id.* Due to *Higgins*, Congress enacted I.R.C. § 23(a)(2) (now I.R.C. § 212). Congressman Disney expressed the disenchantment with *Higgins* when he said: "[s]ince the income from such investments is clearly taxable, it is inequitable to deny the deduction of expenses . . ." attributable thereto.

70. 313 U.S. 121 (1941).

71. 313 U.S. 127 (1941).

72. 313 U.S. at 123-25. Referring to Sections 161 and 162 of the Revenue Act of 1928, the Court concluded that the same rules apply to individuals as well as trusts or estates.

73. *Id.* at 214.

74. *Id.*

75. *Id.* at 126. This holding was followed by the Court over twenty years later when presented with similar facts. *See* United States v. Gilmore, 372 U.S. 39, 44-45 (1963).

The Court was presented with similar facts in *United States v. Pyne*.[76] The only real distinction that can be drawn between the two cases is that *Pyne* involved the activities of the executor of an estate rather than the trustee of a trust.[77] Like the taxpayer in *Higgins* and trustee in *City Bank Farmers Trust Company*, the executor's activities revolved solely around managing the investments of the estate. Following its prior holding in *Higgins*, the Court concluded that the estate was not engaged in carrying on a trade or business.[78]

Again, the Court determined that the taxpayer was not engaged in a "trade or business." Yet, it still was unable to provide a definition for the term. The only guidance which can be discerned from the foregoing cases is that a taxpayer who solely manages his own passive investments, even if he retains others to assist him in such endeavor, will not be considered engaged in a trade or business for purposes of federal taxation. Whether other activities of a taxpayer could constitute a trade or business was left open for debate.[79] Almost twenty-five years elapsed before the Court attempted to readdress the issue in any detail.

In *Whipple v. Commissioner*, the Court was asked to determine whether a taxpayer was engaged in carrying on an trade or business within the meaning of Section 23 of the Revenue Act of 1939.[80] In that case, the taxpayer, an individual, was actively involved in the formation of several businesses.[81] In 1951, he secured a franchise entitling him to produce and distribute certain beverages in Texas.[82] The taxpayer also purchased a bottling business to

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76. 313 U.S. at 129.

77. *Id.*

78. *Id.* Note, this case involved Section 23(a) of the Revenue Act of 1934. It is identical to the same section of the 1928 and 1932 Acts. *See* BARTON, FEDERAL INCOME, ESTATE & GIFT TAX LAWS 34-35 (1936).

79. Some courts have adopted the "goods or services" test as enunciated by Justice Frankfurter in *Dupont*, while others have adopted the term's plain meaning or a derivation thereof with emphasis on an analysis of each case's facts and circumstances. *See infra* notes 109-84 and accompanying text.

80. 373 U.S. 193 (1963), *reh'g denied*, 374 U.S. 858 (1963). Note, this case involved Section 23(k)(1) of the Revenue Act of 1939. This section is the predecessor of I.R.C. § 166. For purposes of our analysis, the term "trade or business" is used in the same context in Section 23 of the 1924, 1928, 1932, 1934 and 1939 Acts. *See supra* note 79; *see also* BARTON, FEDERAL INCOME, ESTATE & GIFT TAX LAWS 73-75 (1944).

81. 374 U.S. at 195.

82. *Id.* at 195-96.

facilitate production.[83] Thereafter, he sold the equipment of the bottling business to a corporation which he had previously organized and currently held eighty percent ownership.[84] In 1952, the taxpayer purchased land and built a bottling plant which he leased to the corporation.[85] To help the corporation through its early years, he extended it sizable loans.[86] The corporation, however, never repaid any of the principle, nor did it make any of the interest payments on the loans.[87] Moreover, it never made any of the rent payments due pursuant to the lease and never paid the taxpayer for his assistance.[88]

In 1953, the taxpayer decided to deduct as bad debt approximately $57,000 of the amount due from the corporation but which remained unpaid.[89] This deduction was made pursuant to Section 23(k) of the Revenue Act of 1939. The statute required that in order for the debt being discharged to be deductible it had to have been created by the taxpayer in carrying on trade or business.[90] It was the taxpayer's position that he was in the trade or business of promoting corporations and that the debt had been created therein.

The Commissioner disallowed the deduction. He contended that the debt had not been created by the taxpayer in carrying on a trade or business.[91] Like the investor in *DuPont*, the taxpayer was merely acting to enhance his investment in the corporation. Never did he expect any return other that that which all shareholders expected. Agreeing with this conclusion, the Tax Court upheld the Commissioner's ruling.[92] It also concluded that the taxpayer was not in the business of "organizing, promoting, managing or financing corporations, of bottling soft drinks or of general fi-

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83. *Id.* at 196.
84. *Id.* at 196-97.
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.* The facts are unclear whether the taxpayer was also an employee of the corporation or whether he had entered into some other agreement whereby he was supposed to advise and assist the business. Moreover, there are no facts to indicate that the taxpayer was ever to be paid for his services.
89. *Id.* at 196.
90. *Id.*
91. *Id.*
92. *Id.*

nancing or money lending."[93] The Fifth Circuit affirmed.[94]

On certiorari, the Court reiterated its earlier holdings in *Higgins* and *DuPont*.[95] It concluded that the taxpayer's activities appeared to be no different than those of the investor in *DuPont* or *Higgins*.[96] In fact, the Court stated: "Absent substantial additional evidence, furnishing management and other services to a corporation for a reward not different from that flowing to an investor in those corporations is not a trade or business. . . ."[97] The activities of Mr. Whipple appeared to be purely for the enhancement of his investment. The lower courts were unable to ascertain any ulterior motive for his activities. This was especially true since the taxpayer did not receive any compensation for his assistance aside from the return on his investment which all other shareholders also expected and received. Therefore, it was the Court's conclusion that the debt which Mr. Whipple sought to have discharged was connected with his investments and not any trade or business.[98] As in its prior decisions, the Court still was unable to express a specific definition for the term "trade or business." It did state, however, that:

> Devoting one's time and energies to the affairs of a corporation is not of itself, and without more, a trade or business of the person so engaged. Though such activities may produce income, profit or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is generated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of the investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. Even if the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from activities peculiar to an investor concerned with, and participating in, the conduct of the corporate business.[99]

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93. *Id.*
94. *Id.*
95. *Id.* at 199-202.
96. *Id.* at 201-04.
97. *Id.* at 203.
98. *Id.* at 203-04.
99. *Id.* at 202. The Court did remand the case for further factual inquiry. The decision

In *Snow v. Commissioner*,[100] the Court was presented with the "trade or business" issue as it pertains to Section 174 of the Internal Revenue Code of 1954.[101] This section allows a deduction for certain research and development expenses incurred "in connection with [the taxpayer's] trade or business."[102] From a review of the salient legislative history, the Court noted that the qualifying language of Section 174 ("in connection with") modifies the term "trade or business" to give it a broader meaning than the term receives when modified by language such as "carrying on."[103] Moreover, the Court stated that by drafting Section 174 in this manner, Congress sought to dilute the stringent requirements of the test adumbrated by Justice Frankfurter in *DuPont*.[104]

With the foregoing statement, the Court gives the impression that it is affirming the "goods or services" test. Accordingly, one would logically deduce that this standard is a threshold requirement for taxpayers who wish to deduct expenses under Section 162 of the Internal Revenue Code of 1954 (the successor to Section 23 of the prior Acts). This conclusion is consistent with the Court's earlier holdings in *Higgins*,[105] *City Bank Trust Company*[106] and *Pyne*.[107] Each of these cases involved a taxpayer who was not engaged in offering goods or services to others. Consistently, the Court found that the taxpayer in each case was not engaged in carrying on a trade or business.

Although the Court never expressly adopted Justice Frankfurter's test, its decisions up through *Snow* give the impression that the theme is strongly entrenched in the law. However, since the Court has never expressly supported the "goods or services" test since *Dupont*, it is likewise arguable that the Court has abandoned it.

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on remand is unpublished.

100. 416 U.S. 500 (1974).

101. *Id.* at 502-03.

102. I.R.C. § 174 (1954).

103. 416 U.S. at 502-03 (citing *Hearings on H.R. 8300 before the Senate Committee on Finance*, 83d Cong., 2d Sess. 105 (1954)). Note, I.R.C. § 162 (1954), which is the successor to § 23 under prior Acts, uses the "carrying on" language.

104. 416 U.S. at 502-03.

105. *See supra* notes 50-69 and accompanying text.

106. *See supra* notes 72-75 and accompanying text.

107. *See supra* notes 76-79 and accompanying text.

The law in this area is anything but clear. Without legislative support or exhaustive analysis, the judiciary has chosen to ignore the plain meaning of the term "trade or business." Thus, all remnants of *Flint*[108] appear to be gone. The debate remains, however, whether the "facts and circumstances" test or the "goods or services" test applies to determine trade or business status.

B. United States Circuit Courts of Appeal

Like the Supreme Court, the United States Circuit Courts of Appeal have all wrestled with the phrase "trade or business" in an effort to develop a useful definitional standard. Their analysis, however, has not always been consistent. With time, though, a majority view has evolved which places the "goods or services" test as the threshold requirement for trade or business status. Nevertheless, none of the courts have been able to postulate a specific definition for the term "trade or business" as it is used in the context of the Internal Revenue Code.

The Second Circuit announced its position on the issue over forty years ago in *Fuld v. Commissioner*.[109] In that case, the taxpayers, brother and sister, were investors in securities. They began this endeavor with the motive of holding their investments indefinitely. Sometime thereafter, however, their strategy changed and they decided to make the venture somewhat more speculative. Accordingly, the taxpayers purchased substantial blocks of securities with the goal of trading them on the market at a profit. Although they continued this endeavor for a substantial period of time, they never held themselves out as dealers. In fact, the Fulds traded solely for their own accounts. Neither taxpayer had any other trade or business. They both derived their livelihood solely from the profits generated from the stock transactions.[110]

Unfortunately, the Fulds' plan was not very successful. During the tax years in question, they sustained hefty losses from this endeavor. Desiring to receive ordinary loss treatment, the taxpayers asserted that the losses were derived from the sale of securities which were held primarily for "sale in the [ordinary] course of

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108. *See supra* notes 14-22 and accompanying text.
109. 139 F.2d 465 (2d Cir. 1943).
110. *Id.* at 467.

trade or business."[111]

On the issue of whether the taxpayers' activities constituted carrying on a trade or business, the court noted that resolution required an analysis of the facts and circumstances of the case. With this in mind, it appeared that the court would have to decide whether the offering of goods or services to others was a prerequisite to trade or business status. In fact, it undertook a thorough review of the test set forth by Justice Frankfurter in his concurring opinion in *Deputy v. Dupont*.[112] The court, however, quickly sidestepped the "goods or services" requirement so that it would not have to deal with the issue.[113] Rather, it distinguished away *Dupont* from the instant case when it stated:

> We think that those remarks do not apply to the present situation. In *Deputy v. Dupont* it did not appear that the taxpayer was trading in securities. His transactions, though involving a large amount of stock, related to the deductibility of expenses incurred in borrowing stock . . . to promote his own interest in the Company. The transactions were not a business but one enterprise.[114]

Based upon this statement and the fact that the taxpayers were actively involved in trading securities rather than effectuating a single transaction, the court held that they were engaged in carrying on a trade or business for federal tax purposes.[115] The court did not, however, draw any conclusion as to the vitality of the "goods or services" test. Moreover, it did not create any guidelines for application in future cases.

In *Gajewski v. Commissioner*,[116] the Second Circuit was afforded the opportunity to reevaluate its earlier holding in *Fuld*. The court was asked to determine whether a full-time gambler was engaged in carrying on a trade or business for purposes of Section 162 of the Internal Revenue Code of 1954.[117] The taxpayer devoted substantially all of his time to gambling and relied on this activity as his sole source of livelihood. Mr. Gajewski had occupied himself

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111. *Id.* at 466-67.
112. *See supra* notes 24-47 and accompanying text.
113. 139 F.2d at 468.
114. *Id.*
115. *Id.* at 469.
116. 723 F.2d 1062 (2d Cir. 1983), *cert. denied*, 469 U.S. 818 (1984).
117. *Id.* at 1063.

in this manner for a number of years. He was not a "bookmaker" and did not offer gambling advice to others.[118]

In light of these facts, no one would dispute that Mr. Gajewski was involved in gambling on a continuous and substantial basis with the motive of making a profit. Therefore, based upon the reasoning expressed by the court in *Fuld*, one would conclude that the taxpayer should be accorded "trade or business" status. The court, however, decided to rethink its prior position. It went all the way back in time to *Flint v. Stone Tracy Company*[119] where the Supreme Court originally interpreted the term "business" to encompass most any activity entered into for profit. Due to the lack of parameters with respect to this definition, the Second Circuit rejected *Flint*.[120] It stated:

> Although the words 'trade or business' in their broadest sense may refer to any activity engaged in by a person, *Flint v. Stone Tracy Company*, 220 U.S. 107, 171 (1911); *Webster's Third New International Dictionary* (1961), pp. 2421-22, 302, they are more commonly viewed as meaning a commercial activity in which a person seeks to earn a livelihood by furnishing goods or services to others for a price. Holding one's self out for such purposes is the universal characteristic of a businessman or trader in a free enterprise society.[121]

The court went on to examine the "facts and circumstances" method of analysis which it appeared to have adopted in *Fuld*.[122] Rejecting the reasoning it had earlier projected, the court stated:

> The 'facts and circumstances' approach does not describe a standard at all; it is instead a predicate for application of a legal test. One must first find the 'facts and circumstances' in every case before applying the proper standard to those facts . . . the phrase amounts to a non-test.[123]

Based upon the foregoing, the court adopted the "goods or services" test and overruled *Fuld* to the extent that it may have promoted the "facts or circumstances" method of analysis.[124] Because Mr. Gajewski was not involved in offering goods or services to others, the Second Circuit concluded that he was not engaged in

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118. *Id.* at 1063-64.
119. *See supra* notes 15-23 and accompanying text.
120. 723 F.2d at 1066.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at 1066-67.

carrying on a trade or business for purposes of federal taxation.[125]

The Second Circuit is not alone in its adoption of the "goods or services" test. In fact, a majority of the circuits appear to have adopted Justice Frankfurter's approach.[126] Nevertheless, these courts still have not been able to formulate a precise definition of the term "trade or business." In *Estate of Cull*,[127] the Sixth Circuit acknowledged that an accurate definition of the phrase "carrying on a trade or business" is essential to the disposition of these types of cases. Yet, it too was unable to formulate a precise definition.

The court in *Cull* was presented with the issue of whether a full-time gambler, who wagered solely for his own account, was engaged in carrying on a trade or business for purposes of federal taxation.[128] Like the Second Circuit, the Sixth Circuit found both the broad definitional approach adopted in *Flint* and the "facts and circumstances" analysis totally unacceptable.[129] Therefore, adopting the "goods or services" test, the court stated: "The unifying principle is that involvement in any profitable activity using only personal funds for one's private benefit, without offering the services to others, does *not* constitute participation in a trade or business."[130] Based upon this reasoning, since the taxpayer was not engaged in offering goods or services to others, the court concluded that he was not involved in carrying on a trade or business for fed-

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125. *Id.* at 1067.

126. The 2nd, 3rd, 4th, 6th, 8th, 9th, 10th, and 11th Circuits have adopted the "goods or services" test. *See, e.g.*, Zell v. Commissioner, 763 F.2d 1139 (10th Cir. 1985); Noto v. United States, 598 F. Supp. 440 (D.C.N.J. 1984) (holding that a gambler is not in a trade or business because he does not offer goods or services to others); Snyder v. United States, 674 F.2d 1359, 1364 (10th Cir. 1982); Weiberg v. Commissioner, 639 F.2d 434, 437 (8th Cir. 1981); Malstedt v. Commissioner, 578 F.2d 520 (4th Cir. 1978); Purvis v. Commissioner, 530 F.2d 1332, 1333-34 (9th Cir. 1976); Bessenyey v. Commissioner, 379 F.2d 252 (2d Cir. 1967), *cert. denied*, 389 U.S. 931 (1967); Mainline Distributors, Inc. v. Commissioner, 321 F.2d 562 (6th Cir. 1963); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir. 1961), *cert. denied*, 368 U.S. 919 (1961); Nubar v. Commissioner, 185 F.2d 584 (4th Cir. 1950), *cert. denied*, 341 U.S. 925 (1951); Commissioner v. Wiesler, 161 F.2d 997 (6th Cir. 1947), *cert. denied*, 332 U.S. 842 (1947); Fackler v. Commissioner, 133 F.2d 509 (6th Cir. 1943); Daily Journal Co. v. Commissioner, 135 F.2d 687, 688 (9th Cir. 1943); and Helvering v. Highland, 124 F.2d 556 (4th Cir. 1942).

127. 746 F.2d 1148 (6th Cir. 1984), *cert. denied*, 472 U.S. 1007 (1985).

128. *Id.* at 1149-50.

129. *Id.* at 1151.

130. *Id.* at 1151 (emphasis added).

eral tax purposes.[131]

The judiciary's inability to adopt a precise definition of the term "trade or business" is best illustrated by the Third Circuit's opinion in *Helvering v. Wilmington Trust Company*.[132] In that case, the court adopted Justice Frankfurther's "goods or services" test.[133] When attempting to describe the parameters of the phrase "trade or business," it was forced to draw an analogy to French bankruptcy law which does not allow one who engaged in stock exchanges to be declared bankrupt on the basis that they are not merchants. The court stated:

> It has an analogy in the interpretation of the 'Commercant' of the Bankruptcy Codes of the civil law countries and the trader of our and the early English bankruptcy laws. In a footnote to the leading textbook on French bankruptcy, we find a summary of certain decisions factually directly applicable to the principle case. The note reads: 'So one who engages in stock exchange operations not constituting the practice of a profession is not a merchant and cannot . . . be declared bankrupt. . . . If carrying on a trade or business were to mean any activity for profit the deduction would be broader than intended.[134]

The Tenth Circuit, also among the circuits adopting the "goods or services" test, when afforded the opportunity to analyze the issue in *Snyder v. Commissioner*,[135] did not have as much of a struggle attempting to conceptualize the term "trade or business" as the Third Circuit did in *Wilmington Trust Company*. In fact, it provided that, although the inquiry in this area is purely factual, the following should be used as a general guideline:

1. The taxpayer must have a good faith expectation of a profit,
2. His activity must be extensive and continue over a substantial period of time, and
3. He must hold himself out as selling goods or services to others.[136]

The query remained, however, whether meeting the above requirements, in and of itself, would give the taxpayer "trade or business"

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131. *Id.* at 1152.

132. 124 F.2d 156 (3d Cir. 1941), *rev'd on other grounds*, 316 U.S. 164 (1942). Note, the court indicated that it felt uneasy about adopting the "goods or services" test in light of the Supreme Court's decisions in *Higgins* and *Pyne*.

133. *Id.* at 158-59.

134. *Id.*

135. 674 F.2d 1359 (10th Cir. 1982).

136. *Id.* at 1364.

status. Unfortunately, none of the circuits have been able to adopt the precision required to answer this question. Rather, they have grasped onto Justice Frankfurter's test and added a few other minor touches of their own. As illustrated by the *Gajewski* opinion, the belief is prevalent that this test is more precise than the unyieldingly broad definition adopted by the Supreme Court in *Flint*.[137] Thus, both the *Flint* definition and the "facts and circumstances" approach find acceptance in only a small minority of the circuits.[138]

C. *United States Tax Court*

The United States Tax Court had its initial opportunity to deal with the "trade or business" issue over sixty years ago. In *Sheridan v. Commissioner*,[139] the court was asked to determine whether the taxpayer, a retired attorney, was engaged in carrying on the trade or business of farming for purposes of Section 214(a)(1) of the Revenue Act of 1921.[140] Unlike the Court in *Higgins v. Commissioner*, the Tax Court was receptive to adopting the broad definition of the term "business" originally expressed by the Supreme Court in *Flint v. Stone Tracy Company*.[141] It concluded that the term "trade or business" for federal tax purposes encompasses: "That which occupies the time, attention and labor of men for the purpose of a livelihood or profit."[142]

With the foregoing definition in mind, the Tax Court recognized that resolution of the issue depended upon the facts and cir-

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137. *See supra* notes 15-23 and accompanying text.

138. *See, e.g.*, Levin v. United States, 597 F.2d 760 (Ct. Cl. 1979) (Court of Claims appears to have adopted the facts and circumstances test); Stanton v. Commissioner, 399 F.2d 326, 329-30 (5th Cir. 1968); Simonsen Industries v. Commissioner, 213 F.2d 1107 (7th Cir. 1957); *see also* Groetzinger v. Commissioner, 179 F.2d 688 (7th Cir. 1950).

139. 4. B.T.A. 1299 (1926). This case was decided by the Board of Tax Appeals. The Revenue Act of 1942 (effective October 21, 1942) provided in Sections 504(a) and (b) that the Board of Tax Appeals would be referred to as the "Tax Court of the United States."

140. Section 214(a)(1) of the Revenue Act of 1921 provided:

> That in computing net income there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in *carrying on any trade or business*, including a reasonable allowance for salaries and other compensation for personal services actually rendered, traveling expenses . . . in the pursuit of *a trade or business* . . . . (Emphasis added).

141. 4 B.T.A. at 1300. *See supra* notes 21 and 49 and accompanying text.

142. *Id.* at 1300-01.

cumstances of each case. It noted that the taxpayer in the instant case had retired from an active law practice and had purchased a farm with the intent of making it his country home. He had no intention to farm the land. Sometime after he had moved onto the property, however, the taxpayer changed his mind and decided to actively operate the farm with the goal of earning a profit. He hired a knowledgeable farm assistant who helped him stock the farm with cattle, plant crops and purchase all the machinery required to operate a farm. The taxpayer devoted substantially all of his time to this endeavor and kept detailed records of his activities.[143] Based upon these impressive facts and the definitional standard established in *Flint*, the court concluded that the taxpayer was engaged in carrying on the trade or business of farming.[144]

The Tax Court's willingness to adopt the plain meaning of the term "trade or business" was not everlasting. In *Gentile v. Commissioner*,[145] the court was asked to determine whether a full-time gambler was engaged in carrying on a trade or business for federal tax purposes. This was a case of first impression for the Tax Court.[146]

Mr. Gentile exclusively earned his livelihood from gambling. He spent substantially all of his time either actually making wagers or studying upcoming events with the intent of wagering thereon. The taxpayer was not a "bookmaker." He did not offer gambling advice to others and only placed bets on his own behalf.[147]

Although it did not make any specific statement, the tone of

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143. *Id.* at 1299-1300.

144. *Id.* at 1301-02.

145. 65 T.C. 1 (1975), *rev'd*, Ditunno v. Commissioner, 80 T.C. 362 (1983); *see infra* notes 161-72 and accompanying text. The issue in this case was whether the taxpayer was engaged in carrying on a trade or business for purposes of imposing self-employment tax under I.R.C. § 1401 (1954). I.R.C. § 1402(c) (1954) provided that for purposes of imposing the self-employment tax, the phrase "trade or business" shall have the same meaning as given to it in § 162.

146. This case was the first time the Tax Court was presented with the issue of whether a full-time gambler was engaged in carrying on a trade or business.

147. 65 T.C. at 4. n.3. The court thoroughly examined the taxpayer's gambling history. It noted that he had been arrested and convicted of several crimes relating to gambling. Although there is no specific expressed statement, the tone of the court's opinion creates the impression that the Tax Court decided, as a matter of public policy, the gambler should not be given the rights corresponding with the status of being engaged in a trade or business.

the court's decision in *Gentile* reveals an implicit policy determination that the gambler should not be given "trade or business" status and thus the potential avenue for deducting all of the ordinary and necessary expenses incident thereto.[148] Accordingly, it retracted its analysis in *Sheridan* and concluded that *Flint* was not controlling in the instant case because the broad definition accepted therein was adopted in the construction of a different statute.[149] Yet, like the Supreme Court in *Higgins*, the Tax Court was unable to draw any distinction between the two statutes or the context in which the term appeared therein.[150] Thus, the court offered no rationale for this conclusion. The term "trade or business" is used in the same context in both statutes. It is modified in both cases by the language "carrying on." Moreover, there is no legislative history which reveals that Congress intended the term to take on a different meaning in each of the two statutes. Therefore, it is only logical that the phrase be ascribed the same definition in both statutes.

Although the Tax Court in *Gentile* acknowledged that the term "trade or business" is not defined anywhere in either the Code or Regulations, it did not attempt to formulate its own definitional standard or propose any sufficiently clear guidelines which other taxpayers could follow. Rather, it merely pointed out that the inquiry is one of fact.[151] With respect to the full-time gambler, the court concluded that he is not engaged in carrying on a trade or business for purposes of federal taxation.[152] It summarized its analysis of the issue when it stated:

> Upon stepping up to the betting window, petitioner was not holding himself out as offering any goods or services to anyone. Petitioner's use of his own resources to wager and his dedicated studies of the activities on which he wagered are akin to the management and investment of one's own estate and the study of market reports in order to do so more knowledgeably. This latter passive activity is clearly not within the bounds of a trade or business.[153]

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148. *Id.* at 1-3.

149. This is the same rationale that the Supreme Court used in *Higgins* to side-step the definition formulated by it earlier in *Flint*. *Id.* at 4; *see supra* note 64.

150. *See supra* notes 64-66 and accompanying text.

151. 65 T.C. at 4 (citing *Higgins*, 312 U.S. 212, 217 (1941)).

152. *Id.* at 6.

153. *Id.*

Based upon the foregoing statement, it was clear that the Tax Court had joined Justice Frankfurter's camp. Without any elaborate explanation, the plain meaning of the term "trade or business" was abandoned. There exists, however, no legislative history which supports or even gives the slightest hint that Congress wanted the judiciary to interpret the term in any context other than by its ordinary meaning. Yet, the courts, ignoring all traditional rules of statutory construction, decided to construe the term "trade or business" in a much narrower realm.

The Tax Court in *Gestrich v. Commissioner*[154] once again pronounced its support for the "goods or services" test. In that case, the taxpayer, a man of multiple interests, spent a majority of his time over a substantial number of years writing articles, advertisements and books. None of his works, however, were ever accepted for publication.[155] On the issue of whether the taxpayer was engaged in carrying on a trade or business, the court again reiterated that the facts and circumstances of each case must be considered.[156] Although no one fact alone is dispositive, the court acknowledged that the taxpayer, as a threshold requirement, must:

1. Have a genuine profit motive; and
2. Be engaged in selling goods or services to others.[157]

Based upon the facts presented, the Tax Court held that the taxpayer was engaged in carrying on the trade or business of being an author.[158] Summarizing its factual inquiry and conclusions, it stated:

> We believe that petitioner was engaged in the trade or business of being an author during the taxable years before us. He clearly spent a significant portion of his time working on his books and other materials. While petitioner had been paid for his [unpublished] works in years past, he earned no income from the sale of his works during the taxable years before us. Nevertheless, petitioner was attempting to get his book published and was, therefore, holding himself out for the sale of goods or services. We concluded . . . petitioner was in the trade or business of being an author. . . .[159]

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154. 74 T.C. 525 (1980), *aff'd mem.*, 681 F.2d 805 (3d Cir. 1982).
155. *Id.* at 528-29.
156. *Id.* at 529.
157. *Id.*
158. *Id.*
159. *Id.*

Although the court was unable to formulate a precise definition of the term "trade or business," its attempt served to create more guidance than any of the court's prior holdings. The taxpayer can be sure under the Tax Court's analysis that if he does not have a genuine profit motive and does not offer goods or services to others (or attempt to so offer), he will not be treated as being engaged in carrying on a "trade or business" for federal tax purposes."[160] In contrast, however, even if the taxpayer possesses these characteristics, he will not be guaranteed "trade or business" status. The law remains unclear whether the taxpayer must comply with any other requisites to be accorded such status.

Before the dust could settle from the Tax Court's decision in *Gestrich*, it was afforded another opportunity to consider the correctness of the "goods or services" test.[161] In *Ditunno v. Commissioner*,[162] the court was presented with facts virtually identical to those in *Gentile*.[163] Mr. Ditunno was a full-time gambler. He had no other profession or type of employment. During the years in question, the taxpayer spent substantially all of his time either gambling or studying books and newspapers in preparation for future wagering. He was not a "bookmaker" and did not make bets on behalf of others.[164] With the exception of a minimal amount of interest income, the taxpayer's sole source of livelihood was from gambling.[165]

Upon reevaluation, the court concluded that the "goods or services" test is "overly restrictive."[166] Renouncing the test, it expressed that failure to provide goods or services will not be sufficient by itself to remove a taxpayer from being considered engaged in carrying on a trade or business.[167] After exhaustively reviewing the prior decisions of the other courts, however, the Tax Court was still unable to articulate a precise definition of the term "trade or business." Rather, it concluded that the court's determination of this issue must be made on a case by case basis pursuant to an

160. *Id.*
161. Ditunno v. Commissioner, 80 T.C. 362 (1983).
162. *Id.* at 363-65.
163. *See supra* notes 145-53 and accompanying text.
164. 80 T.C. at 363-65.
165. *Id.*
166. *Id.* at 363-66.
167. *Id.*

examination of the facts and circumstances presented.[168]

With the foregoing in mind, the court emphasized that Mr. Ditunno was not a passive investor like the taxpayers in *Higgins*,[169] *Pyne*[170] and *City Bank Farmers Trust Company*.[171] In contrast, Mr. Ditunno was a full-time gambler. His activities were not limited to collecting interest and dividends. Rather, Mr. Ditunno devoted a substantial amount of time engaging in gambling activities, studying newspapers and reviewing racing forms. Moreover, he had no assurance of any return on his investment.[172] Based upon these facts, the Tax Court concluded that Mr. Ditunno was engaging in carrying on the trade or business of gambling.[173]

With the exception of the carve-out for the "passive investor," it appeared that the Tax Court was leaning toward the broad definition of the term "trade or business" first ennunciated by the Supreme Court in *Flint*. It must be noted, however, that four members of the court (including the chief judge) dissented and urged that Justice Frankfurther's test be retained.[174] Thus, the stability of the majority's decision appeared impermanent.

Although the Tax Court's decision to abandon the "goods or services" test did not have the appearance of permanence, it was perpetuated a few months later in *Nipper v. Commissioner*.[175] In that case, the Tax Court was again presented with facts virtually identical to those in *Gentile*.[176] The taxpayer, Mr. Nipper, was a full-time gambler. He had no other profession or source of income. Instead, he devoted substantially all of his time to wagering at various racetracks throughout Florida. Mr. Nipper solely wagered on his own behalf and never provided gambling advice to others.[177]

The court continued to look beyond whether the taxpayer was engaged in offering goods or services to others. Rather, analyzing

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168. *Id.* at 371.
169. *See supra* notes 50-69 and accompanying text.
170. *See supra* notes 70-71 and accompanying text.
171. *See supra* notes 72-75 and accompanying text.
172. 80 T.C. at 372.
173. *Id.*
174. *Id.* at 372-77.
175. 47 T.C.M. 136 (1983).
176. *Id.* at 136-37.
177. *Id.*

all of the facts and circumstances presented, it concluded that this case was indistinguishable from *Ditunno*. Thus, the Tax Court held that Mr. Nipper was engaged in carrying on the trade or business of gambling.[178]

One year after *Ditunno* and *Nipper* were decided, the Tax Court, in *Meredith v. Commissioner*,[179] was once again presented with the case of a full-time gambler and asked to determine whether he was involved in a trade or business for federal tax purposes. This case created the perfect opportunity for the Tax Court to sway back into Justice Frankfurter's camp and rejoin the ranks of *City Bank Farmers Trust Company*[180] and *Pyne*, which both appeared to accept the "goods or services" analysis.[181] Nevertheless, refraining from this temptation, the court concluded that the taxpayer's "activities were sufficiently regular, frequent and substantial to constitute a trade or business" for federal tax purposes.[182]

Although the Tax Court's position on what constitutes a trade or business has changed with time, it appears that the court's view has now stabilized. While the Tax Court has not yet articulated an exact definition of the term "trade or business," the following general parameters can be discerned from the foregoing cases:

1. The taxpayer must have a genuine motive to earn a profit;
2. The taxpayer must undertake the given activity with the purpose of earning a livelihood;
3. The activity cannot be merely the management of passive investments;
4. The activity must be substantial in terms of the taxpayer's time; and
5. The activity must be continuous rather than intermittent.

Even though the above guidelines do not remove all of the uncertainty, they do offer more stability than the obscurity emanating from the early Tax Court cases. In light of the court's decisions since *Ditunno*, it appears that the Tax Court has taken a position

178. *Id.* at 137.
179. 49 T.C.M. 318 (1984).
180. *See supra* notes 70 and 71 and accompanying text.
181. *See supra* notes 72 and 75 and accompanying text.
182. 49 T.C.M. at 321.

strongly in opposition to the "goods or services test."[183] Thus, there does not seem to be any danger of the court being wooed back into Justice Frankfurter's camp.

D. Position of the Internal Revenue Service

As illustrated above, the courts have not always agreed with each other's analysis of what constitutes a "trade or business" as the term is used in the Internal Revenue Code. Adding even more confusion to this already perplexing problem, the Internal Revenue Service ("I.R.S." or "Service") has not been consistent in its treatment of the issue.

The Service has routinely taken the position that a full-time gambler's activities do not constitute a trade or business.[184] Consider the following fact situations:

1. Taxpayer A earns income from participating in card games and wagering on sporting events such as baseball, basketball, football, boxing and golf. He devotes substantially all of his time to these activities. Each day, taxpayer A thoroughly analyzes prospective gambling events and computes handicaps with respect to each activity. He then visits various casinos and places his bets. The remainder of his day is spent playing cards. Taxpayer A does not operate a gambling establishment and does not make wagers on behalf of others.[185]

2. Taxpayer B earns his livelihood solely from racetrack gambling. He devotes approximately forty hours per week to this endeavor. In preparation for each day's activities, taxpayer B studies racing forms and newspapers. He does not make wagers on behalf of others.[186]

3. Taxpayer C has no source of income other than from gambling. He attends athletic events on a daily basis with the sole-purpose of developing a successful wagering system. Taxpayer C does this for a period of five weeks during the tax year. He then implements the system and utilizes it with respect to his full-time gambling endeavors. Taxpayer C spends five to six hours per day gambling and does

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183. *See also* Gajewski v. Commissioner, 45 T.C.M. 967 (1983); Estate of Cull v. Commissioner, 45 T.C.M. 691 (1983).

184. *See* Petitioner's Brief on Writ of Certiorari, Commissioner v. Groetzinger, 107 S. Ct. 980 (1987); *See also* Ditunno v. Commissioner, 80 T.C. 362 (1983); Nipper v. Commissioner, 746 F.2d 813 (11th Cir. 1984), *aff'd*, 47 T.C.M. 136 (1983); Meredith v. Commissioner, 49 T.C.M. 318 (1984); Estate of Cull v. Commissioner, 746 F.2d 1148 (6th Cir. 1984), *cert. denied*, 105 S. Ct. 2701 (1985); Gajewski v. Commissioner, 723 F.2d 1062 (2nd Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984); Barrish v. Commissioner, 49 T.C.M. 115 (1985).

185. Tech. Adv. Mem. 8,235,006 (May 21, 1982).

186. Tech. Adv. Mem. 8,206,016 (June 20, 1980).

so six days per week. Even after leaving an activity, he spends additional time sorting tickets, charting results and selecting wagers for the next day. This routine continues for a period of approximately six months, at which time taxpayer C discontinues his full-time gambling activities. He does not make wagers on behalf of others.[187]

4. Taxpayer D resides in the vicinity of several racetracks. For many years, his sole means of livelihood, aside from accruing a minimal amount of interest income, has been from gambling at these racetracks. Taxpayer D devotes a substantial portion of each day handicapping horses in preparation for his visit that day to one of the various racetracks. He also spends a great deal of time maintaining detailed records of his gambling activities. Taxpayer D does not make wagers on behalf of others.[188]

As previously noted, neither Congress nor the Treasury have defined the term "trade or business."[189] Moreover, no guidance is found in the legislative history that accompanies the salient Code sections.[190] Therefore, we are left with a debate over statutory construction.

As a fundamental rule of statutory construction, when Congress fails to provide any definitional parameters or guidelines with respect to the terms used in its legislation, we can rely on the plain meaning of the terms in question.[191] In fact, Justice Frankfurter has stated that: "[W]e assume that Congress uses common words in their popular meaning, as used in the common speech of men."[192]

The term "trade or business" is ordinarily thought of as entailing an activity entered into with the motive of earning a livelihood—an occupation.[193] *Black's Law Dictionary* provides that

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187. Tech. Adv. Mem. 8,040,008 (June 30, 1980).

188. Tech. Adv. Mem. 8,018,017 (January 30, 1980).

189. *See supra* note 3 and accompanying text.

190. A review of I.R.C. §§ 162, 1402, 28, 44 and 174, the parallel Treasury Regulations and relevant legislative history proved to be fruitless in an effort to obtain a definition of the term "trade or business." The Code, Regulations and legislative history offer no guidance in this area.

191. *See* Commissioner v. Groetzinger, 107 S. Ct. 980 (1987) (citing, Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM L. REV. 527, 536 (1947)). It should be noted that Justice Frankfurter failed to apply his own rule of statutory construction in *Dupont*. *See supra* notes 24-49 and accompanying text.

192. *Id.*

193. *See, e.g.*, THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1360 (1981) which defines "trade" as an occupation and similarly defines "business." *Id.* at 180.

"trade" is not a technical term and is ordinarily used to describe an "occupation."[194] More specifically, it defines "trade" as:

> The business which a person has learned and which he carries on for procuring subsistence, or for profit; occupation or employment, particularly mechanical employment; distinguished from the liberal arts and learned professions, and from agriculture. A line of work or a form of occupation pursued as a business or calling, as for a livelihood or for profit; anything practiced as a means of getting a living, money booty, etc.; mercantile or commercial business in general, or the buying and selling, or exchanging, of commodities, either by wholesale or retail within a country or between countries. (Citations omitted).[195]

Incorporating similar language, *Black's Law Dictionary* defines "business" as:

> Employment, occupation, profession, or commercial activity engaged in for gain or livelihood. Activity or enterprise for gain, benefit, advantage or livelihood. (Citation omitted). Enterprise in which person engaged shows willingness to invest time and capital on future outcome. (Citation omitted). That which habitually busies or occupies or engages the time, attention, labor, and effort of persons as a principal serious concern or interest or for livelihood or profit.[196]

There is no logical reason why the taxpayer in each of the foregoing scenarios should be denied trade or business status. Like the legal or the medical practitioner, who are without question engaged in a trade or business,[197] each of the foregoing taxpayers have entered the activity of gambling with the good faith motive of earning a livelihood. With the possible exception of taxpayer C, who's gambling activities only spanned six months, the other taxpayer's activities are extensive and will continue over a substantial period of time.[198] No distinction should be drawn between the lawyer, the doctor, or the gambler for federal tax purposes. All three are well within the parameters of the term "trade or business" as it is used in the ordinary sense.

See also WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY UNABRIDGED 2421, 302 (1971).

194. BLACK'S LAW DICTIONARY 1338 (5th ed. 1979).

195. *Id.*

196. *Id.* at 179.

197. *See, e.g.*, Kaufman v. United States, 233 F. Supp. 123, 124 (E.D. Pa. 1964).

198. It could be asserted, because of C's short-lived career, that he really had no motive to pursue a livelihood by means of gambling. This, of course, would be a question of fact to be considered with all of the other facts and circumstances.

Each of the foregoing fact situations was presented to the National Office of the I.R.S. and in turn analyzed in the form of a Technical Advice Memorandum.[199] The Service, in each case, without any consideration of the term "trade or business" as it is used in the ordinary sense, concluded that the taxpayer (a full-time gambler) was not involved in a trade or business.[200]

In its analysis, the Service acknowledged that neither the Code nor the Regulations define the term "trade or business."[201] Therefore, it looked solely to the case law for guidance.[202] It did not bother, however, to look very far.

In each case, the Service cited *Higgins v. Commissioner*,[203] *Deputy v. Dupont*[204] and *Gentile v. Commissioner*[205] as sole authority for its conclusions.[206] It acknowledged that pursuant to the Supreme Court's decision in *Higgins*, in order to determine whether the activities of a taxpayer constitute carrying on a trade or business, an examination of the facts and circumstances of each case must be undertaken.[207] Moreover, citing *Higgins*, it concluded that continuity and regularity of an activity, together with a profit motive, is insufficient by itself to support a conclusion that a taxpayer is engaged in carrying on a trade or business.[208] The crux of the Service's analysis revolved around Justice Frankfurter's concurring opinion in *Deputy v. Dupont*.[209] As previously noted, in this often-cited concurrence, Justice Frankfurter stated that in or-

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199. *See supra* notes 185-88. Although Technical Advice Memoranda are not authoritative and may not be cited as a precedent, they usually can be used as a tool to give the taxpayer a fairly good overview of the Service's position on particular issues as they relate to a specific set of facts. I.R.C. § 6110(j)(3).

200. *See supra* notes 185-88. Each of the cases presented involved the issue whether the taxpayer was subject to self employment tax as imposed under I.R.C. § 1401. Income subject to this tax encompasses only that income derived as a result of a "trade or business." I.R.C. § 1402(a). I.R.C. § 1402(c) defines the term "trade or business" by reference to its meaning under I.R.C. § 162. Therefore, all analysis focused on the term "trade or business" as used in I.R.C. § 162.

201. *See supra* notes 185-88.

202. *Id.*

203. *See supra* notes 50-69 and accompanying text.

204. *See supra* notes 24-49 and accompanying text.

205. *See supra* notes 145-53 and accompanying text.

206. *See supra* notes 185-88.

207. *Id.*

208. *Id.*

209. *Id.; see also supra* notes 24-49 and accompanying text.

der for a taxpayer's activities to constitute carrying on a trade or business, he must be involved in offering goods or services to others.[210] The Service correctly stated in its analysis that this position was adopted by the Tax Court in *Gentile v. Commissioner*.[211] In that case, although the taxpayer was a full-time gambler, because he was not engaged in offering goods or services to others, the court concluded that his activities did not constitute a trade or business.[212]

Based upon the foregoing line of reasoning, because the taxpayer in each of the scenarios presented above was not engaged in offering goods or services to others, the Service took the position that their activites did not rise to the level required to constitute carrying on a trade or business.[213] This position has been routinely asserted by the Service in cases involving gamblers.[214] In fact, in a General Counsel Memorandum, where the facts presented were similar to the facts in each of the four scenarios above, the Service again concluded that the taxpayer was not engaged in a trade or business.[215] It summarized its position in that memorandum when it stated:

> We think that the characteristic that distinguishes carrying on a trade or business from other income producing activities is whether the taxpayer holds himself out to others as offering goods or services. One way of focusing on this characteristic is to consider whether the activities of the taxpayer were the activities that generated the income in question. We think that this consideration was implicit in the Supreme Court's decision in *Higgins v. Commissioner* . . . when it held that investing one's own money, no matter how large the estate and no matter how continuous or extended the work required may be, does not constitute carrying on a trade or business.
>
> The relevant distinction between carrying on a trade or business and other income producing activities, such as investing, was clearly stated by the Supreme Court in *Whipple v. Commissioner*, 373 U.S. 193, 202 (1963): Though such (investment) activities may produce income, profit, or gain in the form of dividends or enhancement in the value of an investment, this return is distinctive to the process of investing and is gen-

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210. *Id.*

211. *Id.*; *see also supra* notes 145-53 and accompanying text. The Tax Court reversed *Gentile* in *Ditunno v. Commissioner*. *See supra* notes 161-68 and accompanying text.

212. *Id.*

213. *See supra* notes 185-88.

214. *See supra* note 184.

215. Gen. Couns. Memo. 36,603 (February 27, 1976).

> erated by the successful operation of the corporation's business as distinguished from the trade or business of the taxpayer himself. When the only return is that of an investor, the taxpayer has not engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, although substantially the product of his services, legally arises not from his own trade or business but from that of the corporation.
>
> Similar to a return on an investment, the winnings of a gambler are not generated by his activities of studying the odds and placing the bet; rather, the winnings are generated by the gambling operation that takes the bet. It is not the taxpayer's actions of placing a bet at the racetrack window, but the activities of the racetrack that generate and determine his winnings, or the return on his 'investment.'[216]

Although the Tax Court later reversed its decision in *Gentile* and no longer requires that a taxpayer be involved in offering goods or services to be characterized as being engaged in a trade or business,[217] the Service continues to assert the vitality of this requirement.[218] What is even more confusing, however, is that the Service has not been consistent in its analysis and has been caught at times arguing against the validity of the goods or services requirement.[219] In fact, in *Gentile v. Commissioner*, the very same case that the Service cites for authority to deny the taxpayers in the above illustrations trade or business status because they were not engaged in offering goods or services to others, it argued that the goods or services element should *not* be a prerequisite to trade or business status.[220] In that case, the Service contended that the term "trade or business is not limited to the offering of goods and services to others; rather, it is an individual's everyday efforts to earn a living, characterized by continuity, regularity and profit motive."[221] Contrary to the position that it has taken in other cases when presented with similar facts, the Service urged that the Tax Court should adopt a broad definition of the term "trade or business."[222]

The Service's inconsistent analysis of this issue is further illus-

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216. *Id.*
217. Ditunno v. Commissioner, 80 T.C. 362 (1983).
218. *See supra* note 184.
219. *See, e.g.*, Gentile v. Commissioner, 65 T.C. 1, 3 (1975), *rev'd*, Ditunno v. Commissioner, 80 T.C. 362 (1983).
220. *Id.*
221. *Id.*
222. *Id.*

trated in I.R.S. Publication Number 334.[223] Without any reference to a goods or services requirement, the Service provides that the term "trade or business" means:

> . . . an activity carried on for livelihood, or in good faith to make a profit. You do not need to actually make a profit to be in a trade or business as long as you have a profit motive. You do need, however, to make an ongoing effort to further the interest of your business. Regularity of activities and transactions and the production of income are important elements.
>
> The facts and circumstances of each case determine whether or not an activity is a trade or business.[224]

This definition, like the definition found in Black's Law Dictionary,[225] is more in touch with the ordinary meaning of the term "trade or business."

Due to the confusion created by the courts and the lack of uniformity adopted by the Service,[226] the taxpayer has been given little guidance in this area. The Supreme Court, however, attempted to resolve this problem when it accepted the petitioner's writ for certiorari in *Commissioner v. Groetzinger*.[227]

III. COMMISSIONER V. GROETZINGER—ANALYSIS AND OVERVIEW

With the view of the Supreme Court unclear and the circuits not in complete agreement as to what constitutes "carrying on a trade or business" for purposes of federal taxation, the taxpayer in *Commissioner v. Groetzinger*[228] decided to litigate the matter. Mr. Groetzinger appealed his case from the Tax Court up to the Supreme Court of the United States. At each stage, the taxpayer, a full-time gambler, asserted that he was engaged in carrying on a trade or business within the meaning of the Internal Revenue Code

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223. I.R.S. Publication No. 334, Chapter 33 at p. 116 (1986).

224. *Id.* It is interesting to note that this document was published approximately three months prior to the Supreme Court's decision in *Commissioner v. Groetzinger*. A similar definition is found in an earlier version of this same publication. *See* I.R.S. Publication No. 334, Chapter 33 at p. 2 (1981); *see also* Lopez, *Defining "Trade or Business" Under the Internal Revenue Code: A Survey of Relevant Cases*, 11 FLA. ST. U.L. REV. 949, 950 (1984).

225. *See supra* notes 194-96 and accompanying text.

226. *See* Rutana v. Commissioner, 88 T.C. 74 (1987) (where the I.R.S. takes an unreasonable position in litigation, the Tax court may award the taxpayer attorney fees).

227. 107 S. Ct. 980 (1987).

228. *See* 82 T.C. 793 (7th Cir. 1984); 771 F.2d 269 (1985); 107 S. Ct. 980 (1987).

of 1954[229] However, in order to assert a deficiency in alternative minimum tax, the Service took the position that a full-time gambler, who does not offer goods or services to others, is not engaged in carrying on a trade or business for purposes of federal taxation.[230]

Thus, the stage was set for the judiciary to wipe the slate clean and remove the long existing dichotomy in reasoning that the Supreme Court had disseminated over the years. As illustrated above, two relatively different approaches have emerged: the "goods or services" test, originally pronounced by Justice Frankfurter in *DuPont* and later adopted by a majority of the circuits,[231] and the "facts and circumstances" approach, originally pronounced by Justice Reed in *Higgins* and later adopted by the Tax Court.[232] With over four decades having elapsed since these cases were decided, the Supreme Court still has not made it clear which test applies to determine trade or business status. The great number of lower court decisions which have attempted to reconcile *Higgins* and *DuPont* have added to the confusion.[233] Moreover, due to the Supreme Court's lack of careful analysis in its early opinions on this issue, valid arguments exist to support the application of both tests. For example, it could be asserted that the "goods or services" test is the proper approach because the Court, although afforded several opportunities during the past forty-five years since its pronouncement, has failed to expressly reject the test. It is likewise arguable that the "facts and circumstances" test is the proper approach. Justice Reed, who joined in Justice Frankfurter's landmark concurring opinion, wrote the majority opinion in *Higgins*, decided shortly after *Dupont*.[234] In that opinion, Justice Reed never mentioned or even referred to the "goods or services" test.[235] Furthermore, Justice Frankfurter joined in the *Higgins* majority.[236] Thus,

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229. *Id.*; *see also* Respondent's Brief in Opposition to Petition for Writ of Certiorari, Commissioner v. Groetzinger, 107 S. Ct. 980 (1987).

230. *Id.*; *see also* Petitioner's Brief for Writ of Certiorari, Commissioner v. Groetzinger, 107 S. Ct. 980 (1987); Petitioner's Brief, Commissioner v. Groetzinger, 107 S. Ct. 980 (1987).

231. *See supra* notes 109-38 and accompanying text.

232. *See supra* notes 139-83 and accompanying text.

233. *Id.*

234. *See Higgins*, 312 U.S. at 213; *see also Dupont*, 308 U.S. at 499.

235. *Id.*

236. *Id.*

it is equally tenable that the Court abandoned the "goods or services" test.

Due to the vast room which exists for debate, this issue has received a great amount of public notoriety.[237] In addition, a great deal of scholarly discourse has been dedicated to the topic.[238] The Supreme Court, however, even though presented with the opportunity on several occasions, has not attempted to address the issue in many years.[239] In 1984, however, the Tax Court was presented with the case of *Groetzinger v. Commissioner*.[240] The facts of this case presented the judiciary with the perfect opportunity to remove the confusion which had been created. After the case made it through the Seventh Circuit Court of Appeals, the Supreme Court was given the chance when the Commssioner filed a petition for writ of certiorari.[241]

A. *Factual Summary*

The facts of this case are relatively straight-forward.[242] For over twenty years, Mr. Groetzinger had been employed in the marketing department of an Illinois manufacturing company. In February of 1978, his job was terminated. Thereafter, with no other job to turn to, the fifty-eight year old taxpayer began devoting virtually all of his time to parimutuel wagering. Mr. Groetzinger went to the race track six days per week and spent over ten hours there each time. Moreover, he spent time studying racing forms, programs and other materials to assist him in his wagering activities. With the exception of a small amount of income derived from his

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237. *See, e.g.*, Gerver, *Gambling and Other Businesses*, NATIONAL LAW JOURNAL 5 (March 23, 1987); Editorial, NATIONAL LAW JOURNAL 34 (March 9, 1987); Editorial, 34 TAX NOTES 883 (1987); Uhlfelder, *Supreme Court Decisions*, 34 TAX NOTES 856 (1987); Uhlfelder, *Groetzinger Decision Could Affect Deductibility of Some Construction Expenses*, 34 TAX NOTES 856 (1987); Shepperd, *Supreme Court Considers Whether Gambling is a Trade or Business*, 33 TAX NOTES 995 (1986); Editorial, *Whether a Full-time Gambler is Engaged in a Trade or Business*, 33 TAX NOTES 52 (1986). Many other commentaries, too numerous to list, have appeared in various publications dating back to the early 1970's on this subject. For a general overview see the earlier editions of *Tax Notes*.

238. *See supra* note 11.

239. *See, e.g.*, Estate of Cull, 746 F.2d 1148 (6th Cir. 1984), *cert. denied*, 105 S. Ct. 2701 (1985); Gajewski v. Commissioner, 723 F.2d 1062 (2d Cir. 1983), *cert. denied*, 105 S. Ct. 88 (1984).

240. 82 T.C. 793 (1984).

241. Certiorari was filed on January 17, 1986 and granted on March 24, 1986.

242. For complete summary of the facts, *see* 82 T.C. at 793-95.

investments, this was his sole source of livelihood. The taxpayer had no other occupation or type of employment. As illustrated from his testimony at trial, he treated gambling as a business. In fact, he stated:

> I work 60-80 hours a week, and [sic] trying to make a living playing the dogs. I lost my job when I was 58 years old, and I'd been playing some dogs then. So I said well, I'll give it a try. It doesn't look like I'll be able to make it because this is too tough.[243]

Mr. Groetzinger kept detailed accounting records of his wagering activities. At the end of each trip to the track, he made an entry in his journal indicating the net winnings or losses for the day's events.[244]

The taxpayer gambled solely for his own account. He never sold advice or placed bets on behalf of others. Moreover, Mr. Groetzinger was not a "bookmaker."[245]

In 1978, the taxpayer wagered a total of $72,032 and had winnings of $70,000, resulting in a net loss of $2,032. His total income from other sources amounted to $6,498. On Mr. Groetzinger's federal tax return, he reported the non-gambling source income, but did not report the gambling winnings or losses to arrive at adjusted gross income on line thirty-one of Form 1040. Rather, he reported the net gambling loss on Schedule E, which is a supplemental income schedule.[246]

Upon audit, the Commissioner asserted that the taxpayer's $70,000 of gambling winnings were to be included in gross income on the Form 1040. Moreover, pursuant to Section 165(d) of the Internal Revenue Code of 1954, the Commissioner contended that his gambling losses were deductible as itemized deductions, but only to the extent of his winnings.[247] The Commissioner also concluded that, pursuant to Section 56(a) of the same Act as in effect in 1978, a portion of the gambling loss was an item of tax preference. The effect of this operated to subject the taxpayer to a mini-

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243. *Id.* at 794 n.3.
244. *Id.* at 794.
245. *Id.*
246. *Id.*
247. *Id.* at 795. I.R.C. § 165(d) allows a deduction for wagering losses to extent of winnings.

mum tax.[248]

The Commissioner's adjustments resulted in a deficiency of $2,522. Mr. Groetzinger challenged these findings and sought a prepayment redetermination in the Tax Court.[249]

B. *Tax Court Decision*

The sole issue before the Tax Court was whether Mr. Groetzinger's gambling activities constituted carrying on a trade or business so as to exempt his losses from tax preference treatment.[250] To fully understand this inquiry, a brief overview of the Code sections relating to this subject is necessary.

Section 56, as in effect in 1978, imposed a minimum tax on items of tax preference.[251] Included in the potpourri of preference items was "adjusted itemized deductions."[252] The 1978 Code broadly defined this term to encompass all "deductions for the taxable year" except those specifically excluded.[253] Among the items specifically excluded were all "deductions . . . allowable in arriving at adjusted gross income."[254] Section 62(1) of the 1978 Code provided that "adjusted gross income" was equivalent to gross income minus certain deductions, including those allowable deductions which were incurred by the taxpayer in carrying on a trade or busi-

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248. I.R.C. § 56 (1978) imposes a minimum tax on items of tax preference. I.R.C. § 57(a)(1) (1978) provides that such includes adjusted itemized deductions. Adjusted itemized deductions are defined in I.R.C. § 57(b)(1) (1978) as itemized deductions for the taxable year, but certain deductions, such as those allowable in arriving at AGI, are excluded. Under § 62(1) (1978), deductions incurred in carrying on a trade or business fit into this exception. Therefore, if the taxpayer is deemed engaged in carrying on a trade or business, he would be exempt from the minimum tax in this case. If not, however, because his gambling losses are not within the enumerated exceptions, he would be subject to tax on such tax preference item. (This analysis is under the I.R.C. as in effect in 1978).

249. 82 T.C. at 795.

250. Groetzinger v. Commissioner, 82 T.C. 793 (1984).

251. I.R.C. § 56(a) (1978) provided:

> (a) General rule.—In addition to the other taxes imposed by this chapter, there is hereby imposed for each taxable year, with respect to the income of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—
> (1) $10,000, or
> (2) the regular tax deduction for the taxable year (as determined under subsection (c)).

252. I.R.C. § 57(a)(1) (1978).

253. I.R.C. § 57(b)(1) (1978).

254. I.R.C. § 57(b)(1)(A) (1978).

ness.[255] Pursuant to Section 165(a) and (c)(1) of the 1978 code, an individual's losses, if incurred in carrying on a trade or business, were deductible.[256]

With the foregoing in mind, one can appreciate the technical aspects of the issue before the court. If Mr. Groetzinger was found to be in the trade or business of gambling, since his losses were derived therefrom, he would not be subject to the minimum tax imposed on preference items under Section 56.[257]

In order to resolve this issue, the Tax Court undertook an exhaustive review of the case law. It began its analysis by mentioning its recent holding in *Ditunno*[258] where the court had held that a full-time gambler was in the trade or business of gambling even though he did not offer goods or services to others. In that case, the Tax Court stated that: "The proper test . . . requires an examination of all the facts involved in each case."[259] In light of the fact, however, that a majority of the circuits have adopted the "goods or services" test when presented with virtually identical facts, the court decided to reevaluate its position.[260]

The court looked to *Dupont*[261] as the focal point of its analysis. It observed that *Higgins*[262] was decided less than one year after *Dupont*, yet the majority of the Court, of which Justice Frankfurter was a part, never mentioned the "goods or services" test.[263] Moreover, in *Pyne*[264] and *City Bank Farmers Trust Company*,[265] both of which were decided soon after *Dupont*, the Court never mentioned the "goods or services" test. Rather, the Court employed the facts and circumstances approach expressed by it in *Higgins*. Based upon this line of reasoning, the Tax Court affirmed

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255. I.R.C. § 62(1) (1978).

256. I.R.C. §§ 165(a) and (c)(1) (1978). It should be noted that § 165(d) limits gambling loss deductions to the extent of winnings.

257. This is the case because the taxpayer's losses were as great as his winnings. Thus, his tax base for the alternative minimum tax would be zero.

258. 80 T.C. 362, 362-65 (1983); *see supra* notes 169-81 and accompanying text.

259. *Id.* at 367-68.

260. *See supra* note 183.

261. *See supra* notes 24-46 and accompanying text.

262. *See supra* notes 51-69 and accompanying text.

263. 82 T.C. at 798.

264. *See supra* notes 76-79 and accompanying text.

265. *See supra* notes 70-75 and accompanying text.

its rejection of the "goods or services" test.[266] In fact, the Tax Court stated:

> Our rejection of the 'goods or services' requirement . . . [follows] from our conclusion that, given this judicial context, *Higgins* is properly viewed as the controlling Supreme Court precedent on the trade or business issue.[267]

The Tax Court observed that several circuits have criticized the facts and circumstances approach for not describing a standard.[268] The flaw in this critique, as noted by the court, is that it assumes that the term "trade or business" is susceptible of a precise standard. The term has been in the Code for greater than sixty years, yet neither Congress, the Treasury nor the courts have been able to articulate any definitive description of the phrase.[269] Thus, the Tax Court concluded that this inability only supports its position that the question is inherently one of fact.[270]

To further illustrate the obvious inconsistency in the "goods or services" approach, the court discussed several fact situations involving active traders of securities.[271] It noted that the courts in Justice Frankfurter's camp go so far as to conclude that an investor who trades securities for his own account is engaged in carrying on a trade or business if the activity is sufficiently frequent and substantial[272] Yet, these same courts conclude that the full-time gambler is not engaged in a trade or business.[273] The distinction that they attempt to draw is based upon the fact that the gambler does *not* offer goods or services to others. In contrast, however, they assert that the securities trader does offer goods or services to others.[274] This attempt to illustrate a distinction is simply an illusion. As the court concluded, there is no difference between the gambler and the securities trader. It stated:

> We are unable to discern any meaningful distinction between the so-called 'active trader" of securities and the full-time gambler such as peti-

266. 82 T.C. at 802-03.
267. *Id.* at 798.
268. *Id.* at 799-802.
269. *Id.* at 800.
270. *Id.* at 803.
271. *Id.* at 800-03.
272. *Id.*
273. *Id.*
274. *Id.*

> tioner in this case. The essential nature of those activities is identical; to state it simply, one gambles on stocks, the others on dogs. Both bet, or trade, solely on their own account, and do not enter into any transactions with specific individuals. . . .
> . . . The fact that theoretically the market 'matches' the seller's transaction with that of some anonymous buyer does not, in our view, satisfy the meaning of 'holding one's self out.'[275]

For the foregoing reasons, the Tax Court decided to adhere to its prior ruling in *Dutunno*.[276] It concluded that the inquiry requires a "broad examination of all the facts involved in the case."[277] Because Mr. Groetzinger's gambling activities, which he intended to be his sole source of livelihood, were sufficiently regular, frequent, active and substantial, the court concluded that he was engaged in carrying on the trade or business of gambling. Therefore, Mr. Groetzinger was not subject to the minimum tax imposed under Section 56.[278]

The Tax Court's reaffirmation of the "facts or circumstances" test, previously adopted by it in *Ditunno*, reveals its strong commitment to this approach. Moreover, it should be noted that Judge Drennen, who wrote the court's opinion, was joined by fifteen of the court's nineteen judges.[279] As well, Judge Sterrett's concurrence was based upon stare decisis.[280] The only dissenters were Judges Chabot and Cohen who relied on their dissent in *Ditunno* and commitment to the "goods or services" test.[281]

C. *Seventh Circuit Court of Appeals Decision*

In light of the favorable judgment to the taxpayer, the Commissioner filed an appeal with the Seventh Circuit.[282] It was the Commissioner's contention that Mr. Groetzinger's failure to offer goods or services to others precluded characterization of his activities as a trade or business.[283] On this basis, the Commissioner as-

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275. *Id.* at 801-02.
276. *Id.* at 803.
277. *Id.*
278. *Id.*
279. *Id.* at 804.
280. *Id.*
281. *Id.*
282. Groetzinger v. Commissioner, 771 F.2d 269 (7th Cir. 1985).
283. *Id.*

serted that the Tax Court erred and should be reversed.[284]

The sole issue before the court was whether the goods or services test should be an "absolute prerequisite to a finding that a taxpayer [is] engaged in a trade or business." Like the Tax Court, recognizing that the phrase "trade or business" is not defined anywhere in the legislative history, the Code or the Treasury Regulations, the Seventh Circuit undertook an exhaustive review of the relevant judicial authority.[285]

Starting with *DuPont*, the court noted the birth of the "goods or services" test.[286] Less than one year later in *Higgins*, however, the Seventh Circuit observed was its death.[287] As the court pointedly stated: ". . . when . . . squarely faced with the 'trade or business' issue and had the opportunity to employ the ["goods or services"] test to dispose of the taxpayer's claim, the [Supreme Court] failed to adopt the Frankfurter definition."[288] Rather, it rejected the contention that a trade or business encompasses everything about which an individual can be employed and simply ruled that the deliberation requires an examination of the facts of each case.[289]

From its review of the Supreme Court's earlier decisions, the court discerned that the relevant inquiry should focus on whether the taxpayer's activities can reasonably be characterized as an "occupation or means of earning a living."[290] Two general parameters are important to this inquiry: 1) The continuity, repetition and substantiality of the subject activity; and 2) The good faith motive on the taxpayer's part to produce income or earn a profit.[291] As well, as previously noted by the Supreme Court in *Higgins*, purely personal activities, such as managing one's own stock portfolio, no matter how sophisticated, continuous, extended, or profitable, will never constitute carrying on a trade or business.[292]

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284. *Id.*
285. *Id.* at 271-77.
286. *Id.* at 272-77.
287. *Id.* at 272.
288. *Id.*
289. *Id.*
290. *Id.*
291. *Id.* at 277.
292. *Id.* at 275.

In view of the foregoing, and in light of the substantial evidence presented to the Tax Court which supports the finding that Mr. Groetzinger directed an extraordinary amount of time on a continuous basis to his gambling activities with the intent to earn a livelihood, the Seventh Circuit concluded that he was in the trade or business or gambling.[293] Thus, it affirmed the Tax Court.

Like the Tax Court, the Seventh Circuit also responded to the recent criticism extended toward the "facts and circumstances" method of analysis. The crux of these adverse comments is that the test is really not a standard at all. In response to this statement, the Court provided:

> There can be no disagreement that the traditional approach to determining whether activities constitute a trade or business is in need of refinement, but to assert that the 'facts and circumstances' test 'does not describe a standard at all' . . . goes too far. The current standard simply reflects the broad meaning Congress intended by the term trade or business. The types of parameters courts have previously utilized to define the scope of the term . . . have involved *degree, regularity*, and *intent* but have *not* distinguished among certain types of livelihoods. This facts and circumstances test is precisely the type of approach that the Supreme Court intended to sanction in *Higgins* whereas the "goods and services" test marks an *unnecessary* and *unwarranted* departure from the course. (Emphasis added).[294]

Justice Cummings wrote the foregoing opinion on behalf of the entire Seventh Circuit.[295] Without dissention, it appears that the Seventh Circuit has joined the ranks of the Tax Court and a minority of the circuits which have completely dispelled the vitality of the "goods or services" test.

D. United States Supreme Court Decision

The Commissioner filed a petition for writ of certiorari before the United States Supreme Court. Again, it asserted that the lower courts had erred by not applying the "goods or services" test to the facts of the case.[296] Deciding to clear the air of all ambiguity created during the last four decades with respect to the "trade or bus-

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293. *Id.* at 277.
294. *Id.*
295. *Id.* at 265.
296. Commissioner v. Groetzinger, 107 S. Ct. 980 (1987).

iness" issue, the Court granted certioriari.[297]

1. Majority Opinion

Justice Blackmun delivered the Court's opinion. He was joined by Justices Brennan, Marshall, Powell, Stevens, and O'Connor. Justice Blackmun succinctly stated the issue before the tribunal as: "[W]hether a full-time gambler who makes wagers solely on his own account is engaged in a 'trade or business' within the meaning §§ 162(a) and 62(1) of the Internal Revenue Code of 1954 . . . ."[298] At the outset, the Court cautioned that it was only attempting to interpret the phrase "trade or business" as it is used in these specific Code sections.[299] It did acknowledge, however, that the courts have extended the definition derived in this context to several other Code sections where the phrase also appears.[300]

Like the lower courts, the Supreme Court began its analysis with a complete historical overview of the law on this issue which dates back to 1911 and the case of *Flint v. Stone Tracy Company*.[301] Interestingly, the Court did not reject the early definition of the term "trade or business" as many of the other courts have done.[302] Rather, it acknowledged the broadness of the *Flint* definition and went on to examine the later cases in order to provide some fine tuning.[303]

The Court reviewed the test expressed by Justice Frankfurter in *DuPont*, but was quick to reject it after considering the cases which were decided shortly thereafter.[304] Agreeing with the Tax Court and the Seventh Circuit, the Supreme Court implicitly concluded that it had already abandoned the "goods or services" test and did so three months after its birth when it decided *Higgins*. In that case, although implementation of the test would have summarily resolved the dispute in the Commissioner's favor, the Court instead undertook an exhaustive review of all the facts and circumstances involved. Then and only then did they dispose of the case

297. *Id.*
298. *Id.* at 981.
299. *Id.* at 983 n.8.
300. *Id.* at 988 n.16.
301. *Id.* at 983.
302. *Id.* at 983-84.
303. *Id.* at 983-85.
304. *Id.* at 984-85.

in favor of the Commissioner. This implicitly reveals the Court's dissatisfaction with the "goods or services" test. Moreover, it illustrates its commitment to the "facts and circumstances" approach.

To further support the foregoing analysis, the Court took notice of the fact that Justice Frankfurter was joined in his concurrence by Justice Reed. Interestingly, Justice Reed delivered the later opinion in *Higgins* and Justice Frankfurter joined in that majority. Yet, the Court not only failed to use the "goods or services" test, it also failed to even recognize its existence. Moreover, one year later, the Court decided the companion cases of *City Bank Farmers Trust Company*[305] and *Pyne*.[306] Although the facts presented in these cases were similar to *Higgins*, again the Court failed to mention Justice Frankfurter's test.

For those reasons, the Court concluded that the "goods or services" test is not the proper method of analysis. Justice Blackmun summarized the Court's position when he stated:

> [W]e concluded (1) that, to be sure, the statutory words are broad and comprehensive (*Flint*); (2) that, however, expenses incident to caring for one's own investments, even though that endeavor is full-time, are not deductible as paid or incurred in carrying on a trade or business (*Higgins, City Bank, Pyne*); (3) that the opposite conclusion may follow for an active trader (*Snyder*); (4) that Justice Frankfurter's attempted gloss upon the decision in *DuPont* was not adopted by the Court in that case, (5) that the Court, indeed later characterized it as an 'adumbration' (*Snow*); and (6) that the Frankfurter observation, specifically or by implication, never has been accepted as law by a majority of the Court, and more than once has been totally ignored. *We must regard Frankfurter's gloss merely as a two-Justice pronouncement in a passing moment and, while entitled to respect, as never having achieved the status of a Court ruling.* (Emphasis added).[307]

Without overruling or restricting the decision in *Higgins*, the Court held that one's gambling activities, if pursued on a full-time basis, in good faith, with the motive of deriving a profit or producing a livelihood, with regularity and continuity, and not pursued as a mere hobby, will constitute a trade or business for federal tax purposes.[308] Thus, based upon the record from the Tax Court, the

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305. *Id.*; *see supra* notes 70-75 and accompanying text.
306. *Id.*; *see supra* notes 76-79 and accompanying text.
307. *Id.* at 985-86.
308. *Id.* at 988.

Supreme Court affirmed the Seventh Circuit's holding that Mr. Groetzinger was in the trade or business of gambling.[309]

2. Dissenting Opinion

Justice White, joined by Justices Rehnquist and Scalia, dissented.[310] Their opinion solely relates to whether "gambling" may constitute a "trade or business" for federal tax purposes. Due to the controversy surrounding this issue and the fact that this was a six to three decision, the dissenting opinion deserves complete review.

The crux of dissenting Justices' position revolves around the technical aspects of the alternative minimum tax provided under Section 55.[311] It is their argument that by allowing the full-time gambler "trade or business" status for purposes of Section 62(1), an inequity is created because such status may shield him from the alternative minimum tax which Congress intended him to pay. Thus, it is the dissenters' contention that Congress did not intend for gambling to constitute a trade or business.

Before reviewing the example of this asserted inequity, as illustrated in the dissent, an overview of the applicable Code sections is necessary. If one fully understands the alternative minimum tax provisions, it is clear that the dissenting Justices erred in their analysis.

a. Technical Overview of the Relevant Alternative Minimum Tax Provisions

Section 55(a) of the Internal Revenue Code, following Congressional amendments in 1982, imposed an alternative minimum tax (AMT) on noncorporate taxpayers in an amount equal to the excess (if any) of twenty percent of the amount of the "alternative minimum taxable income" which exceeds the "exemption amount" over the "regular tax" for the taxable year.[312]

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309. *Id.*

310. *Id.* at 988-89.

311. I.R.C. § 55(a) (1983). Although the tax year in dispute is 1978, the dissent asserts that Congress' amendments to the alternative minimum tax provisions in 1982 reveal an intent to disallow gamblers trade or business status.

312. I.R.C. § 55(a) (1983) provided:

—In the case of a taxpayer other than a corporation, there is imposed (in

i. Alternative Minimum Taxable Income

The "alternative minimum taxable income" (AMTI) is equal to the taxpayer's "adjusted gross income" (AGI)[313] reduced by the "alternative tax itemized deductions" (ATID).[314]

AGI is defined as gross income less certain specified deductions, including those which are attributable to a trade or business carried on by the taxpayer.[315]

ATID, with two qualifications, is equal to the sum of all allowable deductions for the tax year. Under the first qualification, the deduction cannot be one included in computing AGI.[316] Secondly, the deduction must be of a type enumerated in Section 55(e)(1), which includes wagering losses deductible pursuant to Section 165(d).[317]

ii. The Exemption Amount and the Regular Tax

The exemption amount is defined in Section 55(f)(1). It is $40,000 in the case of a surviving spouse taxpayer or taxpayers filing jointly; $30,000 for a nonmarried individual taxpayer who is not a surviving spouse; and $20,000 in the case of a married individual taxpayer filing separately or an estate or trust.[318] Generally speaking, the "regular tax" as defined in Section 55(f)(2) encompasses that tax imposed under the Income Tax provisions (Chapter 1) of the Internal Revenue Code for the taxable year.[319]

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addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of—

(1) an amount equal to 20 percent of so much of the alternative minimum taxable income as exceeds the exemption amount, over

(2) the regular tax for the taxable year.

313. I.R.C. § 55(b) (1983).

314. *Id.*

315. I.R.C. § 62(1) (1983).

316. I.R.C. § 55(e)(1) (1983).

317. *Id.* I.R.C. § 55 lists the deductions allowable under that section to include losses which are deductible under I.R.C. § 165(d). It should be noted, even if the gambler is in a "trade or business," I.R.C. § 165(d) still limits the losses deductible in any tax year to the extent of the taxpayer's gambling winnings. *See* Boyd v. United States, 762 F.2d 1369, 1373 (9th Cir. 1985); Kozma v. Commissioner, 51 T.C.M. 956, 957 (1986).

318. I.R.C. § 55(f)(1)(A), (B) & (C) (1983).

319. I.R.C. § 55(f)(2) (1983).

iii. The Alternative Minimum Tax Formula

With the foregoing overview in mind, one can easily imagine the great complexity of these Code provisions. Nevertheless, putting all of the above principles together, we are presented with this formula: AMT = [20% (AMTI - exemption amount)] - [Regular tax for the taxable year].

b. Illustration Presented by the Dissent

In an attempt to illustrate the alleged inequity, the dissent created two fact scenarios.[320] Taxpayer A, a non-gambler nonmarried individual, has non-gambling income of $75,000 and $75,000 in itemized deductions for the taxable year. Taxpayer B, a gambler nonmarried individual is deemed in the trade or business of gambling. Taxpayer B has gambling income of $75,000, unrelated income of $75,000, gambling losses of $75,000 and $75,000 in itemized deductions for the taxable year.[321]

The dissent asserts that the above fact scenarios result in A being subjected to a $9,000 tax and B being subjected to no tax as a result of his "trade or business" status. The dissent contends that this occurs because B is able to take a deduction for his gambling losses when computing AGI and again when computing AMTI.[322]

The dissent's analysis is flawed. As illustrated above, for purposes of computing AMTI, the taxpayer is allowed ATIDs. These deductions, however, are limited to those deductions not allowable in computing AGI. Thus, taxpayer B is not allowed to deduct his wagering losses twice. Moreover, the two similarly situated taxpayers (from an economic perspective) both would be subjected to a $9,000 AMT. The following illustrates the correct analysis:

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320. 107 S. Ct. at 988-89 n.2.
321. *Id.*
322. *Id.*

	Taxpayer A	Taxpayer B
Gross Income	$75,000	$150,000
AGI	$75,000	$ 75,000
ATID	(0)	(0)
AMTI	$75,000	$ 75,000
Exemption Amount	$30,000	$ 30,000
Regular Tax	0	0
AMT = 20% [($75,000 − 0) − $30,000]	20% [($75,000 − 0) − $30,000]	
	− [0]	− [0]
	= $9,000	= $9,000

Taxpayer A has AGI of $75,000 because A has no deductions attributable to a trade or business. Likewise, A has no deductions meeting the ATID qualifications. Thus, A's AMTI is $75,000. The AMTI less the exemption of $30,000, multiplied by twenty percent gives Taxpayer A $9,000 of AMT.

Taxpayer B, like Taxpayer A, has $75,000 AGI. B had $150,000 of gross income and pursuant to Section 62(1) and 165(d) was able to deduct the $75,000 of trade or business losses to arrive at AGI. Like Taxpayer A, Taxpayer B has no ATIDs. This is where the dissent erred.[323] Section 55(e)(1) provides:

> The term 'alternative minimum tax itemized deductions' means an amount equal to the sum of any amount allowable as a deduction for the

323. The following is the analysis presented by the dissent:

Consider two single individuals filing for the tax year ending December 31, 1986: A has $75,000 in non-gambling income, and $75,000 in itemized non-gambling deductions; B, a full-time gambler, has $75,000 in gambling winnings, $75,000 in gambling losses, $75,000 in non-gambling income, and $75,000 in itemized non-gambling deductions. A's gross income and adjusted gross income are both $75,000, and so is his alternative minimum tax base. The alternative minimum tax assessed on A is 20% of the excess of $30,000, *see* 26 U.S.C. §§ 55(a), 55(f)(1)(B), or $9,000. Assuming that full-time gambling is a trade or business, B has gross income of $150,000, adjusted gross income of $75,000 (because his gambling losses are attributable to a trade or business), and an alternative minimum tax base of zero (because gambling losses are deducted from adjusted gross income in computing the alternative minimum tax base). Thus, if full-time gambling were treated as a trade or business, B's gambling losses would shield him against the $9,000 minimum tax that Congress clearly intended him to pay. 107 S. Ct. at 988-89 n.2.

> taxable year (*other than a deduction allowable in computing adjusted gross income*) under . . . (A) section 165(a) for losses described in subsection (c)(3) or (d) of section 165. . . . (Emphasis added).[324]

Taxpayer B is not able to deduct wagering losses from both AGI and from AMTI. Thus, B's AMTI is $75,000 and like Taxpayer A, B will be subject to $9,000 AMT.

As the above illustrates, allowing the gambler "trade or business" status does not in any way hinder what Congress attempted to accomplish by enacting the alternative minimum tax provisions. Thus, it appears that Justices White, Rehnquist and Scalia were incorrect in their analysis as it pertains to the alternative minimum provisions which were enacted as part of the 1982 Act. Although the Justices' position may not be persuasive, it illustrates their commitment to the notion that gambling should not be accorded "trade or business" status.

IV. Application of Groetzinger—The Gambler and the Investor

The Supreme Court's holding in *Groetzinger* clears up the confusion which has existed since Justice Frankfurter wrote the concurring opinion in *DuPont*. We now can be sure that the "goods or services" test is no longer a prerequisite to "trade or business" status for purposes of federal taxation. Rather, the proper test requires an examination of all the facts and circumstances of each case. No one fact by itself, however, will be dispositive. The Court has announced that the following factors will be accorded substantial weight:

1. Whether the activity is pursued full-time;
2. In good faith;
3. With regularity;
4. For the production of income for a livelihood; and
5. Not as a mere hobby.[325]

Even with the foregoing guidelines, what actually constitutes a trade or business is still not free from obscurity. Each of the ele-

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324. I.R.C. § 55(a)(1) (1983).
325. *Groetzinger*, 107 S. Ct. at 988.

ments are subject to varied interpretations.[326] Thus, resolution of the issue is probably as far away from uniformity as it was when the courts were operating on two different standards. Unless Congress or the Treasury decide to enter the arena, the taxpayer's only possible source of guidance will be from case law.

A. *Extension of Groetzinger to the Investor*

An argument can be made that *Groetzinger* is authority for securities investors like Mr. Higgins to claim that they are engaged in carrying on a trade or business for purposes of federal taxation. Although this is a logical extension of the rationale adopted by the Court in *Groetzinger*, Justice Blackmun expressly stated that he did not intend to "overrule or cut back" the holding on *Higgins*.[327] Thus, it appears that a carve-out still exists for the investor. Less than two months after *Groetzinger* was decided, however, this very issue was the subject of debate before the United States Tax Court.

1. The Tax Court Refuses to Extend the Application of *Groetzinger* to the Investor

Judge Simpson, writing the Tax Court's opinion in *Beals v. Commissioner*, held that *Higgins* is still good law.[328] Thus, it concluded that Mr. Beals, a full-time investor, was not engaged in carrying on a trade or business. This result, especially in light of *Groetzinger*, is difficult to justify.

Mr. Beals had worked as a securities salesman for many years. After his company dissolved, he continued to be actively involved in the securities market. Rather than continuing as a salesman, however, he began managing his family's portfolio on a full-time basis. Before purchasing a security, he would undertake a thorough investigation of the company, including interviewing management, observing operations and compiling background information on the company's line of business. Thereafter, he would continue to monitor the company's performance very closely. He was not compen-

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326. The debate, undoubtedly, will revolve around what constitutes "full-time," "regularity" or "in good faith." With such nebulous terms, litigation is surely going to continue to flourish.

327. *Groetzinger*, 107 S. Ct. at 988.

328. Beals v. Commissioner, 58 T.C.M. 492 (1987).

sated by his wife or children for these services.[329]

In 1980, the Commissioner asserted a deficiency with respect to Mr. Beals' 1977 return.[330] Ignoring *Higgins*, the Service contended that Mr. Beals was engaged in carrying on a trade or business and therefore was subject to the self-employment tax provisions.[331] The taxpayer did not contest this position. Rather, seeking to reduce his tax liability, he amended his 1978 through 1980 returns, claiming that he was engaged in carrying on a trade or business and therefore able to take advantage of the provisions applicable thereto.[332] Taking an about face, the Service volleyed back and argued in tax court that *Higgins* controlled.

Quoting Justice Blackmun in *Groetzinger*, the Tax Court stated:

> . . . expenses incident to caring for one's own investments, even though that endeavor is full-time, are not deductible as paid or incurred in carrying on a trade or business . . . the opposite conclusion may follow for an active trader.[333]

With this statement, the court stood by the view that an investor is not engaged in carrying on a trade or business. It concluded that the management of one's own investments, despite the extent and scope of the activities incident thereto, is not a trade or business for federal tax purposes.[334]

As illustrated by the Tax Court in *Beals*, although a taxpayer meets the *Groetzinger* requisites, he may not always be granted trade or business status. Without any logical explanation, the investor remains a carve-out.

2. There is No Rationale for Treating the Gambler Differently Than the Investor

There is no rationale for treating the gambler any differently than the investor. The activities of both are identical in almost

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329. *Id.* at 493.
330. *Id.*
331. *Id.*
332. *Id.* Mr. Beals asserted I.R.C. § 1348 (1980) (now repealed) which put a cap on his tax liability with respect to the income he earned from his trade or business.
333. *Id.* at 494.
334. *Id.*

every respect. For this reason, Justice Blackmun's attempt by means of dicta to retain a disparity in the treatment of these individuals is without merit. An examination of the activities of both the gambler and the investor will make this apparent.

The courts have attempted to distinguish the two activities. It is asserted that the investor's activities are purely passive. His profit is derived from the activities of the companies in which he invests. It is the companies' management teams and key employees which determine whether the taxpayer will receive a return on his investment. In contrast, the courts assert that the gambler's profits are derived from his skilled decision-making rather than the work of others.[335]

There is no substance to this distinction. The gambler's activities are indistinguishable from those of the investor. Although skill may be required to choose a dog for purposes of placing a wager, skill is also required by the investor for purposes of choosing an investment. It may be true that the majority of the effort which goes into deriving the investor's profits comes from the company's activities, rather than his investment decision. However, the same holds true for the gambler. It is the dog, its trainers and its owners whose activities control whether the gambler will receive a return on his investment. With this in mind, there does not appear to be any rationale for allowing the gambler trade or business status and not the investor.

One could argue that the investor carve-out is designed to preclude taxpayers from turning capital losses into ordinary losses. With the passage of the Tax Reform Act of 1986 and the revision of Section 1212, however, this is no longer a viable argument.[336] Likewise, with the enactment of Section 469(e)(1)(A)(i)(I), which subjects portfolio income derived in the ordinary course of a trade or business to stringent passive loss rules, no argument can be made that *Higgins* should continue to exist in order to prevent the creation of tax shelters.[337]

Many courts advocate the carve-out of the investor solely on

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335. *See* Lopez, *Defining "Trade or Business" Under the Internal Revenue Code: A Survey of Relevant Cases*, 11 FLA. ST. U.L. REV. 949, 957-61 (1984).

336. *See* I.R.C. §§ 1202 and 1212 (1986).

337. *See* I.R.C. § 469(e)(1)(A)(I) (1986).

the rationale that his activities are personal in nature. On this basis alone, it is concluded that the investor should not be accorded trade or business status. This position, however, is simply a camouflaged version of the "goods or services" test. Therefore, in light of *Groetzinger*, it should not continue to receive support.

The activities of the taxpayer who gambles on his own account with the intent to earn a livelihood, like those of the taxpayer who invests on his own account with the intent to earn a livelihood, are purely personal in nature. Neither the gambler nor the investor offer goods or services to others. Yet, the gambler has been ascribed trade or business status. Thus, it follows that the personal nature of the investor's activities is not a valid basis for refusing to treat him in a manner consistent with the treatment accorded the gambler. In fact, Justice Blackmun made it clear in *Groetzinger* that whether a taxpayer's activities are personal in nature has no effect on the determination of whether he is engaged in carrying on a trade or business.[338] This conclusion is implicit in the Court's decision that offering goods or services to others is not a prerequisite to trade or business status. Moreover, this conclusion finds support in the legislative history which accompanied the enactment of Section 23(a)(2) (the predecessor of Section 212) over forty years ago.[339]

Congress made it clear that it never intended that the full-time investor be carved-out of the trade or business category.[340] Rather, Congress has indicated that its goal, by enacting Section 162 and its predecessors, was to prevent the deductibility of expenses from gross income which relate to activities that are both personal in nature and not entered into with the intent of producing income.[341]

Based upon the foregoing, it is clear that the judiciary's continued carve-out of full-time investors like Mr. Higgins from trade or business status is without merit. The activities of the full-time gambler and the full-time investor are identical. Yet, the investor is not accorded trade or business status. Thus, the expenses which

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338. *Groetzinger*, 107 S. Ct. at 987-88.

339. I.R.C. § 23(a)(2) (the predecessor of § 212) was enacted in 1939.

340. 88 CONG. REC. 6376 (statement of Mr. Disney) ; *see also* H.R. REP. No. 2333, 77th Cong., 2d Sess. 46.

341. *Id.* Mr. Disney explained that the types of activities at issue are hobbies (e.g., yachting, horse breading. . .).

he incurs as a result of his activities, unlike the gambler, are deductible below-the-line and subject to a two percent floor.[342] However, pursuant to Section 274(h)(7), enacted as part of the Tax Reform Act of 1986, the investor is *not* allowed to deduct any expenses incurred as a result of attending seminars or meetings dedicated to investment topics.[343] If he was considered engaged in carrying on a trade or business, however, those expenses would be deductible.[344] Moreover, unlike the gambler, if the investor has had a poor year and incurs a net operating loss, he is not entitled to use the carryover provisions of Section 172.[345]

There is no justification for the disparity in treatment between the gambler and the investor. Unless Congress or the Treasury decide to act, it appears that this inequity will continue to exist.

B. Other Issues Arising from Groetzinger

The *Groetzinger* decision makes it clear that the full-time gambler, pursuant to Section 162, will be allowed to deduct all of the necessary and ordinary expenses incurred in carrying on his trade or business.[346] This will encompass expenses such as the gambler's travel costs, hotel accommodations and meals when away from home overnight, and the cost of wagering programs or related literature. Pursuant to Section 62, these expenses are deductible directly from gross income to arrive at adjusted gross income.[347] Thus, unlike the investor, the gambler's deductions are not below-the-line and subject to a two percent floor. In further contrast to the investor, if the gambler has a poor year and incurs an overall

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342. *See* I.R.C. § 67(6) (1986). Certain miscellaneous itemized deductions, including expenses deductible pursuant to § 212, are deductible below the line and subject to a floor equal to 2% of adjusted gross income. Included in these expenses will most likely be fees incurred for investment advice, fees to collect dividends, fees paid to an IRA custodian, etc. . .

The gambler's expenses, however, because he is considered engaged in carrying on a trade or business, are deductible directly from adjusted gross income. *See* I.R.C. § 62(a)(1) (1986).

343. I.R.C. § 274(h)(7) (1986).

344. *Id.*

345. I.R.C. § 172(d)(4) (1986). Although not entitled to the carryover provisions of § 172, the investor is allowed, pursuant to § 165 (c)(2), to deduct his losses. Via § 62(a)(3), these losses are deductible directly from adjusted gross income.

346. I.R.C. § 162 (1986).

347. I.R.C. § 62(a)(1) (1986).

loss, because he is considered engaged in carrying on a trade or business, he will be able to carryover his unused losses under Section 172.[348]

Although Mr. Groetzinger won the battle and the foregoing rights, his victory was not without casualties. For one, he will now be subject to the self-employment tax provisions of the Code.[349] Under current law, this will result in the imposition of a tax amounting to ten percent of the taxpayer's self employment income.[350] Moreover, his wagering losses will be limited to his winnings.[351]

The task of policing the tax system was assigned to the I.R.S. many years ago. The judiciary has been cognizant of the difficult nature of the Service's job and has traditionally taken this into consideration when formulating its decisions. The *Groetzinger* opinion, however, appears to be an exception to this rule. As previously mentioned, the gambler's losses are deductible pursuant to Section 165(d) and subject to the carryover provisions of Section 172. By allowing the gambler trade or business status and the corresponding right to carryover his excess losses to future years, compliance becomes an issue. Because the gambler's losses are now more valuable, the motivation to inflate these figures is greater than ever.

The losses incurred by the investor from the sale of stocks or securities are easily verified by the records of his broker or the purchaser. The losses incurred by the gambler, however, are not susceptible to such accountability. Thus, if the Service wishes to verify the losses claimed by the gambler, it must undertake a complete review of his financial records. This is not only burdensome, it is likewise time-consuming and expensive. Due to the vast number of tax returns filed each year and the limited manpower of the I.R.S., there is great potential for dishonesty of this nature to go undetected.

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348. I.R.C. § 172 (1986).

349. *See supra* note 145.

350. I.R.C. § 1401(a)(6) (1986) imposes a tax at the rate of 8.55% and § 1501(b)(6) tacks on an additional 1.45%.

351. I.R.C. § 165(d) (1986). *See supra* note 317.

V. CONCLUSIONS

We have come full circle. Beginning with the "facts and circumstances" test originally announced by the Court in *Higgins*, up through cases like *Gajewski* and *Gentile* where the courts grasped onto the "goods or services" test, and now *Groetzinger* where the Supreme Court finally decided to wipe the slate clean. Now, in order to determine whether a taxpayer is engaged in carrying on a trade or business, the "fact and circumstances" test must be employed. Justice Frankfurter's test no longer has vitality.

The "facts and circumstances" test requires that the courts undertake a review of the facts and circumstances of each case. No one fact is to be dispositive. This test is far from precise. Accordingly, vast room for debate exists. Thus, there will continue to be divergence in the decisions of the different courts.

As Justice Blackmun expressed in *Groetzinger*, the term "trade or business" is not susceptible to the parameters which would be created by a precise definition. This point is well supported by the vast amount of litigation that has been perpetuated as a result of the issue and further by the court's inability to resolve the dilemma. Therefore, in light of the expansive nature of the term "trade or business" and the insurmountable difficulty experienced by the judiciary in its quest to define the term, it is unlikely that Congress will enter the arena and attempt to formulate its own definition. Going back to the "goods or services" test, however, may be a viable alternative.

Although the "facts and circumstances" approach creates results which most closely correspond to the meaning which Congress intended to be attached to the term "trade or business," the approach is not without shortcomings. For one, it allows the gambler trade or business status. As previously illustrated, in light of the judicial carve-out of the investor, this creates an inequity which should not exist. Moreover, this result creates potential for compliance problems.

Adoption of the "goods or services" test would be a complete solution to these problems. This approach creates the same results as the "facts and circumstances" test in every case except for the gambler and the investor. Removing these individuals from trade or business status would alleviate the disparity in treatment that

presently exists with respect to these taxpayers. It would also remove, to a great extent, the compliance problems associated with the gambler.

Due to the fact that the Code, as presently drafted, requires that the plain meaning of the term "trade or business" be used, adoption of the "goods or services" test would be in direct conflict with the intent of Congress. Thus, if these problems are to be alleviated in this manner, the solution must be one accepted through the legislative process.

If the legislature refuses to act, the judiciary should at least attempt to remove the disparity in treatment that presently exists between the investor and the gambler. This could be accomplished without frustrating congressional intent by simply removing the investor carve-out. Those investors, who invest with the intent to earn a livelihood and do so on a full-time, substantial and continuous basis, would be accorded trade or business status. Those who fail to meet these requisites, however, would be left with Section 212. This solution, although it removes the gambler/investor disparity, falls short in that it does not resolve the compliance problems associated with the gambler.

Unless Congress or the judiciary chooses to act, the foregoing problems will continue to exist. Moreover, the destiny of the law in this area will continue to be governed by the courts and their examination of the facts of each case.