

Larry's Tax Law

U.S. Tax Court Petition Filed by a Professional Gambler

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Is a full time gambler in the trade or business of gambling? If the answer is yes, two results follow (one result which is good and one result which is not so good): **(1)** the gambler is able to deduct under Section 162 of the Code all of the ordinary, necessary and reasonable expenses incurred in carrying on the business; and **(2)** the net income of the gambler, if any, is subject to self-employment tax under Section 1401 of the Code.

In 1987, the United States Supreme Court was presented with the issue of whether a full time gambler was engaged in the trade or business of gambling. *Commissioner v. Groetzinger*, 480 US 23 (1987). Justice Blackmun issued the court's opinion. The Supreme Court thoroughly reviewed the history of the phrase "trade or business" in the context of the Internal Revenue Code. The court stated: "[T]o be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income profit. A sporadic activity, a hobby, or an amusement diversion does not qualify." Whether a taxpayer is engaged in a trade or business is a question of facts and circumstances.

In *Groetzinger*, evidence revealed the taxpayer spent substantial amounts of time preparing for and actually gambling. He had been gambling for a long period of time; the activity was not sporadic. It was continuous. Mr. Groetzinger had no other "profession or type of employment." He engaged in gambling with the intent to make a profit. The court ultimately concluded, gambling may constitute a trade or business, and based upon the facts presented, Mr. Groetzinger was engaged in the trade or business of gambling.

Mr. Groetzinger won the battle in that his victory allowed him to deduct his ordinary, necessary and reasonable expenses associated with his gambling activities. He lost the war in part because his net income (if any) would now be subjected to self employment taxes. The result was likely unsuspected by the taxpayer.

Another interesting twist to the decision in *Groetzinger* -- what happens if the expenses of a gambling trade or business generate a net operating loss for the tax year? Does Section 165(d) of the Code disallow the loss?

Section 165(d) provides:

“Losses from wagering transactions shall be allowed only to the extent of gains from such transactions.”

Groetzinger did not specifically address this issue. The issue, however, has been encountered over the years since *Groetzinger* was decided by the courts and the Service. Unfortunately, the position taken by the Service and the opinions of the courts have not always been consistent. Taxpayers were left with uncertainty when dealing with this issue. In 2011, however, the IRS ended the uncertainty when it concluded, while gambling losses alone cannot generate a deductible loss, expenses relating to the activity (provided it rises to a trade or business), may generate a deductible loss. See [Chief Counsel Memorandum AM 2008-013](#). See also Reichert, [Wagering Losses Not Deductible, Gambling Business Expenses Deductible](#), *Journal of Accountancy* (May 2011).

The US Tax Court will soon be presented with another saga involving a gambler. On November 29, 2013, Randy Binning, a resident of Nevada and a full time gambler, filed a petition with the tax court. Based upon his petition, the case involves a deficiency of taxes, interest and penalties exceeding \$2,500,000. Mr. Binning was stopped by an Arizona police officer for a traffic violation while driving through the state. The officer discovered over \$400,000 in cash in the automobile. Mr. Binning informed the police that the cash came from gambling activities. The Arizona authorities notified the IRS for further investigation. After concluding its exam, the Service issued a jeopardy assessment, followed by a Notice of Deficiency, based upon its conclusion the taxpayer failed to properly report his gambling income. Mr. Binning asserts the income, considering reasonable, ordinary and necessary business expenses, was properly reported. Stay tuned! Based upon the petition, this case should turn out to be an interesting battle.

If you have an interest in reading about the history of the phrase “trade or business,” see *Brant, The Evolution of the Phrase Trade or Business: Flint v. Stone Trace Company to Commissioner v. Groetzinger – An Analysis with Respect to the Full-Time Gambler and the Investor*, 23 *Gonzaga Law Review* 513 (1987/1988).

Tags: gambling, trade or business, U.S. Tax Court