New York State Department of Taxation and Finance
Office of Counsel
Advisory Opinion Unit

TSB-A-12(2)I
Income Tax
February 27, 2012

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I110615A

The Department of Taxation and Finance received a petition for Advisory Opinion from [redacted]. Petitioner asks whether his gambling activities would be considered the conduct of a trade or business for New York State income tax purposes. Although Petitioner currently resides in Pennsylvania, he is considering the relocation to New York and wishes to ascertain with some certainty the tax treatment of his gambling activities.

We conclude that the facts presented by Petitioner are sufficient to demonstrate the undertaking of a gambling "trade or business" within the meaning of section 162(a) of the Internal Revenue Code. Pursuant to section 165(d) of the Internal Revenue Code, Petitioner may deduct the losses from his wagering transactions only to the extent of the gains from such transactions. Without facts which are unknown at this time, we are unable to answer with certainty whether Petitioner's gambling activities would continue to be considered a "trade or business" in the event Petitioner secured additional full-time outside employment.

Facts

Petitioner regularly and continuously participates in the placing of pari-mutuel bets on thoroughbred horse races throughout the United States for the sole purpose of generating a profit as his sole source of livelihood. Petitioner places his bets into United States pari-mutuel pools through licensed advance-deposit wagering companies. All bets are placed by Petitioner from his computer servers in Pennsylvania.

Petitioner places bets on thoroughbred horse races 364 days per year for a total of over one million individual bets during the year. Petitioner kept a detailed log of his bets, his winnings and his losses. During 2010, Petitioner placed bets of $42,814,683, which generated winnings of $45,393,124 and net income of $1,008,345 after deduction for the cost of bets and other expenses incurred in the operation of the gambling business. Petitioner may in the future decide to obtain a full-time job while continuing to operate his gambling business. The gambling business would continue at the same level. Petitioner expects that the income earned from any such job would be far outweighed by the net income earned from his gambling business, and that his gambling business would continue to be the primary source of his livelihood. Petitioner has not historically engaged in any other trade or business.

Petitioner uses his skills as a mathematician to determine the horses on which his bets are placed. Together with a colleague, Petitioner created a statistical model that predicts the likelihood of certain horses winning a race. The colleague is paid an agreed upon amount by

Petitioner for the right to use within the statistical model an algorithm created by the other individual. Using the odds generated by the statistical model, Petitioner compares his predicted odds to the odds posted by the racing tacks to find mispricings in the markets and places bets accordingly. This methodology requires intense analysis of each horse in each race and voluminous betting on a daily basis. Petitioner devotes approximately 20 hours per week to his gambling activities and need not appear at any racetrack to conduct his activities.

Analysis

The first issue raised is whether Petitioner's gambling activities, were they to be undertaken in New York, would rise to the level of a "trade or business" for New York State income tax purposes.

The New York taxable income of a resident individual is his New York adjusted gross income less certain deductions and expenses. New York adjusted gross income is federal adjusted gross income with certain New York modifications. (Tax Law §§611, 612). Federal adjusted gross income is defined in the Internal Revenue Code as gross income minus certain deductions. Gross income is defined as gross income derived from business, and allowable deductions include all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. 26 U.S.C §§162(a), 62(a)(1), 61(a)(2).

The issue of whether a gambler who makes wagers solely for his own account, and engages in other employment, is engaged in a trade or business within the meaning of sections 62(a)(1) or 162(a) of the Internal Revenue Code is not new. In *Commissioner v. Groetzinger*, 480 U.S. 23 (1987), the Supreme Court acknowledged that this issue has "been around" for a long time and has not met with consistent treatment in the Tax Court itself or in the Federal Courts of Appeals. *Id.* at 32. While recognizing the lack of a helpful consistent standard to determine the issue, the Court held that resolution of the issue must "require an examination of the facts in each case." *Id* at 36, *citing Higgins v. Commissioner*, 312 U.S. 212, 217 (1941). In *Groetzinger*, the Court identified those salient facts to be as follows: the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. The Court concluded that if one's gambling activity is pursued with continuity and regularity and the primary purpose for engaging in the activity is for income or profit, it is a trade or business. "A sporadic activity, a hobby, or an amusement diversion does not qualify." *Id.* at 35.

Treasury regulations provide additional guidance on what constitutes activity engaged in for profit. Regulation §1.183-2 identifies the following relevant factors: the manner in which the taxpayer carries on the activity, the expertise of the taxpayer or his advisors, the time and effort expended by the taxpayer in carrying on the activity, the expectation that assets used in activity may appreciate in value, the success of the taxpayer in carrying on other similar or dissimilar activities, the taxpayer's history of income or losses with respect to the activity, the amount of occasional profits, if any, which are earned, the financial status of the taxpayer and the elements of personal pleasure or recreation.

Petitioner undertakes his gambling activities with consistent, almost-daily effort. Petitioner uses his skills as a mathematician to determine the horses on which his bets are placed. Together with a colleague, Petitioner utilized his expertise to create a statistical model that predicts the likelihood of certain horses winning a race. Petitioner places bets on thoroughbred horse races 364 days per year and places over one million individual bets during the year. Petitioner has not historically engaged in any other profession or business. Petitioner has had success in his gambling activities, earning a net income in excess of $1,000,000 in 2010. Petitioner undertakes his gambling activities out of his home (rather than at a racetrack or casino) where there are likely to be fewer elements of recreation or personal pleasure. Were Petitioner to undertake these identical activities in New York, he would satisfy the requirements for being engaged in a 'trade or business' for New York State income tax purposes.

Petitioner has also inquired about the nature of the deduction of his gambling losses, suggesting that he would be entitled to deduct from his gambling winnings all of his gambling losses and bets and all other ordinary and necessary expenses incurred in carrying on his gambling activities, including but not limited to the amounts paid to his colleague for the use of the colleague's algorithm in Petitioner's statistical betting model. We do not agree that Petitioner's deductions are unlimited. Section 165(d) of the Internal Revenue Code provides that "losses from wagering transactions shall be allowed only to the extent of the gains from such transactions."

Section 165(d) does not distinguish between gambling losses incurred by an occasional gambler and those incurred by a person who engages in gambling as a livelihood. *See Boyd v. United States*, 762 F.2d 1369 (9th Cir. 1985), *Nitzburg v. Commissioner*, 580 F.2d 357 (9th Cir. 1978). *See also Kent v. United States*, 185 F.3d 867 (9th Cir. 1999) *cert. denied* 528 U.S. 1116 (2000); *Valenti v. Commissioner*, 68 TCM 838 (Tax Court, 1994). These courts have all consistently held that the prohibition of section 165(d) applies to both professional and non-professional gamblers. The Court in *Groetzinger* likewise acknowledged that the confinement of gambling loss deductions to the amount of gambling gains closed the door to suspected abuse, while at the same time noting that "Congress has been realistic enough to recognize that such losses do exist and do have some effect on income, which is the primary focus of the federal income tax law." 480 U.S. at 32. Petitioner's losses from his wagering transactions shall be permitted only to the extent of the gains from such transactions.

Finally, Petitioner inquires whether the conclusion regarding the trade or business analysis would change were Petitioner to secure full-time outside employment. While we are unable to answer a hypothetical question with certainty, we note that the analysis set forth above does, in part, turn on the exclusive nature of the gambling activities. If a non-gambling full-time job were to be undertaken by Petitioner, it is possible that the gambling activities would by necessity be relegated to less than 20 hours per week, which may then impact the characterization of these activities.

The facts presented by Petitioner are sufficient to demonstrate the undertaking of a gambling "trade or business" within the meaning of section 162(a) of the Internal Revenue Code.

Pursuant to section 165(d) of the Internal Revenue Code, Petitioner may deduct the losses from his wagering transactions only to the extent of the gains from such transactions. Without facts which are unknown at this time, we are unable to answer with certainty whether Petitioner's gambling activities would continue to be considered a "trade or business" in the event Petitioner secured additional full-time outside employment.

DATED: February 27, 2012

/S/
DEBORAH R. LIEBMAN
Deputy Counsel

NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.