NO. CV 04 4001070S	:	SUPERIOR COURT
PETER B. STONE	:	TAX SESSION
	:	JUDICIAL DISTRICT OF
v.	:	NEW BRITAIN
COMMISSIONER OF REVENUE SERVICES	:	FEBRUARY 7, 2007

MEMORANDUM OF DECISION

The plaintiff, Peter B. Stone (Stone), brings this appeal contesting the decision of the commissioner of revenue services (commissioner) disallowing the plaintiff's deduction of gambling losses against gambling winnings and the imposition of additional income tax assessments against the plaintiff for the calendar years 1998 and 1999 (hereinafter the taxable years).

During the taxable years, the plaintiff resided in New Milford, Connecticut and was a full-time salaried employee of Xerox Corporation until his retirement in October 1999. The plaintiff also was a sole proprietor of Peter Stone Canvas, a part-time seasonal business which manufactured, repaired and installed canvas products. The plaintiff further owned and managed commercial income-producing real estate.

The plaintiff claims to be a professional gambler, a person who is in the trade or

business of gambling, and indicated so when he filed Schedule C[1] of his 1998 and 1999 federal income tax return forms 1040. See Plaintiff's Exhibits 1 and 3.

During the taxable year 1998, the plaintiff played slot machines at various casinos for a total of 43 days and was issued forms W-2G[2] by casinos reporting slot machine winnings. On Schedule C of his 1998 federal return, the plaintiff reported gambling gross receipts of $44,464 and expenses of $44,464 resulting in $0 net profit. See Plaintiff's Exhibit 1.

During the taxable year 1999, the plaintiff played slot machines at various casinos for a total of 22 days and was issued forms W-2G.[3] On Schedule C for his 1999 federal return, the plaintiff reported gambling gross receipts of $120,170 and expenses of $120,170 resulting in $0 net profit. See Plaintiff's Exhibit 3.

On his Connecticut state income tax return, form CT-1040, Stone reported both his federal adjusted gross income and Connecticut adjusted gross income for 1998 as $83,748.[4] See Plaintiff's Exhibit 2. For 1999, Stone reported his federal adjusted gross

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1

IRS Profit or Loss from Business form.

2

IRS Certain Gambling Winnings form. Operators of slot machines are required to furnish forms W-2G to those winners who receive a winning payout of $1,200 or more. See, e.g., Plaintiff's Exhibit 13.

3

See, e.g., Plaintiff's Exhibit 14.

4

Taxpayers are required to list any additions and subtractions to the federal adjusted gross income on lines 30-37 and lines 38-47, respectively, of Schedule 1 to form CT-1040.

income and Connecticut adjusted gross income as $27,888 on form CT-1040. See Plaintiff's Exhibit 4.

The plaintiff testified that he gambled regularly on slot machines at various New Jersey and Connecticut casinos where he typically placed five to ten bets per minute on $5 slot machines. The plaintiff's friend Kathryn Ruzek (Ruzek) accompanied Stone on all of his gambling trips and kept detailed records of his gambling activities on post-it notes. Ruzek recorded the dates and hours of Stone's attendance at the various casinos and the specific slot machines he played, the amount of money he spent, including all checks and ATM withdrawals made, and the amount of jackpots. Following each gambling trip, Ruzak placed the post-it notes in a manila envelope. During the tax filing season, Ruzak entered the information written on the post-it notes[5], forms W-2G, credit card records and checks into a computer spreadsheet. The plaintiff's accountant then used the spreadsheet to prepare the plaintiff's federal and state income tax return forms.

The plaintiff testified that he read gambling instructional materials and periodicals to study slot machines, especially the payouts from different types of slot machines. During the taxable years, the plaintiff was rated in the top 1-2% of gambling patrons by New Jersey and Connecticut casinos. According to the plaintiff, the casinos rate players based upon the total amount of money gambled and treat rated players with "respect" by providing them with privileges such as access to lounge areas, food and parking. In

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[5] Ruzek testified that she discarded the post-it notes once the information written upon them was entered into the spreadsheet.

addition, the plaintiff was invited to play in slot machine casino tournaments during the taxable years.

"Income derived from wagering transactions is includible in gross income under the provisions of section 61 of the Internal Revenue Code." Rev. Proc. 77-29, 1977-2 CB 538. Section 165 (d) of the Internal Revenue Code provides that "[l]osses from wagering transactions shall be allowed only to the extent of the gains from such transactions." 26 U.S.C. 165 (d).

On the federal level, gambling winnings and losses are reported on form 1040 in one of two ways. If the taxpayer is engaged in the business of gambling, the taxpayer files Schedule C to form 1040 and reports the business income or loss from gambling on line 12 of form 1040. If the taxpayer is not a professional gambler, the taxpayer reports gambling winnings on line 21 of form 1040 and files Schedule A to form 1040 in order to itemize deductions attributable to gambling losses to the extent of gambling winnings.

It is the commissioner's position that the plaintiff (1) was not a professional gambler during the taxable years, (2) was not eligible to file Schedule C to form 1040 and to report zero income on line 12 of form 1040 and (3) owes additional income tax on the plaintiff's gambling winnings.

As an example, the plaintiff reported on his 1998 federal form 1040 that he was a professional gambler and that his adjusted gross income was $83,748. See Plaintiff's Exhibit 1. If the plaintiff was not a professional gambler during the taxable year 1998 and therefore, not eligible to file Schedule C, he would have reported his gambling winnings

in the amount of $44,464 on line 21 of his 1998 federal form 1040 and increase his adjusted gross income to $128, 212.

In contrast to the federal level, non-professional gamblers filing their Connecticut state income tax returns must report all winnings as gross income. Connecticut income tax liability starts with a taxpayer's "properly reported" federal adjusted gross income. General Statutes § 12-701 (a) (19) provides, in relevant part, as follows: "'Adjusted gross income' means the adjusted gross income of a natural person with respect to any taxable year, as determined for federal income tax purposes and as *properly reported* on such person's federal income tax return." (Emphasis added.)

Taking the federal adjusted gross income, § 12-701 (a) (20) allows taxpayers to modify their Connecticut adjusted gross income with a list of additions and subtractions. Unless taxpayers filing Connecticut income tax returns have a trade or business from which to deduct business expenses, ordinary gambling losses cannot be deducted from a taxpayer's Connecticut adjusted gross income, unless specifically allowed by statute. This is so "[b]ecause deductions and exemptions from otherwise taxable income are matters of legislative grace . . . ." D. A. Pincus & Co. v. Meehan, 235 Conn. 865, 873, 670 A.2d 1278 (1996).

Having outlined the factual background and statutory context, the issue in this case is whether the plaintiff's gambling activities during the taxable years constituted a trade or business that would have permitted the plaintiff to file a Schedule C to his federal return and deduct his gambling losses to the extent of his gambling winnings. The

resolution of this issue is fact-oriented. See Commissioner v. Groetzinger, 480 U.S. 23, 35-36, 107 S. Ct. 980, 94 L. Ed. 2d 25 (1987) (60-80 hours per week, 48 weeks per year devoted to parimutuel wagering on dog races constitutes professional gambling). See also Pacific Indemnity Ins. Co. v. Aetna Casualty & Surety Co., 240 Conn. 26, 31, 688 A.2d 319 (1997) ("business pursuits means a continued or regular activity that is conducted for the purpose of profit, such as a trade, profession or occupation").

In Groetzinger, the court determined that the term "trade or business" was difficult to define under the Internal Revenue Code. The court further stated that "the difficulty rests in the Code's wide utilization in various contexts of the term 'trade or business,' in the absence of an all-purpose definition by statute or regulation, and in our concern that an attempt judicially to formulate and impose a test for all situations would be counter productive, unhelpful, and even somewhat precarious for the overall integrity of the Code." Groetzinger, 480 U.S. 36. Recognizing that cases of this nature should be decided on the facts, the Groetzinger court considered the following factors in its analysis of whether the taxpayer's gambling activities rose to the level of a trade or business: "if one's gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes with which we are here concerned." Id., 35. The commissioner has adopted the Groetzinger factors for the purpose of determining whether a person is a professional gambler.

The facts in the present case are not as clear as those in Groetzinger because the plaintiff Stone was employed full-time by Xerox Corporation until October 1, 1999, conducted a part-time seasonal canvas products business, owned income-producing real estate and spent 43 days in 1998 and 22 days in 1999 casino slot machines gambling.

The commissioner argues that the plaintiff must be engaged in gambling full-time and pursue gambling to produce income for a livelihood in order for the plaintiff to be engaged in gambling as a trade or business. However, in Connecticut, it is not necessary that a business activity be the principal occupation rather than a part-time or supplemental activity. See Pacific Indemnity Ins. Co. v. Aetna Casualty & Surety Co., 240 Conn. 32.

The court is mindful that the Groetzinger court recognized that the term "trade or business" is difficult to define. The lesson learned from Groetzinger is that no formulae or test can be developed that can be applied universally to all cases. In fact, the Groetzinger court stated that "the Code has never contained a definition of the words 'trade or business' for general application, and no regulation has been issued expounding its meaning for all purposes. Neither has a broadly applicable authoritative judicial definition emerged. . . ." Groetzinger, 480 U.S. 27.

The Treasury Regulations (regulations), in effect pursuant to § 183 of the Internal Revenue Code, provide that "[t]he determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the

activity, or continued the activity, with the objective of making a profit. . . . In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent." Treas. Reg. § 1.183-2 (a).[6]

The facts and circumstances in the present case indicate that the taxpayer was engaged in gambling activity with the objective of making a profit. The plaintiff testified that he believed he was pursuing an income goal for a livelihood and kept track of his wagering for this purpose.

With regard to what factors contribute to whether a taxpayer engages in an activity for profit, the regulations under § 183 provide nine factors to consider: "(1) the extent to which the taxpayer carries out the activity in a businesslike manner; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in other similar or dissimilar activities; (6) the taxpayer's history of income or losses attributable to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the taxpayer's financial status; and (9) any elements of personal pleasure or recreation in the activity. Treas. Reg. § 1.183-2 (b) (1)-(9)." Westbrook v. Commissioner, 68 F.3d 868, 876 (1995).

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[6] Although there is no general incorporation of federal tax concepts into our state tax laws, incorporation of federal tax principles makes sense where applicable to the issue at hand. See Bell Atlantic NYNEX Mobile, Inc. v. Commissioner of Revenue Services, 273 Conn. 240, 261-62, 869 A.2d 611 (2005).

In consideration of the second factor listed in the regulations, the plaintiff argues that skill is involved in order to successfully play casino slot machines. The commissioner produced as an expert witness, Professor Robert Hannum (Professor Hannum), a full professor of statistics at the University of Denver with a special interest in the mathematics of gambling. Professor Hannum testified that the playing of slot machines requires no skill since skill requires an exercise of judgment that affects the outcome of the play. As discussed above, the plaintiff studied gambling techniques and slot machines; however, playing slot machines is squarely a game of chance without the player affecting his success each time the slot machine is engaged.

Professor Hannum discussed how there is a house advantage in playing casino slot machines and that there is a mathematical advantage programmed into the slot machines by the casino operators. According to Professor Hannum, a 92% payback to the player is average; therefore, a slot machine player can expect to lose approximately $8 out of every $100 played. Professor Hannum also noted that a player can be a winner at slot machines over a shot period of time, but in the long-term, a player will lose. In Professor Hannum's opinion, a slot machine player cannot be a professional gambler because he or she would not have the expectation of making a profit. Under Professor Hannum's theory, a slot machine player can never have a profit motive.

The plaintiff contends that he had a profit motive because he exhibited an expectation of winning at slot machines in the taxable years 1998 and 1999. In those years, the plaintiff reported slot machine winnings of $44,464 and $120,174, respectively.

However, Professor Hannum's opinion, that a slot machine player cannot win over the long-term, is supported by the plaintiff's tax returns for 1998 and 1999. In those taxable years, the plaintiff had gambling losses equal to or greater than his gambling winnings.

During the taxable year 1998, the plaintiff had $83,748 listed as federal adjusted gross income on his federal and Connecticut income tax return forms consisting of $46,902 in wages, $373 in taxable interest, a business loss of $3,193 from the canvas operation and a taxable portion for pensions and annuities of $39,666. See Plaintiff's Exhibits 1 and 2. For the taxable year 1999, the plaintiff had $27,888 listed as federal adjusted gross income on his federal and Connecticut income tax returns consisting of $45,821 in wages, $61 in taxable interest, a business loss of $5,494 from the canvas operation and a loss of $12,500 from the real estate rental.

The court accepts Professor Hannum's opinion as credible that, regardless of a player's study of slot machine payouts and instructional materials, a gambler cannot exercise such skill as to affect the payout of slot machines because the machines are programmed to cause the player to lose in the long run. Furthermore, the key test here for determining whether a taxpayer is engaged in the trade or business of gambling is not skill when playing slot machines, but the expectation of winning or having "profit motive".

Although the plaintiff believes he will be successful playing slot machines and this belief is unrealistic from a statistical basis, it is difficult for the court to find that a slot machine gambler has no subjective expectation of winning. See, e.g., Busch v.

Commissioner of Revenue, 713 N.W.2d 337, 349 (Minn. 2006), where the Minnesota Supreme Court reversed the decision of the Minnesota Tax Court and held that "the taxpayer's expectation of profit from a given activity need not always be reasonable for the activity to qualify as a trade or business."[7]

In addressing the first profit motive indicator listed in the regulations, the plaintiff did conduct his gambling activities in a businesslike manner by keeping detailed records of the days he gambled, the types and numbers of machines played and his winnings and losses.

The third indicator, time and effort expended, does not support a finding that the plaintiff's gambling activities were conducted in such depth and with adequate continuity and regularity because the plaintiff gambled only 43 days in 1998 and 22 days in 1999. The court concurs with the commissioner that the plaintiff's visits to the casinos were irregular and infrequent during the taxable years and that the plaintiff's time was limited by his full-time work for Xerox and the approximately 350 hours devoted to his canvas business.[8]

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[7] The court notes that the Busch decision resolved in the taxpayer's favor by placing the burden of proof on the commissioner rather than the taxpayer. However, Connecticut follows the rule that the burden of proving an error in a deficiency assessment is on the taxpayer. See Leonard v. Commissioner of Revenue Services, 264 Conn. 286, 302, 823 A.2d 1184 (2003).

[8] "[T]he Plaintiff's visits to the casinos during the Taxable years were irregular and infrequent. To this end, during the Taxable year 1998, the Plaintiff visited casinos only two days each in May and June, three days in September, one day in October and zero days in November. During the Taxable year 1999, the Plaintiff visited casinos only one day each in March, May

As to the fourth indicator, there was no evidence offered to show that the plaintiff had an expectation that assets used for his gambling would appreciate in value. As to the fifth and sixth indicators, there is nothing to support the plaintiff's contention that he has a successful history of winning while playing slot machines during the taxable years. Although the plaintiff reported substantial jackpots in the years 2000 through 2003, the present issue is whether the plaintiff was engaged in a trade or business as a gambler in the taxable years 1998 and 1999. The plaintiff's financial status during the taxable years, as represented by his pension income, wages, canvas business earnings, and rental income, was sufficient to maintain a gambling lifestyle. It was not the winnings from gambling at the slot machines that sustained the plaintiff's lifestyle, but his other income which was unrelated to gambling.

For the seventh and eighth indicators, the plaintiff did not make a profit and his financial status does not appear to have changed. As to the final indicator, there is no evidence to support a finding that the plaintiff considered his gambling activities during the taxable year to be a hobby or purely for pleasure. While the plaintiff's gambling

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and September, and zero days in January, April and October." (Defendant's post-trial brief, p. 16.) See also Leite v. Commissioner of Revenue, Appellate Tax Board (Mass.), Docket No. C268746 (November 10, 2006) (54 days of slot machine gambling does not constitute the trade or business of gambling); Erbs v. Commissioner, T.C. Summary Opinion 2001-85 (semi-retired taxpayer's 89 sporadic visits to casino throughout taxable year not trade or business of gambling). In addition, the evidence was not clear on how many days in 1998 and 1999 Stone spent gambling in New Jersey casinos versus Connecticut casinos.

activities did not rise to the level of being engaged in a trade or business, his subjective intent appears to be more like a compulsion to gamble rather than just a hobby.

Upon review of all the indicators and the court's analysis of each, it is necessary to consider the standard of proof needed by the plaintiff to be successful in this appeal. In Leonard v. Commissioner of Revenue Services, 264 Conn. 302, the Supreme Court has recognized that, in a taxpayer's challenge of the commissioner's imposition of a deficiency assessment in tax matters, it is the taxpayer's burden to prove that a deficiency assessment is in error by presenting clear and convincing evidence. See also Gavigan v. Commissioner of Revenue Services, 89 Conn. App. 111, 114, 871 A.2d 1101 (2005), citing Leonard.

Under the court's analysis of the facts, the plaintiff has met two of the nine indicators listed above in the regulations, namely, profit motive and conducting gambling activities in a businesslike manner. Under these circumstances and with the high standard of proof required of the plaintiff to show the commissioner's error, the court concludes that the plaintiff has not sustained his burden.[9] The plaintiff has failed to prove that he was a professional gambler operating in the trade or business of gambling sufficient to claim his gambling losses against his gambling winnings during the taxable years.

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[9] The parties filed briefs discussing the clear and convincing evidence standard. Even assuming that a less demanding standard of proof is considered, namely, the preponderance of the evidence standard, the court is not persuaded that the plaintiff would narrow the evidentiary gap to be successful in this appeal. See also Gavigan v. Commissioner of Revenue Services, 99 Conn. App. 903 (2007) (affirmed per curiam trial court's use of clear and convincing evidence standard).

The plaintiff raises a constitutional issue that the plaintiff's equal protection rights have been violated under the Fourteenth Amendment of the United States constitution and article first, § 20, of the Connecticut constitution. As a result of the commissioner classifying the plaintiff as a non-professional gambler, it is the plaintiff's contention that the commissioner gives unequal treatment to the gambling winnings of professional and non-professional gamblers. The plaintiff argues that there is no rational basis for the commissioner to discriminate against non-professional gamblers by taxing them on gross gambling winnings, while professional gamblers are taxed on net winnings, and cites Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, 566, 55 S. Ct. 525, 79 L. Ed. 1054 (1935) (Kentucky tax law unconstitutional by imposing higher tax rate on retailers with large gross sales and lower tax rate on retailers with lower gross sales).

The constitutional issue here is not the disparity in taxing one taxpayer from another based on the size of gambling winnings. Instead, there is a rational basis for the legislature to impose a tax on professional gamblers that is different from how non-professional gamblers are treated. Professional gamblers and non-professional gamblers are simply not in the same class. See the distinction discussed above, on the federal level, of a professional gambler filing Schedule C to form 1040 to report gambling winnings and losses versus a non-professional gambler filing Schedule A to form 1040.

Accordingly, judgment may enter in favor of the defendant denying the plaintiff's appeal for the taxable years, without costs to either party.

Arnold W. Aronson
Judge Trial Referee