STATE OF WISCONSIN

TAX APPEALS COMMISSION

MERLIN AND ALI VOSS, **DOCKET NO. 04-I-263**

Petitioners,

vs. **DECISION AND ORDER**

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DIANE E. NORMAN, ACTING CHAIRPERSON:

The above-entitled matter comes before the Commission on stipulated facts. Petitioners, Merlin and Ali Voss ("petitioners"), appear by Jerry Huser, C.P.A. Respondent, Wisconsin Department of Revenue ("Department"), appears by Attorney John R. Evans. Both parties have filed briefs.

Having considered the entire record before it, the Commission finds, concludes, and orders as follows:

STIPULATED FACTS

As and for its Findings of Fact, the Commission adopts the Stipulation of Facts filed by the parties, making non-substantive changes and incorporating information from the exhibits but omitting references to specific exhibits.

1. Petitioners are adult residents of the State of Wisconsin and subject to the income tax laws of the State of Wisconsin for calendar years 1997, 1998, 1999 and 2000.

2. By notice dated February 11, 2002, petitioners were issued an

assessment ("assessment") by the Department for the years under review in the amount of $8,773.28 (Exhibit 1).

3. By letter dated March 18, 2002, petitioners filed a petition for redetermination of the assessment with the Department (Exhibit 2).

4. On September 17, 2004, the Department issued a notice of action denying the petition for redetermination (Exhibit 3).

5. On November 11, 2004, petitioners filed a petition for review with the Commission.

6. Petitioners have conceded and withdrawn their appeal for the assessment as respects to the calendar years 1997, 1998 and 1999. Petitioners are only pursuing the appeal of the assessment for the year 2000 ("year under review") and have accepted and conceded all audit adjustments set forth on the assessment except those adjustments pertaining to reporting gambling winnings and losses for the year under review. Petitioners' appeal seeks treatment of gambling winnings and losses for the year under review as Schedule C Profit and Loss from a Business, that is, that petitioners be treated as professional gamblers.

7. Pursuant to a notice of refund dated July 11, 2005, the Internal Revenue Service ("IRS") refunded petitioners $1,312.89 of the $1,833 claimed on petitioners' second amended federal 2000 income tax return (Exhibit 7). The refund notice does not explain the difference in the amount claimed and the amount refunded; however, the claim for refund was based upon petitioners' second amended 2000 federal income tax return where they claimed they were professional gamblers and reported related income on Form 1040 Schedule C.

8. Petitioner Merlin Voss formally retired in 1985 from Dane County Co-op as a buyer and seller of cattle. Since that time, Merlin has pursued income producing activities to the extent that his health has allowed.

9. During the year under review, petitioner Ali Voss was employed as a FTE with the University of Wisconsin Hospitals and Clinics with flexible hours. After 19 years of employment, Ali had accrued considerable vacation time with which to pursue a second income.

10. For the year under review, the parties stipulate that the petitioners' gambling winnings and losses were as follows:

- Merlin:

Winnings	$135,141
Losses	$133,431
Difference	$1,710

- Ali:

Winnings	$61,310
Losses	$58,940
Difference	$2,370

11. Petitioners only played slot machines.

12. Petitioners played during all times of the day and every day of the week because of Ali's flexible work schedule and considerable vacation time, that is, they did not have any set schedule for playing, but would play as her work schedule

permitted.

13. Petitioners entered wins, losses and time expended on gambling activities on petitioner Ali's computer on a daily basis.

14. Petitioners calculated their losses from gambling activities by counting cash they started with, with additions and winnings, and cash they ended with. Petitioners did not count ATM charges, check cashing charges or interest paid on credit card accounts in the calculation of winnings and losses. Petitioners also did not account for out of pocket expenses such as food, beverages, tobacco, entertainment tickets or admission or gasoline in the calculation of winnings and losses.

15. Petitioners engaged in gambling as a recreational activity in years prior to the year under review.

16. Petitioners had several sources of income during the year under review and did not intend to support themselves solely from their gambling activities.

17. For each year petitioners reported gambling activities (1997, 1998, 1999 and 2000), before adjustments by the Department the winnings reported were the same as or less than the losses reported, netting out to zero.

18. That on the Wisconsin Income Tax – Amended Return for 2000 (the year under review) dated May 10, 2001, with attached Amended U.S. Individual Income Tax Return for 2000, petitioners reported zero ("0") gross income from the gambling activities on line 7 of the Form "Schedule C," Profit or Loss From Business. Petitioners reported no expenses on Part II of the Schedule C.

19. Petitioners traveled from their home in Verona, Wisconsin to casinos at Baraboo, Wisconsin, Marquette, Iowa, and other locations to engage in their

gambling activities. Petitioners used checks, Automatic Teller Machines, credit cards and casino cashiers to obtain cash for gambling. Petitioners incurred various expenses in the procurement of cash including, but not limited to, service charges, fees and interest.

20. Petitioners' "business plan" was to go into debt so that they could obtain funds to turn a profit from gambling. The "business plan" was not in any written form. Petitioners were going to gain expertise in the field by reading trade journals, watching videos and television to learn the intricacies of playing slots.

21. Petitioners read Midwest Gaming Magazine and watched shows on gambling strategies on Channel 42.

22. Petitioner Merlin obtained a Bachelors degree in accounting from Madison Business College in 1940. Petitioner Ali obtained a Bachelors degree in Applied Music & Sociology/Correctional Administration from UW-Madison in 1976. While obtaining these degrees, petitioners both had to take course work in mathematics and statistics.

23. Petitioner Merlin was still able to drive himself to gambling venues in the year under review.

24. Petitioners mixed gambling and non-gambling expenditures in their checking accounts and credit card accounts.

25. Petitioners obtained the monies to pursue their gambling activities from refinancing their house and obtaining cash advances from credit cards.

26. Petitioners seldom paid off the monthly balance of credit cards in full.

27. Petitioners did participate in slot machine tournaments at casinos in Marquette, Iowa, Turtle Lake, Wisconsin and on Norwegian and Carnival cruises.

28. Petitioners did not retain any business consultants in order to improve their gambling.

29. Petitioners did not receive any complimentary items from any casino.

30. For each year from 1997 through 2000, petitioners showed an increase in total deductible interest paid on Schedule A and Schedule F of their income tax returns as a result of increased borrowing against the equity value of their property.

CONCLUSIONS OF LAW

Petitioners have failed to present clear and satisfactory evidence that the Department erred in rejecting petitioners' characterization of their gambling losses as business losses which were deductible from the federal adjusted gross income on Line 1 of their Wisconsin income tax returns.

OPINION

Assessments made by the Department are presumed to be correct, and the burden is upon the petitioner to prove by clear and satisfactory evidence in what respects the Department erred in its determination. *Edwin J. Puissant, Jr. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶202-401 (WTAC 1984). Tax exemptions, deductions, and privileges are matters of legislative grace and will be strictly construed against the taxpayer. *Hall Chevrolet Co., Inc. v. Dep't of Revenue*, 81 Wis. 2d 477, 484, 260 N.W.2d 706 (1978). Petitioners have failed to meet their burden of establishing that the Department

erred in rejecting petitioners' characterization of their gambling activities as a trade or business and, thereby, denying their deduction for gambling losses.

For income tax purposes, Wisconsin generally follows federal law. Income derived from wagering transactions or gambling is includible in gross income under provisions of Section 61 of the Internal Revenue Code. I.R.C. § 165(d) provides that losses from gambling shall be allowed only to the extent of the gains from such transactions.

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 with 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 with Form 1040 in order to itemize deductions attributable to gambling losses to the extent of gambling winnings.

Prior to the year 2000, Wisconsin's itemized deduction credit allowed taxpayers to add the amounts allowed as itemized deductions under the Internal Revenue Code (I.R.C.), with certain exceptions, in calculating the itemized deduction credit. *See* Wis. Stat. § 71.07(5) (1987-88)-(1997-98). Miscellaneous itemized deductions, including gambling losses, were allowed under I.R.C. § 165(d), and they were not one of the exceptions delineated under § 71.07(5). In other words, Wisconsin taxpayers were allowed to deduct gambling losses from their income as an itemized deduction credit at that time.

However, effective January 1, 2000, the legislature chose to except from its

itemized deduction credit the miscellaneous itemized deductions that a taxpayer may claim under the I.R.C. *See,* Laws of Wisconsin 1999, Act 9, § 1711. Thus, gambling losses, which are allowed as a federal miscellaneous itemized deduction, are no longer allowed in computing the Wisconsin itemized deduction credit. *See, Calaway v. Dep't of Revenue*, Wis. Tax Reptr. (CCH) ¶ 400-856 (WTAC 2005). The only way gambling losses can be deducted from gambling winnings in Wisconsin is if the taxpayer is engaged in the trade or business of gambling.

PETITIONERS HAVE NOT SHOWN THAT THE DEPARTMENT ERRED IN REJECTING PETITIONERS' CHARACTERIZATION OF THEIR GAMBLING ACTIVITIES AS A TRADE OR BUSINESS.

Section 162 of the Internal Revenue Code (I.R.C.) allows deductions for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." The I.R.C. does not define trade or business for purposes of Section 162. However, the United States Supreme Court has provided some guidance. "[I]f 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." *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987). "[T]o be engaged in a trade or business, 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." *Id*.

Guidance for determining whether an activity is engaged in for profit is provided in Treasury Regulations § 1.183-2. Deductions are not allowable under § 162 for activities which are "carried on primarily as a sport, hobby or for recreation." Treas. Reg. § 1.183-2(a). "The 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." *Id.* Further, "[i]n 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." *Id.*

Treasury Regulations § 1.183-2(b) provides a non-exhaustive list of factors to consider when determining whether an activity is engaged in for profit: (1) the manner in which the taxpayer carries on the activity; (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 carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

Treas. Reg. § 1.183-2(b).

(1) Manner in Which the Taxpayer Carries On the Activity

Carrying on an activity in a businesslike manner, maintaining complete and accurate books and records, conducting the activity in a manner substantially similar to comparable businesses which are profitable, and making changes in operations to adopt new techniques or abandon unprofitable methods suggest that a taxpayer conducted an activity for profit. Treas. Reg. § 1.183-2(b)(1).

Petitioners carried on their gambling activities in a minimally businesslike manner, at best. They did keep track of where, when and for how long they played slot machines during the year. They also kept track of the total wins and losses for both Ali

and Merlin on each day they played the slot machines. However, this is the extent of their record keeping.

It does not appear that petitioners kept business records that could accurately show their net income from gambling activities. They failed to keep track of any expenses directly related to gambling (other than losses), such as travel expenses, interest from loans and finance charges for credit card balance carryovers and cash advances for gambling. Moreover, they did not keep separate bank accounts for gambling activities for record keeping purposes. Instead, they commingled their gambling funds with their personal funds.

(2) The Expertise of the Taxpayer or the Taxpayer's Advisors

Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that a taxpayer has a profit objective. Treas. Reg. § 1.183-2(b)(2). A taxpayer's failure to obtain expertise in the economics of an activity indicates that he or she lacks a profit objective. *Burger v. Commissioner*, 809 F. 2d 355, 359 (7th Cir. 1987).

There is no evidence that petitioners gained expertise in playing slot machines. Petitioners did not consult any experts for advice on how to play slot machines as a profession. While petitioners read some magazines and watched some television shows on gambling, the stipulated facts provide no specifics regarding what strategies or intricacies they learned from these sources of information.

Petitioners did not belong to any professional organizations which might have assisted them in their gambling endeavors. Nor did petitioners have a business plan other than to go into debt to finance their gambling activities.

On its face, petitioners' gambling activity, slot machines, appears to involve no skill other than pressing a button. *See, Calaway v. Dep't of Revenue*, Wis. Tax Reptr. (CCH) ¶ 400-856 (WTAC 2005). Although petitioners argue that there were "intricacies" in playing slot machines, they have the burden of showing that playing slot machines involved some skill or strategy and they have failed to meet that burden.

(3) Taxpayer's Time and Effort

The fact that a taxpayer devotes much time and effort to an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate that he or she has a profit objective. Treas. Reg. § 1.183-2(b)(3). A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. *Id.*

Petitioners did not withdraw from any other occupation in order to pursue gambling. Ali continued her occupation during the year under review and Merlin had been retired for several years and was receiving social security benefits.

In petitioners' favor, however, the record reflects that they spent a great deal of time playing slot machines. Undoubtedly, devotion of a substantial amount of time makes it more likely that one is engaged in the trade or business of gambling than it would be if such a time commitment were absent. However, while petitioners appear to have devoted a great deal of time to gambling there is no evidence indicating that they expended much effort towards improving their skills at or results from gambling, as noted above.

(4) Expectation that Assets Used in the Activity Will Appreciate in Value

This factor is inapplicable, as petitioners did not have assets which they used in their gambling activities.

(5) Taxpayer's Success in Other Similar or Dissimilar Activities

This factor is inapplicable since there is no evidence that petitioners have engaged in similar activities for profit in the past.

(6) Taxpayer's History of Income or Losses

A history of substantial losses may indicate that the taxpayer did not conduct the activity for profit. Treas. Reg. § 1.183-2(b)(6).

Petitioners stipulated that for 1997, 1998 and 1999, they reported in their income tax returns that their winnings were the same as the losses or less than the losses, netting out to zero ("0"). Therefore, petitioners have shown no history of profit from playing slot machines in the years prior to the year under review.

(7) Amount of Occasional Profits, If Any

Petitioners' did win $4,080.00 more than they lost playing slot machines during the year under review.[1] This is a profit over the losses and this would be a factor in favor of showing that petitioners were engaged in the business of gambling.

However, this profit does not necessarily show petitioners' net income from gambling activities during the year under review. Petitioners never took into account any expenses directly relating to their gambling activities (other than losses) such as service charges for loans and cash advances (even though it was their plan to

[1] The parties have stipulated to the net gain of $4,080.00, even though petitioners reported no gain on their 2000 income tax return. (Exhibit 5.)

borrow money to finance the gambling activities) or mileage (even though all gambling activities involved some traveling expenses.)

(8) Financial Status of the Taxpayer

Substantial income from sources other than the activity, especially if the losses from the activity generate large tax benefits, may indicate that the taxpayer does not intend to conduct the activity for profit. Treas. Reg. § 1.183-2(b)(8).

Petitioners allege that they intended to support themselves from gambling winnings. They actually supported their lifestyle from other sources of income, including Ali's salary and Merlin's social security income. Instead of relying on gambling activities for income, petitioners supported their gambling activities with other income and debt.

(9) Elements of Personal Pleasure

The presence of recreational or personal motives in conducting an activity may indicate that the taxpayer is not conducting the activity for profit. Treas. Reg. § 1.183-2(b)(9).

The subjective intent of petitioners is difficult to determine due to the unique character of gambling, which is usually a recreational activity. Playing slot machines was an activity that petitioners engaged in recreationally for years prior to the year under review. During the year under review, petitioners gambled together for a majority of the time and at times when Ali was not working. Thus, petitioners appear to have been continuing to engage in the recreational activity of playing slot machines as they had been doing for years.

Prior to the year under review, 2000, petitioners were able to deduct their gambling losses for Wisconsin income tax purposes. Because of the change in the law they are no longer allowed this itemized deduction credit. Taxpayers who gamble recreationally cannot continue to deduct gambling losses by simply designating themselves as professional gamblers unless they meet the burden of proving by clear and convincing evidence that they are in the trade or business of gambling. Based on the foregoing, petitioners have not met this burden.

IT IS ORDERED

That the Department's action on petitioners' petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 12th day of July, 2007.

WISCONSIN TAX APPEALS COMMISSION

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Diane E. Norman, Acting Chairperson

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David C. Swanson, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**