Risky Business – Income Tax on Gambling

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Introduction

A recent decision of the Australia Tax Office has cast doubt on whether the proceeds of spread betting are free from income tax. The long-held view was that gambling, being a habitual, pleasurable pastime or addictive activity, could not be a trade and, therefore, would not be subject to income tax. However, as far back as the 1920s, judges contemplated that there may be situations where income tax would apply.

Gambling proceeds are subject to betting duty, which is currently 1%.[1] Section 613(2) of the Taxes Consolidation Act 1997 states that winnings from betting are not chargeable gains. However, there is no similar provision in respect of income tax.

The issue of income tax on gambling proceeds has arisen in a number of cases over the years with mixed results. The selection of cases that follow demonstrate the various criteria that courts have used to decide the matter.

Before proceeding, it is useful to point out that the "badges of trade" are of limited application. They were formulated in the context of the acquisition and disposal of assets and are applied in situations involving the exploitation of property rights or the provision of professional services.[2]

Addiction

The case that is normally dug up and dusted off when it comes to income tax on gambling receipts is *Graham v Green*,[3] which concerned a man who bet on horses on "a large and sustained scale". He did it with such shrewdness that he made an income out of it and it was his means of living. He was assessed to income tax on his receipts. Rowlatt J first considered the position of a bookmaker who carries on a taxable vocation. He stated that the process of calculating and offering odds on a large scale over a protracted period seemed to him to be "organising an effort in the same way that a person organises an effort if he sets out to buy himself things with a view to securing a profit by the difference in their capital value in individual cases".

1. Section 17 of Finance Act 2009 provides for the rate to increase to 2% on Ministerial Order.
2. John Ward, *Judge: Irish Income Tax* (Dublin: Tottel Publishing, 2007), 493.
3. [1925] 2 KB 37.

He contrasted this with the position of the gambler placing bets with the bookmaker. He likened him to a skilful card player who plays every day. He opined:

> *"I think all you can say of that man, in the fair use of the English language, is that he is addicted to betting. It is extremely difficult to express, but it seems to me that people would say he is addicted to betting, and could not say that his vocation is betting. The subject is involved in great difficulty of language, which I think represents great difficulty of thought. There is no tax on a habit. I do not think 'habitual' or even 'systematic' fully describes what is essential in the phrase 'trade, adventure, employment or vocation'. All I can say is that in my judgment the income which this gentleman succeeded in making is not profits or gains…".*

Rowlatt J pointed to the addictive nature of gambling as the reason why it could not be regarded as a trade.

Enforceability

However, the subsequent Court of Appeal case of *Cooper v Stubbs*[4] highlights that what might be perceived by the average person on the street as gambling may, nonetheless, constitute a trade.

Mr Stubbs was a cotton merchant who, separate from his main trade, speculated in contracts for delivery of cotton at a future date. Mr Stubbs had no intention of taking delivery of the cotton. Rather, he bought the contracts with a view to selling them on at a profit. He did so on a continuous basis. One of the issues in the case was that the Commissioners for Inland Revenue determined that Mr Stubbs had been "gambling". The UK Court of Appeal distinguished between speculating and gambling. Pollock MR stated:

> *"There is no distinction between contracts which are made for the purpose of speculative dealings and contracts which are made for the real purpose of securing the sale or purchase of stock or cotton…It may be that they were speculative in the sense that they were for his own purposes a speculation. It may be that in a loose and colloquial sense of the word they were gambling; you may say that Mr Henry Stubbs was gambling in making these contracts, but the purpose for which he made them does not alter the character or nature of the contracts that he did make; they were real transactions, although the purpose of them may have been in his mind, in respect of all or some of them, to fulfil his desire to gamble in speculative transactions."*[5]

The transactions gave rise to real contractual rights: they were contracts for the purchase or sale of cotton in the future that could be enforced. Therefore, Mr Stubbs was engaged in a trade upon which he could assessed to income tax. In this case, the three-judge court used enforceability as the determining factor. Notably, in their judgments, Atkin LJ and Warrington LJ expressed no opinion on what the treatment would be if the transactions had been wagers. In concluding, Atkin LJ stated:

> *"…I wish to reserve the question of what the position would be if these transactions had turned out to be bets, but if the bets had been proved to be as continuous as these particular bets were. I express no opinion about it. I suppose the matter may some day arise in the Courts."*[6]

Association with an Existing Trade

Down v Compston[7] concerned a professional golfer who, after hours, would engage in private games of golf and wager on them. He won substantial amounts and was assessed to tax. The court held that the gambling proceeds did not arise from his services to the club and that the gambling was not sufficiently organised to constitute a business in itself.

The decision in *Burdge v Pyne*[8] seems to conflict with *Down* but, in reality, merely demonstrates that each case will be decided on its facts. In *Burdge*, the taxpayer owned a gambling club. He was taxable on the profits from running the club. However, he also played cards in the club and won money. He was held to be taxable on his winnings. The court held that the gambling formed part of the business of running the club and that the proceeds were, therefore, taxable.

No Reasonable Chance of Profit

A recent Canadian case on the subject is *Le Blanc v The Queen*.[9] The case concerned two brothers who engaged in playing sports lotteries on a massive scale from their living room. They moved house so they could participate in two lottery regions. Because of a limit on the number of bets that could be placed in a single shop, they employed several people to place their bets for them. They placed CAD$50 million in high-risk bets over four years and made a profit of CAD$5 million.

The court held that, notwithstanding that the brothers employed a very systematic and methodical approach to their frequent gambling, there was no reasonable prospect of profiting from their venture and, therefore, it could not be regarded as a trade. The brothers were "compulsive gamblers who continually tried their luck at a game of chance".

Notably, the judge, Bowman CJ, pointed out that, if the proceeds of gambling are taxable, that would imply that losses should be deductible. He suggested that these matters were in the realm of Parliament and not for the courts to decide. He also stated: "The Court is being asked to apply the traditional tests of business activity to a game of pure chance with which the usual indicia of commerciality simply do not fit." Perhaps, the alternative approach found in the *Brajkovich* decision below would be more appropriate.

A Reasoned Approach

The decision of the Federal Court of Australia in *Brajkovich v Federal Commissioner of Taxation*[10] may be of assistance in an Irish context. The taxpayer was an estate agent turned gambler. He regularly attended race meetings, bet on "Aussie rules" football and also played cards. He owned a number of horses for the primary purpose of keeping them in stables where he could glean information to assist him in gambling

4. [1925] 2 KB 753.
5. [1925] 2 KB 753 at 47.
6. [1925] 2 KB 753 at 57.
7. [1937] 2 All ER 425.
8. [1970] 1 All ER 467.
9. [2006] TCC 680.
10. [1989] 89 ATC 5227.

on other horses. He considered himself to be in the business of gambling and sought to claim significant gambling losses as income tax deductions.

The court reviewed the previous Australian cases on the subject and stated:

> *"The principal criteria by which questions of the present sort appear to have been judged are the following:*
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> 1. *whether the betting is conducted in a systematic, organised and 'businesslike' way;*
> 2. *its scale: i.e. the size of the wins and losses;*
> 3. *whether the betting is related to, or part of, other activities of a businesslike character, e.g. breeding horses;*
> 4. *whether the bettor appears to engage in his activity principally for profit or principally for pleasure;*
> 5. *whether the form of betting chosen is likely to reward skill and judgment or depends purely on chance;*
> 6. *whether the gambling activity in question is of a kind which is ordinarily thought of as a hobby or pastime."*

In applying these criteria, the court said the taxpayer's efforts were not systematic but rather chaotic. However, the same could be said for trading in futures. The taxpayer gambled on a large scale. Owning horses was ancillary to his gambling activities. Given his losses, he could not be said to be gambling for profit, but the court questioned how he could derive pleasure from persistent losses.

The court placed emphasis on the application of skill. If gambling returns stem from pure chance and skill plays no part, those returns cannot be regarded as a trading receipt. The court found that Mr Brajkovich was simply indulging his passion for gambling and was not engaged in a taxable business.

Spread betting

In recent years, spread betting has grown dramatically in Ireland. Spread betting involves placing a bet with a licensed bookmaker that a stock or commodity will rise or fall in value. It does not involve the purchase of the stock or commodity but is a "wagering contract".[11] The proceeds of spread betting (if any) are gambling winnings and are, *prima facie*, exempt from income tax.

The term "contract for difference", or "CFD", is often used interchangeably with "spread betting". However, they are legally separate phenomena.[12] A CFD is an enforceable contract the profits of which are subject to taxation. The taxation of gains arising from CFDs is considered in detail elsewhere.[13]

Viewed from a risk perspective, there is very little difference between a CFD and spread betting. The only distinction is the enforceability of the CFD. However, a CFD is nothing more than a legal artificiality designed to aid our understanding of a particular relationship. To this author, a "CFD" and a "spread bet" could be regarded as two ways of describing the same relationship.

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What would the position be if a person who earned a living trading CFDs turned his or her hand to spread betting instead? Notably, in the *Cooper* case above (which involved speculating on future prices) the judges did not exclude the possibility of wagers being taxable income receipts.

If the *Brajkovich* tests were applied, what would the results be? Given that the person had previously been engaged in the taxable business of trading CFDs, could it be denied that he or she was now applying skill with a view to making a profit? How could what was described as a trade before now be described as a mere hobby or pastime? Or is the truth of the matter that trading CFDs is, in reality, gambling dressed up to look like business?

Australian Tax Office Decision

On 12 March 2010 the Australian Tax Office ("ATO") published Interpretive Decision 2010/56,[14] in which it determined that the proceeds of spread betting were taxable income. Notably, the taxpayer's employment was not in the financial sector and, he claimed, he simply wanted to engage in "sophisticated, exciting and challenging on-line fun".

The ATO emphasised that, in Australia, spread betting is governed by a separate statutory regime from other gambling activities. The ATO stated:

> *"transacting with financial spread betting is closer to the skill end of the chance-to-skill spectrum and the commercial end of the private/recreation-to-commercial spectrum than a bet on horse racing…The winnings tend to be rewards for skill and judgment rather than purely betting on chance."*

The taxpayer, it found, was engaged in a taxable business.

It should be noted that the ATO was waiting for a judicial pronouncement on the issue for some time before the publication of the decision, but that did not materialise. Furthermore, the interpretive decision would be of limited persuasive authority in Ireland. However, it highlights the potential income tax treatment, nonetheless.

Conclusion

Generally, the proceeds of gambling are not subject to income tax. However, there are instances where the activities of the gambler may constitute a taxable trade. For that reason, those who engage in spread betting to earn their livelihood should beware – the stakes may be higher than they first thought!

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11. In *Carlill v Carbolic Smoke Ball Co.* [1892] 2 QB 484 at 490, Hawkins J said:
"A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties."
12. See *City Index Ltd v Leslie* [1991] 3 All ER 180.
13. Weston Allen, "Tax Treatment of Gains and Losses Arising to Individuals from Contracts for Difference", *Irish Tax Review*, 20/2 (2007), 79.
14. See http://law.ato.gov.au/atolaw/index.htm.