
The Taxation of Winnings from Poker and Other Gambling Activities in Canada

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PRÉCIS

Dans le droit fiscal canadien, les gains tirés du jeu sont imposables lorsqu'ils constituent un « revenu provenant d'une source ». Ce qui n'est pas clair, c'est la méthode servant à déterminer quand, où et comment les gains tirés du jeu constituent un « revenu provenant d'une source ». À la lumière de décisions récentes de la Cour canadienne de l'impôt, particulièrement dans *Leblanc* et *Cohen*, le présent article examine la manière dont le tribunal traite cette question au moyen d'une analyse des décisions canadiennes portant sur le jeu du début des années 1950 à nos jours.

ABSTRACT

In Canadian income tax law, winnings from gambling are taxable when they constitute "income from a source." What is not clear is the basis for determining when, where, and how winnings from gambling activities can amount to "income from a source." In light of recent decisions of the Tax Court of Canada, notably in *Leblanc* and *Cohen*, this article examines the court's treatment of this issue through an analysis of the decisions in Canadian gambling cases dating from the early 1950s to the present.

KEYWORDS: GAMBLING ■ TAXATION ■ INCOME ■ SOURCES ■ REASONABLE EXPECTATION OF PROFIT ■ CANADA

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INTRODUCTION

In *Coben v. The Queen*,¹ the Tax Court of Canada was faced with the question of whether losses sustained by the taxpayer from poker playing were tax-deductible. The court held that on the facts of the case, poker did not constitute a “business” of the taxpayer and that, as a result, he was not entitled to recognition of the losses for Canadian income tax purposes.

The decision in *Coben* invites the question “In what circumstances would winnings from poker and other gambling activities be taxable in Canada?” The accepted answer in Canadian income tax law, recited in *Coben*, is that gambling winnings are taxable when they constitute “income from a source.” This tidy response, however appealing it may otherwise be, risks falling into the trap of substituting a label for analysis and threatens to suspend examination of what lies behind a determination of when, where, and how poker and other gambling winnings can amount to “income from a source.” This article undertakes an examination of not only what the courts have said, but also what they have done, about the determination of the circumstances in which gambling gains will be considered to be income from a source. This requires elucidation of the boundary between business income and gains from a hobby in the context of poker and other forms of gambling. The very nature of gambling, however, makes the distinction a messy one, since most gamblers are motivated to a significant extent by the prospect of realizing a monetary gain from their gambling activities. And having a profit-making motivation is recognized by longstanding judicial authority to be the hallmark of income-earning business activities.²

Indeed, as suggested by the outcome in *Coben*, the courts have routinely taken the position that, in theory, gambling winnings are taxable when the gambling activities themselves are sufficiently serious to amount to a “business.” But the cases in which gambling activities on the part of players (as distinguished from the providers of gambling opportunities, such as casinos or bookmakers) have been found to meet this standard are very few, and seem to be limited to non-traditional forms of wagering by especially skilled participants in an activity (such as golf and pool) or the exploitation of insider information to make profits from more traditional gambling opportunities (such as betting on horses). Although previous literature has addressed the relevant court rulings in the process of advancing other arguments,³

1 2011 TCC 262.

2 See, for example, the discussion of the *Smith v. Anderson* case, (1880), 15 Ch. D. 247 (CA), in David G. Duff, Benjamin Alarie, Kim Brooks, and Lisa Philipps, *Canadian Income Tax Law*, 3d ed. (Markham, ON: LexisNexis Canada, 2009), at 492. In that case, Jessel MR said (at 258), “[A]nything which occupies the time and attention and labour of a man for the purpose of profit is business.”

3 See, for example, Benjamin Alarie and Alex A. Igelman, “Bet on It: The Taxation of Online Gaming,” in David W. Chodikoff and James L. Horvath, eds., *The Taxation and Valuation of Technology: Theory, Practice, and the Law* (Toronto: Irwin Law, 2008), at 115-38.

this article is the first to delve deeply into the case law on the subject of the taxation of gambling gains, discussing every reported gambling tax decision of the Canadian courts from the early 1950s to the present.

The analysis is structured as follows. For the purposes of establishing and explaining the legal foundation for this undertaking, the next part of the article (part two) canvasses the relevant Canadian income tax legislation and case law on gambling gains and synthesizes the results. The discussion of the legislation outlines the feasible statutory bases for taxing gambling gains. The first and more accepted basis is to characterize the activities of professional gamblers as participation in the business of gambling, and hence any gains as income from a business. The second and more theoretical or speculative basis would characterize gambling winnings as income from an “unenumerated source.” The review of the case law that follows addresses how Canadian courts have tended to approach the question of the taxation of gambling gains over the past 60 years, and shows that for several decades there have been no reported cases finding that gains from card playing or betting on horses are income subject to tax. Indeed, in the entire body of reported case law on the question, there are relatively few cases where individual gamblers (that is, players) have been found to be operating a gambling business and therefore made subject to income tax on their gambling gains. Moreover, in the majority of the subset of cases where individual gamblers have been found to be taxable, the taxpayer has typically cultivated a well-developed physical skill or has deployed other techniques amounting to a “system” in order to reliably generate gambling gains.

Addressing the questions raised by the decision in *Coben*, and drawing upon the synthesis of the case law outlined in part two, the third part of the article analyzes the potential tax liability of gamblers and suggests that, on the basis of the current state of the case law, it is probably in only unusually active and financially successful circumstances that taxpayers would even potentially face income tax liability on gains from poker playing and other gambling activities in Canada. It is unclear legally—and could hardly be otherwise, given the unsettled state of the case law—at which point a more “usual” or “casual” and therefore non-taxable pattern of generating gains from poker playing or other gambling will shift into a more “unusual” or “business-like” and therefore taxable pattern of activity and financial success. What does seem clear, however, is that in cases of sustained and significant organization and effort, coupled with a consistent and established track record of profiting over a long period, the activity will amount to a business, and therefore gains will be taxed as income from a business of playing professionally.

The article concludes with some thoughts about the appropriate policy regarding the taxation of poker and other gambling winnings.

SYNTHESIS OF CANADIAN LAW ON THE TAXATION OF GAMBLING GAINS

This part of the article provides an overview of the approach of Canadian income tax law to gambling gains. The first section outlines the two possible statutory bases for imposing income tax liability on gambling gains. The second section analyzes

how each of these bases has been addressed over the past several decades by Canadian courts.

The Two Principal Statutory Bases for Taxing Gambling Gains

There are two principal statutory bases for subjecting gambling gains to taxation under the current text of the Income Tax Act.⁴ The first, and by far the more widely considered, is to regard gambling gains as income from a business under part I, division B, subdivision b of the Act.

The second possible basis for imposing income tax liability on gambling gains is to characterize gambling as an “unenumerated source” of income within the purview of paragraph 3(a) of the Act. This second possible basis for the taxation of gambling gains has received relatively little consideration by the courts. Moreover, it has typically been ignored by the minister in cases involving claims that gambling gains are subject to income tax, and is therefore more theoretical and speculative. Indeed, several recent decisions of the Supreme Court of Canada suggest that it is quite unlikely that paragraph 3(a) would be deployed in a generic way to impose income tax on gambling gains.

Gambling Gains as Income from a Business

Gambling gains do not readily fit within the ordinary meaning of any of the four sources of income (office, employment, business, and property) enumerated in paragraph 3(a). Each of the four sources is given an extended defined meaning in subsection 248(1). Gambling gains are certainly not accommodated by the extended statutory definitions of “office,” “employment,” and “property” in subsection 248(1). The extended statutory definition of “business,” however, may apply to certain types of gambling activities. That definition reads as follows:

“[B]usiness” includes a profession, calling, trade, manufacture or undertaking of any kind whatever and . . . an adventure or concern in the nature of trade but does not include an office or employment.

It would be a stretch to conclude that gambling can (barring unusual circumstances) be regarded as a “profession” or a “calling.” However, certain types of gambling gains might be brought within the extended meaning of income from a “business,” since the phrase “undertaking of any kind whatever” is extraordinarily broad and could potentially encompass any activity giving rise to economic gain.

Proceeding for the moment on the assumption that particular gambling activities may in certain circumstances amount to a “business” within the definition in subsection 248(1), subsection 9(1) establishes that a “taxpayer’s income for a taxation year from a business or property is the taxpayer’s profit from that business or property

4 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to this and prior versions of the Act.

for the year.” The reference to “profit” in subsection 9(1) has been interpreted as implicitly authorizing deductions from revenues for expenses that are associated with generating those revenues according to the “well accepted principles of business practice.”⁵

Thus, if gambling activities for a particular taxpayer do in fact constitute a “business” within the definition in subsection 248(1), in the absence of any other limiting provision, any gambling losses associated with a business of gambling would be recognized by the Act and be deductible against income from other sources by virtue of paragraph 3(d). This consideration, coupled with the observation that the vast majority of gamblers lose money overall when they wager through gambling opportunities provided by others (such as racetracks, casinos, and sports betting), perhaps explains the general reluctance of the minister and the courts to be overly vigilant or aggressive in making claims that gambling activities amount to a business, other than in cases involving the use of an organized “system” or inside information, or the deployment of a particularly well-developed physical skill that reliably and predictably generates profits for the taxpayer. (Such cases are discussed in the next section.) If the threshold for taxing gambling gains as income from a business were low, and not restricted to situations in which the taxpayer employs a clear and effective method that consistently results in a profit, many taxpayers would claim that their gambling losses are deductible as losses from a business under subsection 9(2). The use of losses from activities that are not business activities with “a reasonable expectation of profit” in order to offset income from other sources has been a concern of Parliament for some time, particularly in the wake of two judgments of the Supreme Court of Canada concerning the deductibility of interest.⁶

It should be noted at this point that the question of whether a taxpayer has a reasonable expectation of profit is relevant to determining whether gambling gains are taxable as income from a business. The relevance of this requirement in the gambling gains context is based mostly on obiter dicta of the Supreme Court in *Stewart v. Canada*.⁷ In *Stewart*, the question was whether having a reasonable expectation of profit was relevant to the deductibility of expenses from an investment in real estate that was admittedly held by an individual as a tax shelter. The tax shelter was designed to (1) generate net losses for a number of years, which could be

5 See, for example, *Imperial Oil Limited v. Minister of National Revenue* (1947), 3 DTC 1090 (Ex. Ct.); *The Royal Trust Co. v. MNR*, 57 DTC 1055 (Ex. Ct.); and *Symes v. Canada*, [1993] 4 SCR 695.

6 *Singleton v. Canada*, 2001 SCC 61; and *Ludco Enterprises Ltd. v. Canada*, 2001 SCC 62. Two other judgments of the Supreme Court of Canada also contributed to the concern of Parliament surrounding the reasonable expectation of profit: *Stewart v. Canada*, 2002 SCC 46; and *Walls v. Canada*, 2002 SCC 47. Proposed section 3.1, which was introduced by the Department of Finance in October 2003 (Canada, Department of Finance, “Department of Finance Releases Draft Proposals Regarding the Deductibility of Interest and Other Expenses,” *News Release* 2003-055, October 31, 2003), is apparently intended to codify the reasonable expectation of profit standard but, in the face of criticism from tax professionals, has never been enacted.

7 *Supra* note 6.

deducted against other sources of income, and (2) several years later, yield a capital gain. The court held that where an activity is purely commercial in character and there is no personal element to the activity, there is no scope to apply a reasonable expectation of profit test. Inferentially this suggests, of course, that where there is a personal element (as in the context of gambling), a taxpayer's reasonable expectation of profit is relevant to determining whether the activity ought to be characterized as yielding income from a source.

The willingness of the Canadian courts to adopt the approach suggested by the Supreme Court in *Stewart* is questionable, however, given that the *Stewart* case involved a somewhat different question—the deductibility of losses rather than the inclusion of gains. Indeed, there are more recent cases, such as the decision of the Tax Court of Canada in *Leblanc v. The Queen*,⁸ that deal more centrally with gambling gains and are thus likely to be more indicative of the current state of the law surrounding the income taxation of such gains. It is particularly telling that in *Leblanc* Bowman CJ did not refer to the judgment of the Supreme Court in *Stewart*.

Gambling Gains as Income from an Unenumerated Source

The text of paragraph 3(a) makes it clear that it is not necessarily only the four enumerated sources of income (office, employment, business, and property) that may give rise to taxable income. Indeed, paragraph 3(a) states explicitly that a taxpayer's income for a year is all income from a source, both within and outside Canada, and that the four enumerated sources are named “without restricting the generality of the foregoing.” Similarly, part I, division B, subdivision d, entitled “Other Sources of Income,” begins with the following:

56(1) Amounts to be included in income for year. Without restricting the generality of section 3, there shall be included in computing the income of a taxpayer for a taxation year, . . .

This preamble is followed by a series of specific, more or less miscellaneous amounts that must be included in a taxpayer's income for the purposes of the Act. Therefore, the text of section 3—and, indeed, the entire structure of part I, division B—suggests that there are unenumerated sources of income that ought to be included in a taxpayer's income for a year, even though there are no specific rules appearing in the Act relating to their computation or explicitly mandating their inclusion.

How is it to be determined whether a given gain or amount of income can be attributed to a “source”? One relevant consideration is the history of the “source” concept of income. The concept can be traced to Adam Smith.⁹ Smith's ideas surrounding the concept of source had a powerful effect on early income tax legislation

8 2006 TCC 680.

9 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, 5th ed., edited by Edwin Cannan (London: Methuen, 1904), at book I, chapter VI, paragraph 18.

in the United Kingdom. These ideas have in turn had a significant, if not controlling, influence on the interpretation and development of Canadian income tax law.¹⁰ The central observation relevant here is that, for Smith, all sources of income are productive sources of income; each involves the production of value from various combinations of labour (paradigmatically, wages given to workers for labour effort) and capital (paradigmatically, interest paid for the use of borrowed funds or rent paid for the use of real property). The source concept of income can be contrasted with the accretion concept of income deployed in the United States' Internal Revenue Code,¹¹ which taxes gains more or less regardless whether a gain has a "source" in the sense developed by Smith, the English Parliament, and the English courts.

In light of the continuing influence of the source concept of income embodied in paragraph 3(a), one of the hallmarks of most wagers is that they are merely redistributive: one individual wins precisely what another individual has lost. In the shadow of the source concept of income, this merely redistributive aspect of wagers, gifts, and other wealth transfers leads to the result that wealth transfers do not constitute income from a source for Canadian income tax purposes. After an early case in which it was (arguably) found that section 3 imposed income tax liability on so-called unenumerated sources of income,¹² the Supreme Court of Canada has exhibited considerable and consistent reluctance to impose income tax liability on such gains.

This uneasiness is obvious, for example, in the context of whether strike pay is income from a source. In *Canada v. Fries*,¹³ the Supreme Court held simply that it was "not satisfied" that strike pay was income from a source, and reversed the judgment of the Federal Court of Appeal, which had held to the contrary.¹⁴ More recently, the Supreme Court's reluctance to find gains from unenumerated sources to be taxable was expressed in *Schwartz v. Canada*,¹⁵ where the majority of the court strained its interpretation of the scheme of the Act to avoid the conclusion that damages relating to the loss of an intended employment should be taxable as income from an unenumerated source. More specifically, the court held that the damages in issue were not captured by subparagraph 56(1)(a)(ii), which taxes retiring allowances, on the basis that they were not received for the loss of an actual employment, but only for the loss of an intended employment. The fact that this provision did not apply, however, was considered sufficient evidence of parliamentary intent that the damages

10 Benjamin Alarie and David G. Duff, "The Legacy of UK Tax Concepts in Canadian Income Tax Law" [2008] no. 3 *British Tax Review* 228-52.

11 Internal Revenue Code of 1986, as amended.

12 *Curran v. Minister of National Revenue*, [1959] SCR 850.

13 [1990] 2 SCR 1322; rev'g. [1989] 3 FC 362 (CA).

14 For an extended discussion of the Supreme Court's decision on strike pay, see Benjamin Alarie and Matthew Sudak, "The Taxation of Strike Pay" (2006) 54:2 *Canadian Tax Journal* 426-49.

15 [1996] 1 SCR 254.

were meant to be addressed by the inapplicable provision, such that they could not be considered income from an unenumerated source under paragraph 3(a).¹⁶

In light of this pattern of case law, it is not surprising that the minister has not relied on the unenumerated source argument as a basis for imposing income tax liability. Indeed, it appears that, given the recent case law from the Supreme Court of Canada emphasizing the virtues of consistency, certainty, predictability, and fairness in the interpretation and application of income tax law,¹⁷ any such attempt would encounter insuperable difficulties.

The Approach of the Courts to the Statutory Framework

Judgments in recent decades addressing the taxation of gambling gains frequently recite as a test of taxability whether the taxpayer's dominant object in gambling was entertainment or whether the activities were sufficiently organized to amount to commercial activity. This distinction can be traced back to the 1925 English case of *Graham v. Green* (discussed further below).¹⁸ As a test of taxability, however, the distinction is profoundly unhelpful. Most gamblers find gambling activities to be entertaining to a significant extent, specifically because of the possibility of profit. In addition, it is equally unhelpful to attempt to disqualify a certain activity as a business or as business-like on the basis that the taxpayer enjoys engaging in that activity. Many (perhaps most) individuals enjoy engaging in various income-earning activities, and it would not occur to those taxpayers to claim that they are not earning taxable income solely by virtue of that enjoyment.

The courts therefore are faced with the difficulty of applying a test that is not well suited to the task of discriminating between taxable and non-taxable gambling winnings. In practice, as this article shows, the courts tend to take the position that gambling gains are non-taxable in the absence of a demonstrable "system" or a well-developed and observable physical skill that ensures that financial success will be reliable, consistent, and expected. In other words, the courts have addressed the question of whether gambling gains are taxable by concluding that there is a presumption that they are not taxable. This appears to be consistent with the administrative approach taken by the Canada Revenue Agency (CRA) as well.

The cases that address the taxation of gambling gains can be conceptually organized into four categories. In this context, there are two distinctions that are relevant. The first distinction to be made is whether taxpayers have tended to experience gains or losses from their gambling activities over the period under investigation. The second distinction is whether taxpayers are characterized as conducting gambling activities on a predominantly personal basis (with no income tax implications

16 See also *Tsiapralis v. Canada*, 2005 SCC 8, and the commentary in Martha O'Brien, "Surrogatum, Source, and Tsiapralis: Is There a Principled Basis for the Tax Treatment of Replacement Payments?" (2006) 54:4 *Canadian Tax Journal* 862-906.

17 See, for example, *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraphs 12 and 61.

18 (1925), 9 TC 309 (KB).

in respect of losses or gains) or on a predominantly professional basis (with gains being included in income and losses being deductible).

Applying this framework, in the first category are cases in which the courts found that taxpayers had gambling gains and those gains were considered to arise from a business. (These cases are discussed below under the heading “Gambling Gains Found Taxable.”) In the second category are cases in which the courts found that gambling gains were not taxable on the basis that the gambling activities were not sufficiently organized or commercial in character to constitute a business. (These cases are discussed under the heading “Gambling Gains Found Non-Taxable.”) In the third category are cases in which the courts denied the deductibility of the taxpayers’ losses from gambling on the basis that the losses were personal in nature. (These cases are discussed under the heading “Gambling Losses Found Not Deductible.”) Tellingly, there are no cases in the fourth category—cases in which taxpayers have successfully argued that they have losses from gambling that are deductible because they are business losses. This salient fact will be taken up in part three of the article, in the discussion of how the case law applies to characterize the nature of gambling gains as a general matter.

Gambling Gains Found Taxable

There are relatively few cases that have found gambling gains to be taxable income in Canada. Moreover, despite the fact that the issue has been considered in a significant number of cases, not one reported Canadian decision in the past 56 years has found that gains from either card playing or betting on horses give rise to taxable income from a business.

There are some reported cases in which conventional gambling businesses have been found liable to tax. The most straightforward cases have involved taxpayers who have profited from illegally operated video lottery terminals (VLTs)¹⁹ or have been convicted of operating illicit bookmaking businesses.²⁰ In these cases, of course, the taxpayers had organized systems for ensuring that they would reliably generate profits from the gambling opportunities that they made available to others. In a sense, however, such profits are not really gambling gains per se, but rather gains accruing from facilitating the gambling activities of others. These are indubitably cases involving businesses or business-like activities. The risk of loss is deliberately minimized by the proprietors. Unlike the individuals to whom these gambling opportunities are provided, bookmakers and operators of VLTs do not generally take on significant or appreciable risks—and when they do, they try to hedge against

19 *Rigby Estate et al. v. The Queen*, 2000 DTC 2194 (TCC); and *Marchildon v. The Queen*, 2004 TCC 47.

20 *W. George v. MNR* (1964), 36 Tax ABC 81. The taxpayer was convicted of a bookmaking charge, and it was shown that he had earned \$17,620 from his bookmaking activities over a 10-week period in the autumn of 1959. He was assessed for income tax on the earnings from this business, and the Tax Appeal Board upheld the minister’s assessment.

potential losses to the greatest extent possible. Moreover, the system they deploy in running their operations (whether mechanical, electronic, or bet matching) are designed to ensure that profits will ensue.

Apart from the cases involving commercial gambling operations, only two cases decided since the 1950s have found individuals to be taxable on their gambling gains. These two cases, decided in the 1990s, involved wagers on the outcome of pool games and golf games, respectively.

In *Luprypa v. The Queen*,²¹ the taxpayer regularly played pool for money from 1989 to 1991. He would practise every day for several hours in the afternoon, and then, each weekday evening beginning after 11:00 p.m., he would challenge inebriated patrons at a local bar to games played for money. He drank alcohol only on weekends in order to maximize his probability of winning against his opponents during the week. Most evenings, he won between \$200 and \$300. The Tax Court found that the taxpayer's approach was sufficiently organized, planned, and deliberate to result in taxable income. McArthur J held:

This is a fact-driven case. Considering the facts, there is no doubt that pool playing was not a hobby for the Appellant. It was his livelihood and his business. He had income from a source as required in section 3 of the Act.²²

The physical skill that the taxpayer cultivated and deployed in a manner calculated to maximize his chances of winning appears to have been decisive for the court.

In *Dowling v. The Queen*,²³ the taxpayer was a professional golfer during the tax years in issue. He was also a frequent gambler on the outcomes of his own private golf games, poker games, and sporting events. He had been involved in approximately eight poker games per year, winning about 75 percent of the time, for a total of about \$5,000 per year. These gains were found not to be income from a business and were therefore not subject to income tax. The Tax Court found, however, that the taxpayer also earned about \$5,000 each summer from gambling on his golf matches with other players. With respect to his golf gambling, the court held:

With his experience in this field he was sure most of the time that he would win at golf gambling. Overall, I would conclude that the appellant did not meet the burden of proving, on a balance of probabilities, not only how much he earned from golf gambling, but that these amounts would really represent "gambling gains" instead of income earned in his capacity as a golf professional, which, as such, should have been included in his income.²⁴

21 97 DTC 1416 (TCC).

22 *Ibid.*, at 1419.

23 96 DTC 1250 (TCC).

24 *Ibid.*, at 1258.

It is not clear from the court's holding with regard to the gambling gains from golf whether the gains were taxed as professional golf gambling gains or rather as the earnings of a golf professional associated with playing golf professionally. It seems reasonable to interpret the court's comments as indicating that, but for the taxpayer's professional status as a golfer, the gains from golf gambling would not have been taxable. As a counterpoint to *Dowling*, and in support of a narrower interpretation of the court's holding, there is an analogous English case involving a professional golfer in which gambling gains from private golf wagering were found not to be taxable income.²⁵

There are two observations that should be made about the *Luprypa* and *Dowling* decisions. The first is that the taxpayers were being assessed after net worth audits, and were therefore in the position of having to rebut the presumption established by the minister's position that the increases in their net worth were attributable to taxable sources of income. In *Luprypa*, the taxpayer argued that in addition to his gains from playing pool, many of the assets discovered in the net worth audit arose out of gifts from relatives and friends. In *Dowling*, the taxpayer argued that there were thousands of dollars in outstanding loans that had been falsely identified as net assets by the audit. In both cases, these assertions were made in addition to the claim that many of the assets resulted from non-taxable gambling gains. Also in both cases, the presiding judge did not express confidence in the probity of the taxpayer's testimony. It is an open question, then, to what extent the finding that the gambling gains were taxable was based on a lack of confidence in the evidence presented by the taxpayer. In situations in which taxpayers can establish credibly that gains were associated with bona fide gambling activities through, for example, detailed records and the testimony of reliable witnesses, cases like *Luprypa* and *Dowling* may be somewhat diminished as persuasive authorities.

The second observation is that on the stated facts in each case, the taxpayer did indeed have considerable and demonstrable physical skill that went into the finding that the particular gambling gains were taxable. *Luprypa's* skills were honed through daily practice, and when combined with a risk-minimizing strategy of playing tired, inebriated opponents, they led to consistent financial success. *Dowling* was a professional golfer, was highly skilled (he apparently held a number of course records), and played for money principally against amateur players. The court found that he was better than his opponents and would reasonably have expected to win about 90 percent of the games he played. In both cases, the taxpayer had a clear physical edge in skill over the opponents with whom he wagered. This physical edge undoubtedly contributed to the finding that the gains were subject to income tax. The same cannot typically be said of other forms of gambling, such as online poker, where luck can loom larger than skill, even over hundreds of thousands of hands.

It is necessary to go all the way back to 1954 to find the single reported Canadian case in which gambling gains from an individual's card playing were determined to

25 See *Down v. Compston*, [1937] 2 All ER 475 (KB).

be income from a business under the Act. In *Peter J. Belawski v. MNR*,²⁶ the taxpayer admitted to playing cards and dice profitably over several years, from which he earned the amounts of \$4,095 (1946), \$4,034 (1947), \$4,799 (1949), and \$9,082 (1950). Unfortunately, Monet C of the Tax Appeal Board did not report the facts in any detail in his decision. He simply stated:

With the evidence adduced, I am satisfied that even though the gambling activities of the appellant did not constitute his sole business or occupation during the years under review, nevertheless these activities amounted to the carrying on of a business the profits from which are taxable.²⁷

Given the thinness of the facts reported and the brevity of the judgment, comment on the basis for the decision is necessarily speculative; however, it seems that the key distinguishing factor in the *Belawski* case was that the taxpayer had generated a considerable and consistently growing stream of profit from his gambling activities over the years at issue. In 2009 dollars, the amounts won by the taxpayer would be in the range of \$40,000 to \$100,000 per year. The evidence that the winnings grew over the years, were considerable in quantum, and did not fluctuate dramatically over an extended period of time suggests that the taxpayer may have cultivated well-established skills in dice or cards. Perhaps for those reasons Monet C found that it would not be unreasonable to conclude that the taxpayer was devoting a lot of time, organization, and skill to his gambling activities.

It is possible, and again this is speculative, that Monet C was also influenced by factors such as a lack of confidence in the honesty of the taxpayer's claims regarding the origin of the funds, not unlike what seems to have happened in *Luprypa* and *Dowling*. This is not an infrequent occurrence. In many cases, individuals have claimed that "gambling" was the origin of otherwise unexplained funds.²⁸ It could also be the case that Monet C simply reached the wrong conclusion about the taxpayer's liability for income tax, particularly in light of the subsequent decisions on this point.

In *MNR v. Walker*,²⁹ a 1952 case involving betting on horses, the Exchequer Court made it clear that having an edge in the odds through privileged access to inside information was an appropriate factor to consider in finding that a taxpayer ought to be taxed on gains from gambling. The court held in obiter dictum:

26 (1954), 11 Tax ABC 299.

27 *Ibid.*, at 300.

28 A few recent examples include *R v. Hobbs*, 2008 NSSC 226 (where the accused was convicted of drug offences despite claiming that \$32,000 in cash was accumulated from winning at poker); *Thomassin v. The Queen*, 2007 TCC 702 (involving a net worth audit of a fortune teller who unsuccessfully claimed that the unexplained source of large amounts of money over several taxation years was video poker); and *Philip v. The Queen*, 96 DTC 1893 (TCC) (another case involving a net worth audit, where the taxpayer unsuccessfully claimed that a \$7,000 deposit was won from gambling with friends rather than from performing construction services).

29 52 DTC 1001 (Ex. Ct.).

[W]hen it is considered that the taxpayer did have an interest in several race horses; had the benefit of inside information from jockies [sic] and other interested persons on the probable outcome of races, which he admits he had due to the fact that he was running some horses which he owned or had an interest in; and the further fact that for ten years or more he systematically attended all the races in sometimes four different cities and bet on most of the events, one is almost driven to the conclusion that this set of facts constitutes a business or calling within the meaning of the tax Acts, and the monies made thereby would therefore be taxable. There does not seem to be any doubt that money made on casual bets made for pure amusement, or a hobby, are not assessable.³⁰

It thus appears that the determining factor for the court in *Walker* was the taxpayer's privileged access to inside information and the familiarity of the taxpayer with horse racing insiders as a result of his ownership of several racehorses. This, of course, would have made winning on bets significantly more likely than it would be for the average bettor. Cultivating relationships with insiders in order to obtain privileged information would clearly constitute a "system" that would reliably generate profits. The taxpayer could be regarded as an "informational entrepreneur" engaged in collecting, synthesizing, and deploying information for profit through gambling on horse races. In this sense, the activities he engaged in were little different from those of a stock market speculator. It seems also that the court was willing to exclude from the realm of taxable gains bets that are made for amusement or as a hobby, apparently regardless of the profitability of the betting to the hobbyist.

The only other reported case in which gambling gains were found to be taxable for a taxpayer other than a provider of gambling opportunities is the 1951 decision of the Tax Appeal Board in *J. Badame v. MNR*.³¹ In *Badame*, the taxpayer raised and raced horses for a living. At any given time, he had up to 18 horses, which he personally trained and raced on various tracks. He bet on both his own and other horses. He spent almost all his time at racetracks, and earned \$8,435 in 1947 and \$4,908 in 1948 from horse betting. Monet C found that the taxpayer's activities amounted to a business:

I do not agree with the submission made by the able Counsel for the appellant that the fact that the appellant owns a racing stable is irrelevant and that, if anything, it would "detract from his capacity to win bets because he would have to spend a certain amount of time training his horses and thinking about their racing position or quality which the true bettor would be able to devote to reading racing forms and computing his odds." It is, I think, precisely because he had a racing stable and because he entered his horses in races that he had access to the race tracks every day at times when the ordinary racegoer could not go; it is also because he had a racing stable that he had a closer association with the owners, trainers and jockeys than the ordinary bettor and thus had the advantage of getting most valuable information; it is also because he had a racing stable that he could make a closer check-up of every horse to be entered in races,

30 *Ibid.*, at 1003.

31 (1951), 3 Tax ABC 226.

thus diminishing the element of risk in his betting. There is all the difference in the world between the ordinary bettor on horse races, even if this be his only occupation—like it was in the *Grabam v. Green* case—and the present appellant, whose betting activities were so organized as to form an integral part of his business or occupation.³²

It is noteworthy that in *Badame* as in *Walker*, one of the decisive factors that led to the finding that gains from betting were taxable income was that the taxpayer had access to inside information. Monet C continued:

It was pointed out that if the Board decided that race track earnings constitute taxable income, it would have to be borne in mind that losses from race track betting would have to be deducted from income. I fully agree with that proposition and I do not see why it would be otherwise if it was proven that the appellant had organized an effort with a view to securing a profit. If the appellant had sustained losses from his race track activities and had wanted to deduct same from his income, I would have had no hesitation, with evidence similar to that presented in this case, to allow the deduction claimed.³³

A survey of the case law shows that Monet C is an outlier in his view that where gambling gains constitute taxable business income, gambling losses should be readily deductible as business losses; no Canadian court has reached this conclusion in any reported case. Indeed, it will become clear in the discussion of the other categories of gambling tax cases that the two judgments of Monet C in *Belawski* and *Badame* are anomalous. The *Badame* decision has been cited as recently as the 2006 judgment of the Tax Court of Canada in *Leblanc* (discussed in considerable detail below).³⁴ However, in *Leblanc*, which is probably now the leading Canadian case on the taxation of gambling gains, the *Badame* decision itself was not followed, and it has not been followed by any Canadian court in the more than 50 years since it was decided.

This survey of the Canadian cases in which gambling gains have been found to be taxable as income suggests that there are three principal ways for gambling gains to amount to income from a business:

1. The taxpayer has access to inside information that allows him or her to make substantial profits from bets, especially when these gambling opportunities are pursued systematically and in an organized fashion.³⁵
2. The taxpayer manifests a cultivated physical skill that provides a demonstrable betting advantage over his or her opponents.
3. The taxpayer is a bookmaker, casino operator, or other provider of gambling opportunities.

32 Ibid., at 231.

33 Ibid., at 232.

34 *Leblanc*, supra note 8, discussed in the text below at note 60 and following.

35 This is not always sufficient, though; see *Markowitz* discussed below, infra note 45 and the related text.

Thus, although there is some authority for the taxation of gambling gains as outlined above, particularly where taxpayers are organized and reasonably assured of earning profits, there are many more cases, as is demonstrated in the next section, in which gambling gains have been regarded as personal and therefore found not to give rise to income tax liability.

Gambling Gains Found Non-Taxable

By far the greater weight of authority has held that gambling gains are not taxable in Canada. A frequently cited passage from the 1925 English case of *Graham v. Green*, referred to earlier, set the tone for both British and Canadian income tax jurisprudence with respect to gambling gains. In that case, Rowlatt J stated:

Now we come to betting, pure and simple. . . . It has been settled that a bookmaker carries on a taxable vocation. What is a bookmaker's system? He knows that there are a great many people who are willing to back horses and that they will back horses with anybody who holds himself out to give reasonable odds as a bookmaker. By calculating the odds in the case of various horses over a long period of time and quoting them so that on the whole the aggregate odds, if I may use the expression, are in his favour, he makes a profit. That seems to me to be organising an effort. . . .

Now we come to the other side, the man who bets with the bookmaker, and that is this case. These are mere bets. . . . I do not think he could be said to organise his effort in the same way as a bookmaker organises his. . . . In effect all he is doing is just what a man does who is a skilful player at cards, who plays every day. He plays to-day and he plays to-morrow and the next day and he is skilful on each of the three days, more skilful on the whole than the people with whom he plays, and he wins. But I do not think that you can find, in his case, any conception arising in which his individual operations can be said to be merged in the way that particular operations are merged in the conception of a trade. I think all you can say of that man, in the fair use of the English language, is that he is addicted to betting.³⁶

Even in the 1950s—a time when the question of whether gambling gains ought to be subject to tax was what could be characterized as a frequently litigated legal issue—it took considerable activity and insider access for betting on horses to be considered taxable. In *No. 230 v. MNR*,³⁷ Monet C concluded that \$15,011 won by the taxpayer through betting on horses was not income from a business. There are many other similar cases from that period in which gambling gains were found not to be taxable.³⁸

36 *Supra* note 18, at 313-14.

37 (1955), 12 Tax ABC 136.

38 See, for example, *Jack Di Cosimo v. MNR* (1951), 5 Tax ABC 95 (where the taxpayer won significant sums playing dice on two occasions and his gains were found to be non-taxable); *B.A. Carey v. MNR* (1957), 17 Tax ABC 97 (where a wholesale butcher was found to be not taxable on winnings from dice-throwing games); *No. 469 v. MNR* (1957), 18 Tax ABC 145 (where a life insurance salesman was found to be not taxable on gains from two regularly held

In a case originally heard by the Tax Appeal Board as *No. 364 v. MNR*,³⁹ the taxpayer engaged in extensive gambling activities over several taxation years. He owned a horse racing stable from 1942 to 1948, and had as many as 12 horses during that period. He was also the proprietor of the Morden Hotel in Sarnia, Ontario. While he owned the racing stable, he bet continuously and heavily on horses, cards, and sporting events. He sold the stable and his horses in 1948. The taxpayer was reassessed by the minister on gambling gains he earned in 1949 to 1953, following the sale of his racing stable. The Tax Appeal Board held:

In the present appeal it has been clearly shown that the appellant has a certain marked propensity for gambling and betting. As already pointed out he did not hesitate to admit that he oftentimes felt an urge to get into a game. Whatever game he engaged in held a special attraction if a substantial bet featured its outcome. In this respect it must be said from general knowledge that the appellant does not occupy a lone position. There was no suggestion that the appellant was a bookmaker. . . . In the judicial language set out above it is found that he was betting as a hobby or for pure amusement. The result is that the winnings are not assessable to income tax.⁴⁰

The minister appealed the decision to the Exchequer Court (where the case was heard as *MNR v. Morden*).⁴¹ In dismissing the appeal, the court held that

[the taxpayer's] gambling activities up to the year 1948 were so extensively organized and occupied so much of his time and attention that, had they continued throughout the years in question, any net gain therefrom might possibly have been income from a business.⁴²

The court concluded with respect to the tax years at issue that,

[w]hile [the taxpayer's] bets were high at times and his gains substantial, I can find no evidence that his operations amounted to a calling or the carrying on of a business. Gambling was in his blood and it provided him with the excitement which he craved. It was his hobby.⁴³

The Exchequer Court agreed with the disposition of the case by the Tax Appeal Board and found that the gambling gains were not taxable to the taxpayer. *Morden*

poker games and from wagers on municipal, provincial, and federal elections); and *No. 573 v. MNR* (1958), 20 Tax ABC 436 (where a grocer and butcher who won \$29,000 on sports bets in 1948 and 1949 was found to be not taxable on his winnings).

39 (1956), 16 Tax ABC 81.

40 *Ibid.*, at 85.

41 61 DTC 1266 (Ex. Ct.).

42 *Ibid.*, at 1267-68.

43 *Ibid.*, at 1269.

is the only wagering case referred to in the CRA's interpretation bulletin addressing the taxation of gambling winnings.⁴⁴

In *A. Markowitz v. MNR*,⁴⁵ decided shortly after *Morden*, the taxpayer had engaged in significant horse race betting activities from 1957 to 1960. The minister at first contested the large increases in the taxpayer's bank accounts, and reassessed on the basis that the taxpayer had an unreported source of income. The taxpayer produced meticulous records of his betting activities along with associated returns and bank deposits matching the winnings on these bets. The minister then claimed in the alternative that the taxpayer had been so diligent and dedicated to betting on horses that it amounted to a business. The Tax Appeal Board held that the taxpayer had met the burden of rebutting the minister's original contention that the funds had a source other than gambling, and that the taxpayer was not in the business of earning income from betting on horses. According to the board's ruling,

[a] number of witnesses were called on behalf of the appellant. This list included certain gentlemen highly placed in the business, political and court life of Toronto as well as friends and acquaintances and all these persons testified that they were frequenters of the several local tracks in the racing season and all knew Mr. Markowitz as a frequent and regular attendant at the race meetings. They were unanimous in agreeing that Mr. Markowitz was an enthusiastic participant in the racing meets and that he enjoyed a reputation as a successful bettor—based, it was said by some, on the many good tips received by the appellant from those who had special knowledge about the horses, the condition of the tracks, the weather, the riders and other matters entering into the success or failure of a certain horse to win a certain race.⁴⁶

It seems that the Tax Appeal Board, unlike the Exchequer Court in *Walker* and *Monet C in Badame*, was not sufficiently moved by the suggestion that Markowitz may have had access to inside information to conclude that his winnings from betting constituted income from a business. The board's decision in this respect also contrasts to some extent with the findings of some of the cases discussed above, such as *Luprypa* and *Dowling*, where it was held that having an edge in placing bets, such that the odds on the whole tend to be in one's favour, can tip a taxpayer from conducting a hobby to earning taxable income from a business. It is possible, though speculative, that the Tax Appeal Board was not fond of the form of reasoning used by the tax authorities—namely, that in the absence of detailed records you lose, because you cannot rebut the presumption of a taxable source; and in the presence of detailed records you lose, because you were so well organized that your activities must be regarded as amounting to a business.

44 See *Interpretation Bulletin* IT-334R2, "Miscellaneous Receipts," February 21, 1992, at paragraph 10.

45 (1964), 35 Tax ABC 348.

46 *Ibid.*, at 350.

In *C.G. Chapman v. MNR*,⁴⁷ the taxpayer was the owner and publisher of a magazine entitled *The Canadian Sportsman*, a publication focusing on horse racing. The taxpayer also owned one racehorse. The minister took the position that the taxpayer's gains from wagering on horse racing (\$7,303 in 1965, \$1,204 in 1966, and \$9,550 in 1967) ought to have been taxable as income from a business. The minister argued that because the taxpayer's father and brother were professional horse-racing drivers, because he himself trained and raced a horse, and because he published the magazine, his wagering activities were integral to his business, and further that he wagered systematically with a view to making money, such that he should be taxed on the gains. The Tax Appeal Board held:

The question as to the taxability of gambling winnings is one of considerable complexity. It is clear from an examination of the various decisions to which my attention has been directed that each case must depend on its own particular set of facts, the important factor being whether or not there was an organized intention on the bettor's part to minimize his chances of loss and to make a profit from his activities rather than merely pursue them as a form of amusement.⁴⁸

The board found that the taxpayer was not sufficiently organized to be considered to be in the business of gambling, and noted that although the taxpayer had "access to the paddock and to the private room where the drivers take their refreshment after their racing schedule for the day is finished," there was no evidence that he used or had access to inside information in his wagering.⁴⁹

In *Chorney v. MNR*,⁵⁰ again the taxpayer made gains from betting on horses. He attended races three or four days each week, placing bets on two or three races on each occasion in amounts ranging from \$200 to \$1,000 per race. At the Tax Review Board, Cardin C held that the taxpayer "bet on horses for the thrill and pleasure he derived from such activities, and which was, for him, a form of recreation."⁵¹ He noted that the taxpayer was "engaged in a service station business with his partner on a full-time basis from which he received a good and steady income" and that he did not have "any special scheme of betting which might assure him a steady income without the risk of losses."⁵² The taxpayer's gambling gains were found to be non-taxable.

In *Balanko v. MNR*,⁵³ the minister reassessed the taxpayer for the 1974, 1975, and 1976 taxation years by adding to his income amounts that the taxpayer had made

47 [1971] Tax ABC 81.

48 *Ibid.*, at 85.

49 *Ibid.*, at 85-86.

50 77 DTC 168 (TRB).

51 *Ibid.*, at 170.

52 *Ibid.*

53 81 DTC 887 (TRB); *aff'd.* 88 DTC 6228 (FCTD).

through gambling (\$2,485, \$5,796, and \$15,741, respectively). Over this time period, the taxpayer played cards an average of three or four times per week at various social clubs and in private poker games. He also bet, though less regularly, on sporting events and horse races. Only from August 1975 did the taxpayer have another occupation; he worked at a pool room for \$150 per week in late 1975 and early 1976. The Tax Review Board found that, “[s]ave for gambling, [the taxpayer] had no substantial source of income”; however, it held that his gambling gains were not taxable, stating its reasons as follows:

There can be no doubt that the Appellant freely indulged his inordinate passion for gambling, but I cannot conclude that in doing so he carried on a business. Counsel for the Minister stressed that the Appellant gambled with a view to profit. However, it must be observed that such intention is one shared by all who gamble, and the presence of the intention to win or make money in gambling, which is there in all who gamble, does not lead to a conclusion that all who gamble, or even all those who gamble frequently, are carrying on a business.

Counsel for the Minister stressed that the appellant took risks, and that he borrowed money in order to carry on his gambling activities. While risk-taking is necessary in a business, it is management or minimization of risk which is the characteristic of business activity. For example, in the case of an insurer, he would have regard to the statistical incidents of losses in deciding whether to insure or how much to charge for coverage. There is a total absence of any evidence here which indicates the presence of any organized system for the minimization or management of risk. This lack of system distinguishes the Appellant, an intemperate gambler, from the professional gambler.⁵⁴

The board’s reasons were adopted by the Federal Court Trial Division in dismissing the minister’s appeal.⁵⁵

It is remarkable that in this case the taxpayer had no other consistent occupation except for gambling, was obviously a skilled and frequent poker player, and yet was found not to be in the business of gambling. It appears that a key element in the decision was the finding that the taxpayer could not directly manipulate and control the chances of winning and the risks of losing, as might a bookmaker or an insurer (though he would certainly strive to do so). Although he was a regular player and successful enough to be able to support himself by his winnings, he was found to be, at most, a skilled player operating within someone else’s system for making money as a provider of gambling opportunities.

In *Epel v. The Queen*,⁵⁶ the taxpayer was a recent Russian immigrant to Canada who operated a shoe repair business as a sole proprietor. He gambled at private establishments four or five times a week and claimed to have won substantial amounts

54 Ibid. (TRB), at 888.

55 Supra note 53 (FCTD), at 6230, per Collier J.

56 2003 TCC 707.

(on average, \$300 to \$400 per day). At the Tax Court of Canada, Campbell J found that the taxpayer's gambling gains were not taxable, stating her reasons as follows:

The Appellant's evidence is that he gambled on a very regular basis throughout the years in question, and that he had substantial and consistent wins. According to the facts, these wins appear to be largely beginner's luck, which were sustained over a lengthy period of time rather than wins based on any type of system or background knowledge of the game as described by John Turmel [the owner of a private casino frequented by the taxpayer]. In fact Turmel in his evidence indicated that the Appellant was lucky for a number of years, but described this as a one-time occurrence. It is clear from Turmel's evidence that Epel was a regular player who consistently won, sometimes up to \$4,000.00 weekly. . . .

The Appellant testified that he did not attend movies or theatre productions unless they were in the Russian language, as his knowledge of English was not sufficient for him to enjoy these forms of entertainment. He therefore used gambling as his entertainment. It was a hobby from which he derived pleasure. He did not require adept language skills when sitting in a game of poker. Although his wins were substantial, the evidence supports that he did not view his gambling activities as anything akin to a business operation. The evidence does not disclose that he had any type of system or organization to his wins. For these years in question, his wins appear to simply be the "luck of the draw" and the excitement and pleasure of the wins kept him returning.⁵⁷

It is striking that it was accepted by the court that the taxpayer "was lucky for a number of years" but that this was a "one-time occurrence." From a statistical perspective, it is difficult to reconcile these two factual findings. It is, indeed, far more likely that Epel was a skilled poker player and a shrewd judge of his opponents' skills. Nevertheless, the court appears to have been inclined to accept Turmel's evidence and found Epel's gambling gains from poker not to be taxable.

The results in cases like *Balanko* and *Epel* have made the presumption against treating gambling gains as taxable even stronger than it was in earlier cases such as *Morden*. In *Lupton v. The Queen*,⁵⁸ the taxpayer had failed to file income tax returns for 1998 to 2001. The minister conducted a net worth audit and assessed the taxpayer as earning \$19,300, \$12,159, \$16,584, and \$13,479 in each of those years. Although the taxpayer described himself as a professional gambler and had been playing poker in private games since at least 1991, Sheridan J at the Tax Court of Canada held that the taxpayer was not taxable on his gambling gains, highlighting the fact that he had no formal training at poker and noting that he had been more "successful at inspiring others to pay his bills" than at "making a living at the gambling table."⁵⁹ The taxpayer worked only casually on a cash basis, delivering flyers 35 to 40 days per year.

57 Ibid., at paragraphs 27-28.

58 2005 TCC 702.

59 Ibid., at paragraph 12.

In *Leblanc*,⁶⁰ a 2006 Tax Court case referred to earlier, the taxpayers were brothers, each of whom was assessed as having earned taxable income of \$875,874, \$755,271, \$418,178, and \$715,221 from 1996 to 1999 inclusive, by playing three different sports lotteries in Ontario and Quebec. The Leblanc brothers rented a house in Aylmer, Quebec, so that they could more easily play both the Quebec and Ontario sports lotteries. As Bowman CJ observed, the brothers

led unusual lives. They spent their time playing lottery games or watching sports on television. They also played ping pong and golf and sat around the house drinking beer and eating pizza. Despite their winnings, they lived cheaply and spent very little on material goods. Their winnings were all ploughed back into the lottery games.⁶¹

The Leblanc brothers wagered heavily on sports lottery games designed to strongly favour the lottery corporations, and yet they lost only around 90 percent as much as they gained over the period. They estimated that they made wagers of up to \$13 million per year on the sports lotteries, and lost on approximately 95 percent of their wagers. (This, of course, suggests that when they won, they won significantly more than they typically lost.) Since the lotteries had limits on how many tickets could be sold to an individual and how many could be sold in total, the brothers worked through helpers with many different lottery retailers. They negotiated discounts of 2 to 3 percent with retailers and paid up to 15 helpers to pick up tickets for them. They won consistently over several years, and played the sports lotteries intensively.

Despite the remarkable nature of the brothers' financial success (no other litigants in the gambling cases canvassed to this point came close to wins of this magnitude), despite the fact that they had no occupation other than playing the sports lotteries (prior to 1996, they had worked in the family window-washing business), and despite the long-term nature of their successes (which extended over several years), Bowman CJ held that their winnings were not taxable. He explained the result as follows:

Compulsive gamblers, whether they play lotteries or gaming tables may spend a lot of time and money gambling and they certainly do so with a view to winning. People who go every day to the racetrack devote time and money to this pastime and after a while they may develop a degree of expertise, or at least persuade themselves that they do. Traditionally, however, their gains are not taxed and, more importantly, their losses are not deductible.⁶²

Bowman CJ then set out the primary reason for the success of the Leblanc brothers in avoiding tax liability on their gains:

60 *Supra* note 8.

61 *Ibid.*, at paragraph 11.

62 *Ibid.*, at paragraph 29.

It is suggested that the appellants must have had a system because they were so successful and that that system involved buying a significant number of tickets on long shot outcomes, which, it is argued, minimized their risk, because it ensured that if they did win, they won big. For the reasons that I set out below this strikes me as a *non sequitur*.

I shall deal with the last point first. If I understand it correctly it is this: since you won it proves you must have had a system and therefore a business. If you had lost it would have proved you had no system and therefore no business and you could not have deducted your losses. This contention is about as classic an exposition as I have ever seen of the logical fallacy *post hoc ergo propter hoc*. It is true, they won, but to say they won because they had a system has no basis in the evidence at all. They won in spite of having no system. If one is looking for a pattern it is that they bet massively and recklessly and in those games where they could, they bet on long shots. Certainly it meant that if they won they won big, but the converse is that if they lost they lost big and given the astronomical odds against winning, their chances of losing were far greater than their chances of winning.⁶³

It appears strange that Bowman CJ states that the brothers had “no system” even though the facts recited in the decision state that they “considered and compared the lottery corporations’ odds with the Las Vegas odds” and “used a computer program to come up with combinations of long shots.”⁶⁴ In light of their consistent wins, and their pattern of betting heavily in some weeks and not at all in other weeks, it seems vastly more likely that the brothers did in fact have a system capable of overcoming the lopsided odds set in advance by the lottery corporations. The weeks in which they did not play could easily be attributed to there being no attractive combinations of games to wager on according to their system. Bowman CJ’s statement that their ticket-purchasing behaviour was “no different from a Las Vegas gambler placing large stacks of chips all over the roulette table, for one spin of the wheel”⁶⁵ is therefore perhaps deliberately disingenuous, and in any event not analogous. His ultimate conclusion was delivered as follows:

The appellants are not professional gamblers who assess their risks, minimize them and rely on inside information and knowledge and skill. They are not like the race-horse-owner, who has access to the trainers, the horses, the track conditions and other such insider information on which to base his wagers. Nor are they like seasoned card players or pool players who prey on unsuspecting, inexperienced opponents. Rather, they are more accurately described as compulsive gamblers, who are continually trying their luck at a game of chance.⁶⁶

The *Leblanc* decision is the most recent reported Canadian judgment on the taxation of gambling gains. It is also the one that presented the strongest set of facts in

63 Ibid., at paragraphs 41-42.

64 Ibid., at paragraph 40.

65 Ibid., at paragraph 45.

66 Ibid., at paragraph 48.

favour of the minister. The taxpayers did not have outside employment. They played extremely intensively. They compared the odds offered by the lottery corporations with the prevailing odds in Las Vegas and bet on those combinations of games that, according to their computer program, had attractive prospects of large gains. They won substantial amounts of money. They won reliably over a number of years. They not only engaged full-time in the wagering themselves, but also hired 15 paid helpers to assist them in their scheme. They were running an operation that was very much like a small business. Despite all these factors suggesting that the taxpayers had a reliable system for profit making, Bowman CJ held that their gains were not taxable. His decision is consistent with the general result that unless a taxpayer is providing gambling opportunities for others (and not taking on significant risk personally), deploying a reliable system for profit making, relying on inside information, or using considerable skill and knowledge that systematically places one at an advantage over one's wagering counterparties, then a taxpayer's gambling gains will not be considered to be income from a business.

In the aftermath of the *Leblanc* decision, and in light of the considerable time that has elapsed since the last reported Canadian case in which winnings from sports betting, card playing, or horse race wagering were found to be taxable, it has arguably never been clearer that the courts will not be inclined to consider gambling gains to be income from a business in the absence of a proven system for profit making (such as that of a bookmaker or an operator of slot machines or VLTs), clear evidence of inside information (such as receiving tips on horses), or other means of ensuring success (for example, cheating at online poker through various reliable, though illicit, strategies, such as conspiring with others at the same table).

This conclusion is supported also by the successes that the minister has had in arguing against considering gambling activities to be a business where taxpayers have generated losses that they have sought to deduct from other sources of income, as shown in the next section.

Gambling Losses Found Not Deductible

In the cases described above in which gambling gains were found to be taxable, the minister took the position that the taxpayers were engaged in the business of gambling and that therefore their winnings should be taxable. Of course, the minister adopted this position in part because the taxpayers did in fact realize considerable gains from their gambling activities. In a few cases, however, the tables have been turned: the taxpayers have argued that they were in the business of gambling, in order to be able to claim a deduction for gambling losses, while the minister has argued that the taxpayers have not established satisfactorily that they were actually in the business of gambling, in order to preclude the deduction of losses.

In *Wright v. MNR*,⁶⁷ the taxpayer was a commercial fisherman who spent two months in California in 1981, betting on horse races. For the 10 years prior to this

67 85 DTC 444 (TCC).

foray into Californian racetrack wagering, the taxpayer had been interested in horse racing, and he subscribed to a number of newsletters and quarterly periodicals to assist him in his gambling activities. Throughout the 1970s, he engaged in horse race betting casually. In 1980, he won \$12,000, and in 1981 he lost \$41,892, from betting on horses. For the two months that he was in California in 1981, he spent between 4 and 6 hours each day in his hotel room, handicapping horses, and was at the track from 9:30 a.m. to 4:15 p.m. He also hired horse race experts as consultants for a total of \$500. He claimed that he was “not like the people who go to the racetrack to have fun, to relax, and to bet on hot tips or to choose a horse by the name of a child or a friend.”⁶⁸ The Tax Court of Canada denied the deduction of the taxpayer’s racetrack betting losses on the basis that it was obvious that in 1981 his occupation was the fishing business and that he was engaged in gambling as a hobby, despite the fact that he chose to miss the best fishing month of the 1981 taxation year in order to bet on horses in California, and despite the fact that during that visit he spent most of his time on wagering and relied on a (supposedly) scientific system to assist him in placing his bets. In disallowing the taxpayer’s losses, the court explained that “[g]ambling is a risky business and it is difficult to have a reasonable expectation of profit even if a taxpayer is a sophisticated gambler who uses scientific methods of gambling.”⁶⁹

In *Dubrovsky v. MNR*,⁷⁰ the taxpayer claimed gambling losses of \$60,500 and \$49,296 in 1981 and 1983, respectively, associated with trips to Las Vegas and Atlantic City. The taxpayer had spent 21 days in casinos in 1981 and 11 days in casinos in 1983. According to the taxpayer’s evidence, “[h]e read a lot of books on the theory of probability, and was convinced that he could win a lot of money from gambling in casinos, but he lost because of a miscalculation.”⁷¹ The minister had argued that the taxpayer’s activities were not continuous and that the taxpayer did not have a reasonable expectation of profit. Although the court considered the arguments of both the taxpayer and the minister, the deduction of the losses was disallowed on the narrower ground that the taxpayer had no written record of his gains and losses for the taxation years at issue, and for that reason, no matter what the characterization of the taxpayer’s activities, he would not have been able to satisfactorily substantiate the claim that he had in fact incurred the losses.

In *Molony v. MNR*,⁷² the taxpayer was a compulsive gambler. He worked at the Canadian Imperial Bank of Commerce and embezzled funds from the bank beginning in 1980 until his termination in 1982. He eventually defrauded the bank of a total of

68 Ibid., at 444.

69 Ibid., at 446.

70 88 DTC 1712 (TCC).

71 Ibid., at 1714.

72 90 DTC 1394 (TCC).

\$10.2 million to fund his addiction to gambling.⁷³ In his tax return for 1980, he included in income the funds he had embezzled during the year, in the amount of \$276,425, and also claimed a deduction for his gambling losses of \$287,690. In 1981, he included \$2,431,683 as income and claimed his gambling losses as a deduction amounting to \$2,444,524. His 1982 return included embezzled income of \$7,509,000 and losses of \$7,515,041. The minister disallowed the deduction of all the losses on the basis that the taxpayer was not in the business of gambling. At the Tax Court, Christie J explained that the deductions were not permissible for the following reason:

It strikes me that it is self-contradictory to speak of a pathological gambler being in the business of gambling. This activity impairs his intellect and his sense of perspective is lost. The impulse to go on regardless of the financial consequences is overwhelming. His attitude is irrational. Dr. Walsh [an expert witness for the Crown] says: “A (pathological) gambler comes to rely on what can only be called magical thinking.” All of these things place him on the road to certain financial ruin or, as in the case of the appellant, worse. I accept that at the relevant time the appellant believed or expected he would profit from his gambling, but when asked whether on reflection he regarded that belief or expectation to have been reasonable he said no.⁷⁴

Thus, in *Molony*, the minister’s argument that the taxpayer was not in the business of gambling prevailed, and the claimed losses from a business of gambling were not permitted. Again, this finding is consistent with the dominating factor in determining whether gambling gains or losses should be considered to be from a business—namely, whether the taxpayer is actually in a position to ensure that gambling will provide consistent and reliable profits through, for example, providing gambling opportunities to others, relying on inside information (as an informational entrepreneur), or deploying considerable skill, knowledge, and expertise to tilt the odds in his or her favour.

In the 2011 Tax Court decision in *Cohen*,⁷⁵ an individual who had been a senior associate at a large Toronto law firm decided to leave the firm and aggressively pursue poker instead of practising law. In the 2006 taxation year, he claimed losses of \$121,991.43 from his poker-playing activities. Pizzitelli J rejected the taxpayer’s argument that he had been in the business of earning income from poker, stating:

Losing money every month can hardly be considered a steady source of income. It is obvious his income from employment and severance above were the sources he relied upon to fund his poker-playing activities.⁷⁶

73 The *Molony* case was made into a movie, released in 2003 under the title *Owning Mahowny* and starring Philip Seymour Hoffman as the taxpayer. Further details (including a trailer of the film) can be found at www.imdb.com/title/tt0285861/.

74 *Molony*, supra note 72, at paragraph 1398.

75 Supra note 1.

76 *Ibid.*, at paragraph 44.

Pizzitelli J set out a number of reasons why the taxpayer's losses were not deductible, including that he was apparently not a skilful player; that he was not disciplined; that the 2,500 hours spent playing poker were consistent with being an avid hobbyist; and that his credibility regarding the commerciality of his endeavour was dubious, given that he did not recall a trip to Las Vegas in December 2005 and he had failed to notify his previous employer that he had started a new business, as required by his termination agreement.⁷⁷ In light of these reasons, the taxpayer was found not to have been in the business of playing poker such that he could deduct his losses from other sources of income.

LEGISLATION AND CASE LAW APPLIED TO POKER

In *Interpretation Bulletin* IT-334R2, "Miscellaneous Receipts," the CRA explains that the following criteria are relevant in determining whether gambling activities amount to a business:

- a) the degree of organization that is present in the pursuit of this activity by the taxpayer,
- b) the existence of special knowledge or inside information that enables the taxpayer to reduce the element of chance,
- c) the taxpayer's intention to gamble for pleasure as compared with any intention to gamble for profit as a means of gaining a livelihood, and
- d) the extent of the taxpayer's gambling activities, including the number and frequency of bets.⁷⁸

In January 2008, the CRA wrote to a taxpayer who had requested an advance income tax ruling with respect to the taxation of online gambling gains.⁷⁹ The CRA referenced the paragraph of IT-334R2 reproduced above and explained its basic position with respect to the taxation of poker winnings as follows:

The determination of whether a person's gambling activities constitute the carrying on of a business in the pursuit of profit that results in a source of income under the *Income Tax Act* . . . is a question of fact that can only be determined by an examination of all the circumstances and the taxpayer's entire course of conduct.⁸⁰

Without reciting the factual details provided by the taxpayer, the CRA stated:

Based on the limited facts described in your correspondence, your gambling activities appear to be conducted primarily for your pleasure as a hobby and without special

77 Ibid., at paragraphs 45-50.

78 IT-334R2, supra note 44, at paragraph 10.

79 See CRA document no. 2007-0238601E5, January 23, 2008.

80 Ibid.

knowledge. In [these circumstances] . . . earning or losses from such gambling activities would be of a personal nature and would not constitute earnings or losses of a business.⁸¹

With due respect to the CRA, the position outlined in IT-334R2 and in the letter cited above appears to marginally overstate (in favour of the minister) the legal approach that the courts are likely to adopt with respect to the taxation of online gambling gains. This is particularly so in light of the most recent decisions, such as *Leblanc*, in which gains in the millions of dollars earned by the taxpayers from heavy and frequent betting over several years, with the assistance of up to 15 hired helpers, were not considered by the court to constitute income from a business.

Although other types of gambling opportunities are made available online, such as sports betting and horse race wagering, the most common form of online gambling is poker. It is popular in Canada, and its popularity appears to have stabilized at a significant level. The foregoing analysis of the legislation and the case law suggests that it is only with some difficulty that the minister will be able to successfully collect income taxes from poker players. Only when a taxpayer has established a clear and consistent record of accomplishment in poker will there be sufficient evidence to take the position that he or she has the requisite skill or knowledge to ensure profitability. Even then, as Bowman CJ observed in *Leblanc*, there is something problematic about using the ex post fact of success to justify a finding of a system and therefore find that the gains are taxable.

Online poker is played at a variety of websites. Typically the game is played against other players on a downloadable software platform installed on a player's computer. The "house" facilitates the game by providing the software platform, accounting for the bankrolls of players, and ensuring the integrity of the system. The financial return for the services that the house provides comes predominantly in the form of a rake collected from the pot for each hand played at a table, though the house also profits from earning interest on outstanding bankrolls held by players and by running tournaments at a profit-yielding entry fee per player. The providers of these services are undoubtedly engaged in the business of providing gambling opportunities to players. An open question surrounds the possible tax liability of the players, however. Could Canadian-resident players be open to income tax liability on winnings?

From the state of the legislation and the case law, canvassed above, it seems unlikely that Canadian income tax law applies in ordinary circumstances to consider poker gains to be income from a source, for at least four reasons.

First, it is not the players who are prima facie engaged in a productive activity—it is the poker website itself that is providing the gambling opportunities, minimizing risks, and guaranteeing itself a stream of revenues. Although poker is a game that is a mix of skill and luck, when players play in a game organized by a casino or

81 Ibid.

other operator, the operator demands a rake from each pot; as a result, the players at each table, considered as a group, will inevitably experience net losses. When individual players do not sustain net losses, at least in the short and medium term, this result can frequently be attributed to brute luck; among the many tens of thousands of players, many will by chance be ahead at any given time over the short-medium run. Only a small proportion of players are in fact so skilled at the game that they can overcome the net toll that the rake takes on their wagers and winnings. The reference is to the “net toll” that the rake takes because many of the most frequent online poker players participate in various rake-back programs that give them valuable points or cash back based on their volume of play. The effect of these programs is to diminish the extent of the rake, but does not go so far as to eliminate it. The number of players who believe themselves to be in the select “profitable player” group naturally far exceeds those who actually are in this group.

Second, in ordinary cases, online gambling is engaged in casually by individuals looking for part-time amusement and the thrill of wagering. These individuals will have other employment and/or business pursuits and will play poker to unwind, relax, or simply try their luck in a real game of poker against real opponents from the convenience of their study, living room, or kitchen table. Because of the instantaneous and convenient nature of the opportunity that online poker presents, it is not uncommon for participants to spend many hours playing online each week. Nevertheless, where players have other occupations, these hours are not inconsistently regarded as hours spent indulging in a poker hobby. Even where players do not have other occupations, the appropriate legal characterization of these hours as a hobby or as professional activity remains ambiguous. Unemployed individuals can obviously engage in hobbies such as gardening, stamp collecting, playing video games, and gambling, just as any employed person can. The lack of another occupation coupled with winnings cannot be decisive.

Third, it is not at all clear how players could be using a system to guarantee success at online poker. Most sites attempt to ensure the integrity of games by using sophisticated technology to detect cheating. In the absence of cheating, a player’s system would inevitably turn on a mix of estimating the relative strength of one’s hand and predicting how other players will react to the various strategies available to the player (call, raise, fold, etc.). However, one of the features of poker is that all players are in the same position vis-à-vis each other. Ultimately, it is inevitable that a dynamic will develop in which relatively strong players will tend to gravitate to the higher stakes tables or tournaments where they will tend to compete against other strong players, diluting the winnings available from the weaker players that are reasonably available to each of them. In addition, the rake does not discriminate on the basis of a player’s skill level; in cash games, each pot is subject to a fractional interest taken by the house. The mental or psychological skills associated with playing poker can be contrasted with the physical skills involved in cases such as *Luprypa* and *Dowling*, where the taxpayers were found to be taxable when they profitably gambled on the basis of their superior ability in playing pool or golf. In poker, one does not control the destiny of the cards in the same way as it is possible to control

or manipulate the ball in pool or golf. A skilled Texas hold 'em poker player cannot control the cards in the flop and will frequently lose to less skilled players because of the sheer randomness of the cards. The outcome of a pool game or golf match, on the other hand, is only rarely determined by something other than the relative skill of the competitors (except for competitors who are very closely matched in ability). It is only in the very long run that the mental or psychological abilities of strong poker players will ensure gains, and even then only when they can be confident that they are playing against less skilled opponents. It is impossible to establish conclusively that one player in Texas hold 'em is more skilled than his opponents; any superior skill can only be inferred probabilistically from long-run financial success in competing against the same players.

Fourth, from a pragmatic perspective, it would be hazardous for the minister to be overly aggressive in attempting to impose tax liability on poker gains because if a taxpayer were found to be in the business of gambling in one year, it would not readily be open to the minister to claim that the same taxpayer (or other similarly situated taxpayers) could not deduct losses from a gambling business in a subsequent year. Since, overall, the only reliable winnings will be netted by the websites facilitating poker play, the minister can be expected to exercise caution in imposing income tax liability on the poker winnings of individuals. An overly ambitious strategy that picks up players who have truly only been lucky over the short and medium term could easily backfire and result in claims for losses offsetting any revenues that might be realized on the taxed gains.

From the perspective of social policy, it is undoubtedly important to ensure that the tax treatment of poker winnings does not lead to inefficient distortions in the labour market, whereby highly talented individuals shift efforts from productive and taxable activities to merely redistributive, unproductive, and non-taxable activities. Probably more important, however, is to ensure that redistributive, unproductive, and otherwise non-taxable activities do not unduly reduce the tax base by drawing a cross-subsidy through the deduction of gambling losses from other sources of income. Given that the vast majority of individuals engaged in playing poker are apt to sustain net losses from the game over their lifetime, it seems that the greater revenue threat lies in the reduction of the tax base through the deduction of gambling losses against other sources of income, rather than the forgone revenues associated with not taxing the relatively rare net lifetime winners. From a pragmatic perspective, then, the optimal approach is likely to be considerable restraint in concluding that a taxpayer's poker activities yield income tax consequences. More specifically, in the absence of a statutory amendment that clarifies how the Act should treat gambling gains for income tax purposes, the CRA and the courts should seriously entertain a claim that a player is in the business of playing poker only once it becomes apparent beyond any doubt that the player's financial successes are consistent and reflect true skill, knowledge, strong mental abilities, and solid psychological adjustment to the changing tides of fortune.

In light of the foregoing discussion of the case law and the legislation, and the pragmatic policy considerations underlying the taxation of online (and, equally, live)

poker gains, what characteristics, with respect to activities and performance, would be most likely to expose a poker player to liability for income tax on his or her winnings? The strongest case that the minister could muster would be to find a player who has the following profile or attributes:

1. The player would have experience playing poker full-time without maintaining any significant alternative occupation for several years, with little variation in earnings on a year-over-year basis (or, more promisingly for the minister, with steadily growing earnings). Owing to the nature of the activity, one would expect daily, weekly, and even monthly results to swing wildly from large gains to large losses; nevertheless, over the long run (potentially involving hundreds of thousands or millions of hands played over the course of several years), the taxpayer would exhibit consistently positive results.
2. The taxpayer would not have any income-earning occupation other than playing poker. This would reveal that the taxpayer's own estimation and assessment of his or her abilities is positive. The minister should be cautious, however, since many gamblers dramatically overestimate their own abilities, selectively ascribing successful outcomes to their own skill and explaining away losses as due to bad luck (or fatigue, or personal distractions); such a bias is known in the psychology literature as a "self-serving bias" and is a common feature of the human psyche.⁸² If a taxpayer had successfully supported himself or herself over the course of at least two years exclusively through poker, this would add to the confidence of the minister and the courts in the conclusion that the taxpayer had the requisite skill and abilities, and had devoted the required time and attention for poker playing to possibly be a business of the taxpayer.
3. The player would demonstrably be a student of the game. The player would constantly study poker strategy, attend courses, practise with poker software, and otherwise consciously and systematically seek to improve his or her abilities. This factor alone is not dispositive, however, since many casual poker enthusiasts also study poker in this way and consider it part of the pleasurable pursuit of their hobby.
4. The player would consider himself or herself to be a professional poker player and would hold himself or herself out as such to others in the poker community. This could be done through informal social networks, public advertising of poker success, endorsements of poker products and services, writing books

82 For a sampling of the extensive literature on self-serving bias, see Dale T. Miller and Michael Ross, "Self-Serving Biases in the Attribution of Causality: Fact or Fiction?" (1975) 82:2 *Psychological Bulletin* 213-25; William R. Bowerman, "Subjective Competence: The Structure, Process and Function of Self-Referent Causal Attributions" (1978) 8:1 *Journal for the Theory of Social Behaviour* 45-75; Miron Zuckerman, "Attribution of Success and Failure Revisited, or: The Motivational Bias Is Alive and Well in Attribution Theory" (1979) 47:2 *Journal of Personality* 245-87; and Neal J. Roese and James M. Olson, "Better, Stronger, Faster: Self-Serving Judgment, Affect Regulation, and the Optimal Vigilance Hypothesis" (2007) 2:2 *Perspectives on Psychological Science* 124-41.

explaining how to profit from playing poker, giving seminars or courses explaining the player's methods in exchange for fees, etc.

5. The player would participate not only in online poker but also in live games and tournaments with relatively consistent success. This is an important criterion, since it would be unlikely that poker skill would manifest itself only in online games and not in live games. Some of the largest financial rewards available to poker players are associated with live tournaments. If a player were skilled enough to generate consistent financial success online, it would be surprising if he did not also want to pursue greater possibilities to profit from his acquired skills and knowledge in live games. There is also a common perception (misperception?) among players that live games are easier and less competitive than online games.
6. A related point is that the player would be selective in participating in online games. The player would deliberately seek out weak players with large bankrolls and try to avoid strong players in order to maximize the profits associated with the time spent playing.

Even with all these factors in the minister's favour, in light of the case law it would not be guaranteed that the minister would succeed in attempting to characterize the taxpayer as being in the business of playing poker. The principal business associated with online poker is clearly that of the poker website itself, rather than the individual player making use of the gambling opportunities provided by the website. With respect to bricks and mortar playing, it is clear that when this occurs in a casino setting, the business is primarily the casino's rather than that of an individual player.

To succeed in showing that an individual taxpayer was engaged in the business of earning income from poker, the minister would have to be able to convincingly demonstrate that the taxpayer is sufficiently skilled to be able to generate reliable profits from poker playing and that the taxpayer was organized and systematic in deploying this skill to generate profits. To do this, it would be essential that the minister be able to demonstrate that the taxpayer is skilled enough to overcome the costs imposed by the websites or casinos through the rake. This would, in turn, be difficult to demonstrate. In contrast to competitions involving physical skills (as in *Luprypa* and *Dowling*) and other games involving mental skill (such as chess), the only reliable indicator in games involving a considerable mix of luck and skill, such as poker, would be a long and sustained track record of financial success, combined with high levels of play and little or no outside income-earning activities.

It should be mentioned here, too, that even in the seemingly most promising circumstances for the minister, there is no reason to believe that a player's success at winning at poker will necessarily continue. An inherent element in the structure of the game is an "arms race" among participants to develop the skill and knowledge to win. This is a central feature of the game that makes it appealing to those who play frequently. In addition, as emphasized throughout this discussion, over the short to medium term luck plays a large role in realized financial outcomes, even for the most skilled players.

Given the pragmatic considerations discussed above relating to the asymmetry between forgone revenues associated with not taxing the winners and allowing deductions of losses against other sources of income for the much greater number of losers, the minister ought to be quite careful to restrict the acceptance of claims that the taxpayer is in the business of earning income from poker only to those cases where, by a long track record of financial success, the taxpayer can clearly demonstrate superior skill and dedication to the point where he or she must be considered a professional player.

CONCLUSION AND POLICY IMPLICATIONS

As the foregoing analysis has shown, it is difficult to legally establish the time at which a personally enjoyable activity switches from being a hobby pursued out of the thrill of wagering and the entertainment associated with the activity to a business pursued with a view to profit. The main deficit in the status quo is that there is great uncertainty about what intensity, duration, and degree of success in poker or other gambling will elevate a player from the ranks of casual enthusiast to gambling business person. This deficit clearly has implications for the optimal policy response. Specifically, is there a legal reform that can address these difficulties?

There are at least two options that suggest themselves to improve upon the status quo. The first possibility would be to prescribe in the income tax regulations the hallmarks of those engaged in taxable gambling businesses (and, possibly, the hallmarks of those engaged in casual wagering), to assist the courts in making appropriate distinctions between taxable and non-taxable gambling activities. The advantage of this approach is that there would be no departure from the current legislation and the structure of the Act, and only the addition of explicit criteria to guide the minister and the courts in determining whether a gambler is in the business of gambling. While these additional criteria would almost certainly not address all fact situations clearly and straightforwardly, one can easily imagine that they would bring greater clarity to a significant subset of circumstances. The principal shortcoming of this “additional guidance through regulation” approach is apt to be of the same kind as the status quo, though not likely of the same degree, but there is also a possibility that mistakes will be made in specifying the hallmarks of casual or professional gambling such that the resulting distinctions may be over- or underinclusive.

The second possibility would be to address the concern about gambling losses being offset against gambling gains by explicitly adopting a rule similar to the one in the United States that all gambling gains must be included in income, but that gambling losses can only be deducted against gambling gains.⁸³ The experience in the

83 In the United States, net gambling gains are subject to income tax, but the question sometimes still arises as to whether or not a particular gambler is in the business of gambling. See, for example, the judgment of the United States Tax Court in *Donald J. Hastings*, 97 TCM 1355 (2009).

United States with this approach suggests that its weakness would be the difficulty of consistently enforcing the rule, particularly in the case of gambling activities that yield relatively small but relatively frequent winnings (such as cash games of poker). Another worry is that it may damage tax morale in that it arbitrarily taxes net winners while not allowing any deductions for net losers. These effects, when discussed in the US context, are often regarded as unproblematic, not least because it is generally felt that gambling is an activity that ought to be discouraged for moral reasons. A natural possibility in this kind of regime would be to allow the carryforward and carryback of losses to years in which there are gains. This sort of quarantining of losses already exists in Canada, of course, with respect to capital gains and capital losses, so it is not too much of a stretch to imagine the same sort of policy applying to gambling gains and losses. The US policy exhibits the weakness of a “heads I win, tails you lose” approach, as well as being difficult to enforce.

In practice, it is unlikely that any of these options—the status quo, guidance through regulation, or the taxation of net gains—will be regarded as entirely satisfactory by policy makers or by affected taxpayers. The boundary between hobby and business in the context of gambling is perhaps destined to forever be a source of controversy.

