BY JACK TADMAN

The Tax-Exempt Status of Gambling Winnings in Canada

Money won is (almost) twice as sweet as money earned

"Counsel for the Minister stressed that the Appellant gambled with a view to profit. However, it must be observed that such intention is shared by all who gamble…" – M.J. Bonner in Balanko v. M.N.R. 81 D.T.C. 887.[1]

In Canada, gambling winnings are generally free from taxation. The tax exempt status of gambling winnings comes from the longstanding principle in British law that the winnings of a person placing bets should not be taxed, while the winnings of a bookmaker are taxable.[2] This principle has been codified in Canadian law by 40(2)(f) of the Income Tax Act ("the Act").[3]

While there is no debate as to whether paragraph 40(2)(f) of the Act applies to the casual gambler, there are occasions where the Minister of National Revenue ("the Minister") takes the position that gambling winnings of certain individuals should be taxable as income from a business. It is important to be aware of the factors and considerations leading to the Minister's and the Court's determinations of whether gambling winnings are taxable.

Legislation

"The Appellant's gambling activities were not a source of income since there was no reasonable expectation of profit and it was just a question of luck." – St.-Onge T.C.J. in Dubrovsky v. Canada (Minister of National Revenue), 88 D.T.C. 1711[4]

The basic statute governing the taxation of gambling winnings is 40(2)(f) of the Act. According to paragraph 40(2)(f), a taxpayer's gain or loss from the disposition of a chance to win a prize or bet, or a right to receive an amount as a prize or as winnings on a bet, in connection with a lottery scheme or a pool system of betting referred to in section 205 of the criminal code is nil.[5] In other words, gambling winnings are not taxable, and gambling losses are not deductible. Gambling winnings are considered "windfalls" and as such are exempt from income tax.

The Minister occasionally takes the position that the income of individuals that are (a) able to consistently profit from gambling and (b) spend a considerable amount of time in pursuit of gambling profits is not a "windfall", but is instead income from a business. Section 248 of the Act defines a "business" as including "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."[6]

If the actions of the gambler are classified as a business, then subsection 9(1) applies. Subsection 9(1) of the Act states that "…a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year."[7] In other words, if gambling winnings are considered income from a business, then they become taxable.

The Common Law

"There is no tax on a habit. I do not think "habitual" or even "systematic" fully describes what is essential in the phrase "trade, adventure, employment, or vocation." – Rowlatt J., Graham v. Green, [1925] 2 K.B. 37[8]

There are three categories of cases that deal with the taxation of gambling winnings. On one end of the spectrum are people that gamble either as a hobby or compulsively. The gambling revenue of these people is not taxable even though they may consistently win and have a "system" for betting.

The courts have held:

a. Winning enough money gambling to make a living does not, by-itself constitute taxable income.[9]
b. The degree of interest or zeal to which a person devotes to gambling does not change its nature.[10]
c. An organized system for minimization of risk is what distinguishes the intemperate gambler from the professional gambler, and the profits of an intemperate gambler are not taxable.[11]

At the opposite end of the spectrum are cases where people's gambling activities directly relate to their business. The gambling winnings of these individuals are taxable.

Examples in this category include:

a. The owner of a casino being assessed tax on his gambling winnings at his own casino.[12]
b. A horse handicapper who consistently wins money at the track also races and raises horses, bets on his own horses, bets on other horses, has no other

source of income and spends about thirty weeks per year at the track.[13]

In the preceding categories it is clear whether gambling winnings are taxable. The final category makes the determination more difficult by introducing a new variable: skill. The case establishing this principle is Luprypa v. The Queen.[14]

Mr. Luprypa lost his job and began playing pool for money. He practiced Monday to Friday, and would then go to a bar (sober) and play intoxicated opponents. He averaged about $1000/week in winnings over a 48-week period. McArthur, T.C.C.J. held that where a person uses expertise and skill to earn a livelihood in a gambling game in which skill is a significant component, their gambling winnings are taxable.[15]

Luprypa remains the only case in Canadian jurisprudence where gambling winnings were held to be taxable even though the winnings had no connection to a previously established business or occupation. The rule in Luprypa is limited to gambling games where skill is a significant component. How does one determine whether the skill required to excel at a gambling game is "significant" enough for the rule in Luprypa to apply?

Lelanc v. Canada: Two lucky brothers

"The appellants are not professional gamblers, who assess their risks, minimize them, and rely on inside information and skill…rather they are more accurately described as compulsive gamblers, continually trying their luck at a game of chance." – Bowman C.J.T.C., Leblanc v. Canada, [2006] T.C.J. No. 542.[16]

The most recent decision where the Minister attempted to tax gambling winnings is Leblanc v. Canada. The appellants in this case were Brian and Terry Leblanc; two brothers who were assessed income tax on their gambling winnings from government-run sports lotteries. The Leblanc brothers made an average of $650,000 per year, from 1996 to 1999 by winning at sports lotteries in Ontario and Quebec. On average, they bet $10 to $13 million dollars per year. Their only source of income was their gambling winnings, and they employed fifteen people to purchase and handle the tickets.[17]

Basically, the Leblanc brothers compared the provincial lottery odds to the odds in Las Vegas, and when enough of a discrepancy existed between the Las Vegas odds and the provincial lottery odds, a wager was placed. They developed a computer program to aid them with which bets to place and how much to wager.

The position of the Minister was that wagering on government-run sports lotteries was a business of Brian and Terry Leblanc because their activity was managed and organized with the object of realizing a profit.

Bowman C.J.T.C. reviewed the case law and considered three elements that must be present in order for gambling activities to be considered income from a business: risk assessment, risk minimization, and reliance on inside information, knowledge, and skill. Bowman C.J.T.C. found that the systems they developed were not due to any risk assessment or minimization strategy, but instead was due to the betting limits imposed by the provincial lottery authority.[19]

The holding that Brian and Terry Leblanc's gambling winnings did not constitute income from a business is illustrative the reluctance of the court to determine that gambling winnings are taxable. As Bowman C.J.T.C. notes, "the general perception that lottery winnings are not taxable is deeply embedded in the Canadian fiscal psyche."[20]

In Leblanc, Bowman C.J.T.C. equates sports lottery parlay games with other lottery games, such as Lotto 6-49. The method Brian and Terry Leblanc used to consistently profit from sports lottery parlay games would not apply to games of pure chance. It is not acknowledged in the judgment that Brian and Terry Leblanc were able to use a specialized skill: an expert understanding of odds and line movement.

The implications of the Leblanc decision are two-fold. First of all, it is difficult to conceive of a situation where money made from sports lottery parlay games will be taxable. Second, the notion of "skill" as articulated in Luprypa is intended to refer to either professional gamblers, or seasoned hustlers who prey on unsuspecting, inexperienced opponents.[21]

Conclusion

"Money won is twice as sweet as money earned." – "Fast" Eddie Felson in The Colour of Money

Rooted in the British common law, and codified by paragraph 40(2)(f) of the Income Tax Act, Canada has a longstanding tradition of not taxing gambling winnings. Where the Minister assesses tax on gambling winnings by classifying the winnings as income from a business, courts are reluctant to resolve the appeal in favour of the Minister. Unless the gambling winnings of the appellant are directly related to their vocation, or they are skilled pool or card players preying on unsuspecting marks, the money they win will be (almost) twice as sweet as the money they earn. CGL

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1 Balanko v. M.N.R., 81 D.T.C. 887 at para. 9
2 Graham v. Green, [1925] 2 K.B. 37
3 Income Tax Act, R.S.C. 1985, c. A-1, Sched. II
4 Dubrovsky v. Canada (Minister of National Revenue), 88 D.T.C. 1711 at pg. 1714
5 Supra. note 3. at para. 40(2)(f).
6 Ibid. at s. 248.
7 Supra. note 4 at ss. 9(1).
8 Graham v. Geren at pg. 42
9 See for ex, Graham v. Green, [1925] 2 K.B. 37 and Balanko v. M.N.R., 81 D.T.C. 887
10 M.N.R. v. Beaudin, 64 D.T.C. 5077
11 Supra. note 1
12 Burdge v. Pyne, [1969] 1 All ER 467 (Ch. Div.)
13 Badame v. M.N.R., 51 DTC 29.
14 Luprypa v. The Queen, 97 D.T.C. 1416.
15 Ibid.
16 Leblanc v. Canada, [2006] T.C.J. No. 542 at para. 48
17 Ibid.
18 Ibid. at para 47
19 Ibid.
20 Ibid at para. 38
21 Ibid.