

Mayo v. Commissioner, 136 T. C. 81 (2011)

In *Mayo v. Commissioner*, the U. S. Tax Court clarified that professional gamblers' wagering losses are subject to the limitation of IRC Section 165(d), which restricts deductions to the extent of gains from wagering. However, business expenses incurred in the gambling trade, excluding direct wagering costs, are deductible under Section 162(a). This ruling overturned the precedent set in *Offutt v. Commissioner*, impacting how professional gamblers report their income and expenses.

Parties

Ronald Andrew Mayo and Leslie Archer Mayo, petitioners, were the taxpayers in this case. They filed their case against the Commissioner of Internal Revenue, the respondent, challenging the disallowance of certain gambling-related deductions.

Facts

Ronald Andrew Mayo was engaged in the trade or business of gambling on horse races during the 2001 tax year. He reported \$120,463 in gross receipts from winning wagers and claimed \$131,760 as wagering expenses, along with \$10,968 in business expenses related to his gambling activity. The Mayos deducted the excess of these expenses over the gross receipts, totaling \$22,265, as a business loss against other income on their 2001 Federal income tax return. The IRS issued a notice of deficiency disallowing this loss, asserting that losses from wagering transactions should be limited to the extent of gains from such transactions under IRC Section 165(d).

Procedural History

The IRS initially determined a deficiency in the Mayos' 2001 Federal income tax and assessed an accuracy-related penalty. After acknowledging Mayo's status as a professional gambler, the IRS adjusted its position, allowing deductions only to the extent of reported gross receipts from gambling. The Mayos filed a petition with the U. S. Tax Court, challenging the IRS's disallowance of the excess of wagering and business expenses over gross receipts. The Tax Court reviewed the case, applying a *de novo* standard of review to the issues of law and fact.

Issue(s)

Whether a professional gambler's engagement in the trade or business of gambling entitles them to deduct losses from gambling without regard to the limitation of IRC Section 165(d)?

Whether business expenses, other than the costs of wagers, incurred in carrying on the gambling business are deductible under IRC Section 162(a) without regard to IRC Section 165(d)?

Whether the petitioners are liable for an accuracy-related penalty under IRC Sections 6662(a) and 6662(b)(2) for a substantial understatement of income tax?

Rule(s) of Law

IRC Section 162(a) allows a deduction for all ordinary and necessary expenses paid or incurred in carrying on any trade or business.

IRC Section 165(d) states that “Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions. “

The principle of statutory interpretation holds that a more specific statute (Section 165(d)) trumps a more general one (Section 162(a)).

Holding

The Tax Court held that IRC Section 165(d) applies to professional gamblers and limits their wagering losses to the extent of their gains from wagering transactions. The Court followed the precedent set in *Offutt v. Commissioner* for this issue.

The Court also held that business expenses incurred in the trade or business of gambling, other than the cost of wagers, are deductible under IRC Section 162(a) and are not subject to the limitation of IRC Section 165(d). The Court declined to follow *Offutt v. Commissioner* on this point.

The Court further held that the petitioners were not liable for an accuracy-related penalty under IRC Sections 6662(a) and 6662(b)(2).

Reasoning

The Court reasoned that the legislative history and judicial interpretations of Section 165(d) supported the limitation of wagering losses to gains from such transactions, even for professional gamblers. The Court rejected the argument that *Commissioner v. Groetzinger* altered this settled law, noting that *Groetzinger* addressed a different issue related to the minimum tax scheme.

Regarding business expenses, the Court reconsidered the interpretation of “Losses from wagering transactions” as applied in *Offutt*. It noted that the more specific statute (Section 165(d)) should not override the general allowance for business expenses under Section 162(a) for nonwagering expenses. The Court found support for this view in the narrow interpretation of “gains from wagering transactions” in other cases and the Supreme Court’s decision in *Commissioner v. Sullivan*, which did not apply Section 165(d) to similar business expenses.

The Court also considered the inconsistency in the IRS’s application of *Offutt* and the potential for further administrative inconsistency if the precedent were not overturned.

The Court determined that the accuracy-related penalty did not apply because the resulting understatement of income tax, after allowing the business expenses, would not be substantial under IRC Section 6662(d).

Disposition

The Tax Court sustained the IRS's disallowance of the excess wagering expenses over gross receipts but allowed the deduction of business expenses related to the gambling trade. The Court ruled that the petitioners were not liable for the accuracy-related penalty. The case was decided under Rule 155 of the Federal Tax Court Rules of Practice and Procedure.

Significance/Impact

This case clarified the application of IRC Section 165(d) to professional gamblers, limiting their wagering losses to gains from wagering but allowing deductions for nonwagering business expenses under IRC Section 162(a). The decision overturned the precedent set in *Offutt* regarding the treatment of business expenses, providing a more favorable tax treatment for professional gamblers. The ruling has implications for how professional gamblers report their income and expenses and may influence future IRS guidance and enforcement in this area.