Lottery Winnings

Profession > **Tax Forum**

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Typically not taxable, lottery winnings may occasionally be considered business income.

FROM: MAY-JUN 2007 ISSUE | BY DON GOODISON

Canadians pay more tax than our American neighbours, but we are able to smugly point out that winnings from lotteries, gambling, horse racing, and other games of chance are not taxed in the True North.

However, in some cases, the Canada Revenue Agency (CRA) considers lottery winnings income from a business. In *Brian Leblanc and Terry Leblanc v. Her Majesty, the Queen [2006TCC680]*, the Tax Court of Canada was called upon to rule that the appellants were operating a business that earned its income from sports lottery winnings.

The appellants are brothers who began playing sports lottery games prior to 1992. In 1996, they spent all their time playing Pro-Line, Point Spread, and Over/Under, which involve placing bets on sporting events. They moved their residence to Aylmer, Quebec, in order to be able to play both Ontario and Quebec lotteries. They bet between $200,000 and $300,000 per week and estimated that they might have bet between $10 and $13 million per year.

They would call their orders in to various retail outlets because of limits on the number of tickets a retailer can sell to any individual. They employed people to pick up their tickets and deliver them to their home.

Notwithstanding that they estimated losses on 95 per cent of the bets placed, they did win substantial amounts from 1996 to 1999, at which point the CRA decided they should be taxed on their winnings. Each of the appellants received assessments on $875,874 for 1996, $755,271 for 1997, $418,178 for 1998, and $715,221 for 1999. They appealed to the Tax Court of Canada, arguing lottery winnings are always tax exempt and can never be considered income from business. Lottery winnings are considered capital gains, and are not taxable by virtue of paragraph 40(2)(f) of the *Income Tax Act*.

Counsel for the respondent submitted that their activities constituted a business because it was managed and organized with the object of realizing a profit and, as such, was subject to tax under subsection 9(1) of the *Act*. Counsel listed facts he felt proved the Leblancs were engaged in a business:

1. They did not have jobs but lived on the proceeds of their sports lottery play;
2. They played in a number of jurisdictions and moved near the Quebec-Ontario border to facilitate this multi-jurisdictional gambling;
3. They only chose long shots with high payout potential;
4. They used a computer to come up with combinations of long shots;
5. They structured their bets to maximize retail outlet payouts;
6. They bought a significant number of tickets on a regular basis;
7. They bought tickets at various retail outlets;
8. They requested volume discounts from retailers and only dealt with those who agreed;

9. They used up to 15 paid helpers to handle the purchasing and checking of the tickets;
10. The more they won, the more they bet.

The respondent suggested that the LeBlancs' success must have been due to a system that minimized their risk.

The trial judge decided that the system argument was a non sequitur, stating:

> *If I understand it correctly it is this: since you won it proves you must have 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.*

The court also looked at the odds of winning and losing, in particular evidence presented by Professor Gary Smith, whose report made four major points:

1. Odds against the Leblanc brothers winning at the sports lotteries were astronomical.
2. There is no way one can beat the odds.
3. The payouts are reflective of the true odds.
4. Skill plays no part in winning.

In allowing the appeal, the court found that the Leblancs' gambling activities were of a personal nature and not business income. The winnings were capital gains and were not taxable by virtue of paragraph 40(2)(f) of the *Income Tax Act*.

The court cited nine cases in which the Minister has attempted to tax gambling winnings when they are an "adjunct or incident of a business carried on, for example, by a casino owner who gambles in his own casino or an owner of horses who trains and races horses and who bets on the races." Winnings have also been taxable when the gambler uses expertise and skill, such as a pool shark.

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