FEDERAL INCOME TAXATION—TRADE OR BUSINESS—A FULL-TIME GAMBLER WHO GAMBLES SOLELY FOR HIS OWN BENEFIT IS ENGAGED IN A TRADE OR BUSINESS—*Commissioner v. Groetzinger*, 107 S. Ct. 980 (1987).

The application of many of the provisions of the federal income tax law has been based on whether the taxpayer's activities fall within the definition of a trade or business.[1] The statutes, however, fail to define the term "trade or business."[2] Consequently, that term had to be defined through the judicial process.[3] Historically, the courts have construed the term "business" in a very broad sense to encompass all activities en-

[1] Under the Corporation Tax imposed by the Tariff Act of 1909, a taxpayer corporation would not be subject to the corporate tax unless it was "carrying on or doing business." Tariff Act of 1909, ch. 6., § 38, 36 Stat. 11, 112-17 (1909) (current version at I.R.C. § 11 (1982 & Supp. IV 1986). Since 1909, there has been a dramatic increase in the statutory use of the term trade or business. *See* Boyle, *What is a Trade or Business?*, 39 TAX LAW 737, 737 (1986). According to one commentator, a 1986 LEXIS search of the Internal Revenue Code (Code) for the term "trade or business" revealed that the term appears in over 25 subsections and in over 32 regulations. *Id.* at 737, 737 n.3.

The significance of whether a taxpayer's activities falls within the definition of a trade or business may be shown by describing some of the various statutory contexts in which it is used. Under Code section 166 the taxpayer is required to show that he is engaged in a trade or business before he may avail himself of the more favorable tax treatment afforded to business bad debts. I.R.C. § 166(d)(2) (1982). Generally, the deduction for net operating losses is limited to trade or business expenses. *See id.* § 172(d)(4) (1982 & Supp. IV 1986). The deduction for moving expenses is permitted only if the move relates to a change in the location of the taxpayer's trade or business. *See id.* § 217 (1982). A passive activity is defined under Code section 469 as any activity "which involves the conduct of any trade or business, and in which the taxpayer does not materially participate." I.R.C. § 469(c) (Supp. IV 1986). Section 469 limits the extent to which losses may be deducted if the losses are generated by an individual or certain entities while engaged in a passive activity. *See id.* Under Code section 513, a tax is imposed on charities if they earn income from an unrelated trade or business. *See id.* § 513(a) (1982). Code section 1231 provides for favorable tax treatment for the gain or loss on the disposition of assets used in a trade or business. *See* I.R.C. § 1231 (Supp. IV 1986). The self-employment tax is imposed on an individual's income earned in a trade or business. *See id.* § 1402(a) (Supp. IV 1986).

[2] The term "trade or business" has been specifically defined for certain limited purposes. *See, e.g.*, I.R.C. § 355(b)(2) (1982), *as amended by* Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10233, 101 Stat. 1330-411 (defines "trade or business" in the context of stock distributions of a controlled corporation); I.R.C. § 502(b) (1982) (defines "trade or business" in the context of "feeder organizations"); I.R.C. § 513 (1982) (current version at 1 I.R.C. § 513(d), (h) (Supp. IV 1986)) (defines "trade or business" in the context of tax-exempt organizations); I.R.C. § 7701(a)(26) (1982) (defines "trade or business" to include the position of public officer).

[3] *See infra* note 8 and accompanying text.

tered into for the purpose of earning a livelihood.[4] As the term evolved, it became apparent that this definition was too expansive and that the term "trade or business" should be more narrowly interpreted to exclude certain activities.[5] In an effort to narrow this definition, two divergent standards have emerged. One standard required a case-by-case analysis of all the facts and circumstances surrounding the application of the term.[6] The other standard, the minority view, required that a taxpayer hold himself out as offering goods and services before he could be considered as engaging in a "trade or business."[7]

Each standard has gained a degree of acceptance in the lower courts, resulting in inconsistencies regarding the appropriate standard that should be applied.[8] Recently, a split of authority has developed among the various circuit courts of appeals as to which standard should be applied to a full-time gambler.[9] In

---

[4] In 1910, the United States Supreme Court defined the term "business," adopting BOUVIER'S LAW DICTIONARY definition as "[t]hat which occupies the time, attention and labor of men for the purpose of a livelihood or profit." Flint v. Stone Tracy Co., 220 U.S. 107, 171 (1911) (citation omitted). This language continues to be quoted by the courts when determining the trade or business status of the taxpayer. 1 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 20.1.2 (1981). In Commissioner v. Groetzinger, 107 S. Ct. 980, 988 (1987), the Supreme Court held that the trade or business status of a full-time gambler is established if the taxpayer can show that the activity is "pursued full time, in good faith, and with regularity, to the production of income for a livelihood."

[5] In 1941, the Supreme Court concluded that the ordinary dictionary definition of "business" was too broad and held that the activities of overseeing one's personal investments, even if performed full time, could never constitute a trade or business. *See* Higgins v. Commissioner, 312 U.S. 212, 218 (1941). *See also infra* notes 75-83 and accompanying text (discussing *Higgins*).

[6] This standard was first established in 1941 by the Supreme Court in *Higgins*, where the Court held that the determination that a taxpayer's activities constitute a trade or business requires a review of all the facts and circumstances in each case. *Higgins*, 312 U.S. at 217. *See also infra* notes 73-81 and accompanying text (discussing *Higgins*).

[7] This standard for defining a trade or business was first expressed in a sole concurring opinion written in 1940 by Justice Frankfurter in Deputy v. du Pont, 308 U.S. 488 (1940). Justice Frankfurter concluded that " 'carrying on any trade or business,' . . . involves holding one's self out to others as engaged in the selling of goods or services." *Id.* at 499 (Frankfurter, J., concurring). *See also infra* notes 59-72 and accompanying text (discussing *du Pont*).

[8] *See, e.g.*, Groetzinger v. Commissioner, 771 F.2d 269, 277 (7th Cir. 1985) (applying facts and circumstances test), *aff'd*, 107 S. Ct. 980 (1987); Estate of Cull v. Commissioner, 746 F.2d 1148, 1151-52 (6th Cir. 1984) (applying test that one must hold himself out as offering goods or services); Gajewski v. Commissioner, 723 F.2d 1062, 1066 (2d Cir. 1983) (applying test that one must hold himself out as offering goods or services); Ditunno v. Commissioner, 80 T.C. 362, 367 (1983) (applying facts and circumstances test); Gentile v. Commissioner, 65 T.C. 1, 5 (1975) (applying test that one must hold himself out as offering goods or services).

[9] The conflict involved whether a full-time gambler is engaged in a trade or

Commissioner v. Groetzinger,[10] the United States Supreme Court resolved this conflict by applying the "facts and circumstances" test to a taxpayer engaged in full-time gambling activities.[11]

In February 1978, Robert P. Groetzinger was terminated from his employment with an Illinois manufacturer.[12] During the remaining portion of 1978, Groetzinger spent from sixty to eighty hours per week gambling on parimutuel dog races.[13] Throughout this period of time, Groetzinger did not engage in any other profession or employment other than gambling.[14] He also did not place bets for others, sell tips, or receive commissions for placing bets.[15] He bet solely on his own behalf.[16]

During 1978, Groetzinger realized gross gambling winnings of $70,000 on total wagers of $72,032, resulting in a net gambling loss of $2,032.[17] In addition to his gambling winnings, Groetzinger received $6,498 in income from interest, dividends, sales of stocks, and salary earned before he lost his job.[18] In completing his 1978 federal tax return, Groetzinger reported as income only $6,498 received from the non-gambling sources.[19] He did not report his gross income from the gambling win-

---

business. Some of the circuit courts have applied Justice Frankfurter's "goods or services" test to hold that the full-time gambler is not engaged in a trade or business. *See* Estate of Cull v. Commissioner, 746 F.2d 1148, 1152 (6th Cir. 1984); Noto v. United States, 598 F. Supp. 440, 444 (D.N.J. 1984), *aff'd*, 770 F.2d 1073 (3d Cir. 1985). Other circuit courts have applied the *Higgins* "facts and circumstances" test and have reached the opposite conclusion. *Compare* Groetzinger v. Commissioner, 771 F.2d 269, 277 (7th Cir. 1985); Nipper v. Commissioner, 47 T.C.M. (CCH) 136, 137 (1983), *aff'd*, 746 F.2d 813 (11th Cir. 1984). Even the Tax Court has vacillated over the appropriate standard to apply to determine the trade or business status of the full-time gambler. *Compare* Groetzinger v. Commissioner, 82 T.C. 793, 796-97 *with* Ditunno v. Commissioner, 80 T.C. 362, 370-72 (1983) *and* Gentile v. Commissioner, 65 T.C. 1, 6 (1975).

[10] 107 S. Ct. 980 (1987).

[11] *Id.* at 988.

[12] *Id.* at 982. Prior to his termination, Groetzinger had been employed in marketing and sales for a period of 20 years. *Id.*

[13] *Id.* In 1978, Groetzinger "went to the track 6 days a week for 48 weeks" and spent a large portion of his time engaging in gambling-related activities. *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.* Groetzinger maintained a daily record of his winnings and losses from his wagering. *Id.*

[18] Groetzinger v. Commissioner, 82 T.C. 793, 794 n.4 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985), *aff'd*, 107 S. Ct. 980 (1987). The $6,498 income was comprised of "interest of $1,330, dividends of $1,337, taxable gain on the sale of stock . . . of $1,507, wages (earned prior to the termination of his job) of $1,323, and 'commissions' . . . of $1,000." 82 T.C. at 794 n.4.

[19] *Groetzinger*, 107 S. Ct. at 982.

nings.[20] Further, he did not deduct his gambling losses either as trade or business deductions,[21] or as itemized deductions[22] in

---

[20] *Id.*

[21] *See id.* Trade losses or business deductions may be deducted from a taxpayer's gross income to arrive at adjusted gross income. I.R.C. § 62(1) (1976 & Supp. III 1978) (current version at I.R.C. § 62(1) (1982)). According to Code § 62(1) an individual's adjusted gross income is calculated by reducing gross income by:

"[t]rade and business deductions . . . which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of services by the taxpayer as an employee." *Id.*

Adjusted gross income has been described as "an intermediate figure somewhere between gross income and taxable income which may be defined generally as gross income minus business deductions." Gardiner v. United States, 391 F. Supp. 1202, 1207 (D. Utah 1975).

[22] Itemized deductions can be described as certain personal expenditures permitted under the Internal Revenue Code as deductions from adjusted gross income to arrive at taxable income. BLACK'S LAW DICTIONARY 747 (5th ed. 1979). Expenditures include medical expenses, state sales taxes, home mortgage interest, and charitable gifts, among others. *Id.* Under the statutory provisions in effect from 1977 through 1986, an individual taxpayer could elect to deduct itemized deductions but only to the extent they exceeded a statutory minimum defined as the "zero bracket amount." *See* I.R.C. § 63(b)-(d) (1976 Supp. I 1977) (current version at I.R.C. § 63(b)-(d) (Supp. IV 1986)) (concept of zero bracket amount replaced by standard deduction). The zero bracket amount was incorporated into the tax computation as a nontaxable portion of income and functioned as a standard deduction for those taxpayers who did not itemize their deductions. W. ANDREWS, BASIC FEDERAL INCOME TAXATION 324 (2d ed. 1979). Until 1977, this provision was known as the standard deduction which was defined as the statutory amount taxpayers could elect to deduct in lieu of itemizing their personal deductions without being required to keep records. *Id.* The standard deduction was originally established to reduce the administrative burden of the Internal Revenue Service. B. BITTKER, FUNDAMENTALS OF FEDERAL INCOME TAXATION ¶ 14.4, at 14-17 (1983). The zero bracket amount was subsequently created to simplify the tax computation. S. REP. No. 66, 95th Cong., 1st Sess. 51-53, *reprinted in* 1977 U.S. CODE CONG. & ADMIN. NEWS 185, 229-33. Interestingly, under the Tax Reform Act of 1986, Congress has returned to the standard deduction believing that taxpayers were finding it difficult to understand the concept of the zero bracket amount. S. REP. No. 313, 99th Cong. 2d Sess. 36 (1986).

Code section 63 defines taxable income, itemized deductions and the zero bracket amount. I.R.C. § 63 (Supp. I 1977) (current version at I.R.C. § 63 (Supp. IV 1986)). The relevant provisions are as follows:

§ 63. Taxable income defined

(b) Individuals

For purposes of this subtitle, in the case of an individual, the term "taxable income" means adjusted gross income —

(1) reduced by the sum of —

(A) the excess itemized deductions. . . .

. . . .

(c) Excess itemized deductions

For purposes of this subtitle, the term "excess itemized deductions" means the excess, (if any) of —

(1) the itemized deductions, over

(2) the zero bracket amount

calculating his adjusted gross income.[23]

Upon auditing Groetzinger's 1978 return, the Commissioner of Internal Revenue (Commissioner) found that the entire amount of Groetzinger's gambling winnings were includible in his gross earnings.[24] Moreover, the Commissioner concluded that Groetzinger's gambling losses were deductible as itemized deductions, but only to the extent of his gambling winnings.[25] Thus, only $70,000 of Groetzinger's gambling losses constituted itemized deductions.[26] Under the Internal Revenue Code (Code)

(d) Zero bracket amount

For purposes of this subtitle, the term "zero bracket amount" means —

(1) $3,200 in the case of —

(A) a joint return under section 6013, or

(B) a surviving spouse (as defined in section 2(a))

(2) $2,200 in the case of an individual who is not married and who is not a surviving spouse (as so defined)

(3) $1,600 in the case of a married individual filing a separate return, or

(4) zero in any other case.

. . . .

(f) Itemized deductions

For purposes of this subtitle, the term "itemized deductions" means the deductions allowable by this chapter other than—

(1) the deductions allowable in arriving at adjusted gross income. . . .

Id.

[23] *Groetzinger*, 107 S. Ct. at 982. Groetzinger did not deduct the net gambling loss of $2,032 in arriving at adjusted gross income but he did report the loss on Schedule E or "Supplemental Income Schedule." *Id.* at 982 n.3.

[24] *Id.* at 982.

[25] *Id.* Code section 165 governs the deductibility of wagering losses and specifically allows a deduction for such losses, but only to the extent of winnings. *See* I.R.C. § 165 (1976) (current version at I.R.C. § 165 (1982)). Section 165 states in pertinent part:

(a) General Rule

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise.

. . . .

(c) Limitation on losses of individuals

In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business. . . .

. . . .

(d) Wagering losses

Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

Id.

[26] *Groetzinger*, 107 S. Ct. at 982.

as it existed in 1978, the Commissioner found that Groetzinger's gambling losses constituted itemized deductions and therefore a portion of the $70,000 losses should have been included as an "item of tax preference"[27] subject to the minimum tax.[28] Consequently, the Commissioner issued a notice of deficiency to

---

[27] *Id.* Under the Commissioner's determination, Groetzinger's gambling losses constituted itemized deductions subject to the minimum tax provision. *See* I.R.C. §§ 56(a), 57(a)(1), 57(b)(1) (1976 & Supp. I 1977) (current version at I.R.C. §§ 55, 56, 57 (Supp. IV 1986)). For tax years beginning after 1982, deductions for gambling losses are specifically excluded from the minimum tax provision. *See* I.R.C. §§ 55(b), 55(e)(1)(A) (1982) (current version at I.R.C. §§ 55, 56, 57 (Supp. IV 1986)); I.R.C. § 165 (d) (1982). Under the statutory scheme in effect in 1978, deductions allowable in arriving at adjusted gross income, which primarily include trade or business deductions, were excluded as items of tax preference and, therefore, not subject to the minimum tax provision. *See* I.R.C. § 57(b)(1)(A) (1976 & Supp. I 1977) (current version at I.R.C. § 57 (Supp. IV 1986)). *See also infra* note 28 and accompanying text for discussion of the minimum tax provision.

[28] *Groetzinger*, 107 S. Ct. at 982. In 1969, Congress enacted the minimum tax provisions in response to a growing concern that many high income taxpayers, by virtue of various tax relief provisions, were able to substantially avoid taxation. *See* S. REP. No. 552, 91st Cong. 1st Sess., *reprinted in* 1969 U.S. CODE CONG. & ADMIN. NEWS 2027, 2142. To remedy this apparent abuse, Congress developed a statutory scheme whereby certain items of income and specified deductions would be defined as items of tax preference subject to a minimum tax. *See id.* at 2143-49. Upon computing the minimum tax liability, the taxpayer is required to pay the minimum tax liability plus his regular tax liability. *See id.* at 2144.

The characterization of Groetzinger's gambling losses as itemized deductions caused those losses to fall under the item of tax preference defined as adjusted itemized deductions. *See* I.R.C. § 57(b)(1) (Supp. I 1977) (current version at I.R.C. § 57 (Supp. IV 1986)). Adjusted itemized deductions is defined as an amount by which the sum of all deductions for the taxable year, other than certain specified deductions, which include trade or business deductions, exceed a certain percentage of the taxpayer's adjusted gross income. *See id.* It is this amount that is subject to the minimum tax provision. *See* I.R.C. § 56(a) (1976) (current version at I.R.C. § 55 (Supp. IV 1986)).

Sections 56 and 57 of the code provide the statutory scheme for the imposition of the minimum tax provision for 1978. I.R.C. §§ 56, 57 (1976 & Supp. I 1977) (current version at I.R.C. §§ 56, 57 (Supp. IV 1986)). The relevant provisions of section 56 read:

> § 56. Imposition of Tax.
> (a) General Rule
> In addition to the other taxes imposed by this chapter, there is hereby imposed for each taxable year, with respect to the income of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—
> (1) $10,000 or
> (2) the regular tax deduction for the taxable year (as determined under subsection (c)).

I.R.C. § 56 (1976 & Supp. I 1977) (current version at I.R.C. § 56 (Supp. IV 1986)). Section 57 provides in pertinent part:

> § 57. Items of tax preference
> (a) In General
> For purposes of this part, the items of tax preference are—

Groetzinger in the amount of $2,142, for failure to pay the minimum tax.[29]

Groetzinger subsequently filed a petition for redetermination of the deficiency with the United States Tax Court.[30] The tax court held that Groetzinger's gambling activities were sufficiently frequent and "substantial to constitute a trade or business," and as a result, his gambling losses should not have been subject to the minimum tax provision.[31] In so holding, the tax court rejected the "goods or services" test applied by United States Court of Appeals for the Second Circuit in *Gajewski v. Commissioner*,[32] and instead followed its prior decision in *Ditunno v. Commissioner*.[33] In *Ditunno*, the tax court held that the determination of whether a taxpayer's activities constitute a trade or business requires an examination of all the facts and circumstances in each case.[34] The tax court found the facts in *Groetzinger* to be virtually indistinguishable from the facts in *Ditunno*, and thus concluded that Groetzinger was, in fact, engaged in the trade or business of gambling.[35]

---

(1) Adjusted itemized deductions

An amount equal to the adjusted itemized deductions for the taxable year (as determined under subsection (b)).

. . . .

(b) Adjusted itemized deductions

(1) In General

For purposes of paragraph (1) of subsection (a), the amount of the adjusted itemized deductions for any taxable year is the amount by which the sum of the deductions for the taxable year other than—

(A) deductions allowable in arriving at adjusted gross income. . . .

exceeds 60 percent (but does not exceed 100 percent) of the taxpayer's adjusted gross income for the taxable year.

I.R.C. § 57 (1976 & Supp. I 1977) (current version at I.R.C. § 56 (Supp. IV 1986)).

29 *See Groetzinger*, 107 S. Ct. at 982.

30 *Id.* at 982.

31 *See* Groetzinger v. Commissioner, 82 T.C. 793, 803 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985), *aff'd*, 107 S. Ct. 980 (1987).

32 723 F.2d 1062 (2d Cir. 1983). In *Gajewski*, the court held that in order for a taxpayer to be considered as carrying on a trade or business he must, at a minimum, hold himself out publicly as offering goods or services. *Id.* at 1067. The Second Circuit held that the activities of a full-time gambler do not constitute a trade or business because he gambles solely for his own benefit and as such does not offer goods or services for sale to others. *Id. See also Groetzinger*, 82 T.C. at 796-803 (rejecting the ruling of *Gajewski*).

33 80 T.C. 362 (1983). *See also Groetzinger*, 82 T.C. at 803 (adopting test articulated in *Ditunno*).

34 *Ditunno*, 80 T.C. at 370-72. The *Ditunno* court held that the taxpayer's gambling activities constituted a trade or business. *Id.* at 372.

35 *Groetzinger*, 82 T.C. at 796.

This decision of the tax court was affirmed by the United States Court of Appeals for the Seventh Circuit.[36] The Seventh Circuit held that Groetzinger was not precluded from characterizing his gambling activities as a trade or business merely because he failed to offer goods or services for sale to others.[37] After reviewing all the facts and circumstances, the court of appeals concluded that Groetzinger was engaged in the trade or business of gambling.[38] The United States Supreme Court granted certiorari,[39] and held that a full-time gambler who bets solely for his own benefit is engaged in a trade or business as contemplated under sections 162(a)[40] and 62(1)[41] of the Code.[42]

Neither Congress nor the United States Treasury Department has provided a concrete definition for the term trade or business.[43] Thus, the courts have been left with the difficult task of defining the term within a variety of statutory contexts.[44]

---

[36] Groetzinger v. Commissioner, 771 F.2d 269, 277 (7th Cir. 1985), *aff'd*, 107 S. Ct. 980 (1987).

[37] *See id.* at 276-77.

[38] *See id.* at 274. The Seventh Circuit emphasized that Groetzinger spent virtually all his time on gambling related activities with the intention of earning a living from those endeavors. *See id.*

[39] 106 S. Ct. 1456 (1986). The Supreme Court granted certiorari due to a conflict among the Circuit Courts of Appeals regarding the issue of whether gambling is a trade or business. *Groetzinger*, 107 S. Ct. at 983 & n.5.

[40] I.R.C. § 162(a) (1976) (current version at I.R.C. § 162(a) (1982)). Section 162(a) of the Code states that a deduction shall be allowed for all "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." *Id.*

[41] *See supra* note 21 and accompanying text (discussing I.R.C. § 62(1)).

[42] *See Groetzinger*, 107 S. Ct. at 981, 988. The specific issue raised by the facts in *Groetzinger* is whether full-time gambling activities constitute a trade or business under Code section 62(1). Groetzinger v. Commissioner, 82 T.C. 793, 795 (1984), *aff'd*, 771 F.2d 269 (7th Cir. 1985), *aff'd*, 107 S. Ct. 980 (1987). On appeal, however, the Seventh Circuit noted that "the Commissioner concede[d] that the meaning of the term 'trade or business' is the same under [sections] 62(1) and 162(a)," because both Code sections involve the issue of deductibility of expenses related to a trade or business carried on by the taxpayer. *Groetzinger*, 771 F.2d at 271 (footnote omitted). The Supreme Court, therefore, confined its holding to these particular Code sections. *Groetzinger*, 107 S. Ct. at 981. The Seventh Circuit pointed out that "the precise meaning or connotation of the term [trade or business] appears to vary depending upon the [Code] provision in which it is used." *Groetzinger*, 771 F.2d at 271 (citing Steffens v. Commissioner, 707 F.2d 478, 482 (11th Cir. 1983)); 4A J. MERTENS, MERTENS LAW OF FEDERAL INCOME TAXATION § 25.08 (1979)).

[43] There are, however, several Code sections where the term "trade or business" is specifically defined for limited purposes. *See supra* note 2.

[44] The trade or business issue arises most often in determining whether trade or business expenses are deductible under Code section 162. Boyle, *supra* note 1, at 738. Code section 162 provides that three requirements must be met before an expense may be deducted. First, the expense must be ordinary and necessary; second, the expense must be paid or incurred during the taxable year; and third, the

However, the courts have been unable to provide an authoritative definition that may be applied broadly in all contexts.[45]

In an early case, *Flint v. Stone Tracy Co.*,[46] the Supreme Court made its first significant attempt at defining the term trade or business.[47] In *Flint*, the Supreme Court decided several issues pertaining to the Corporation Tax Law of 1909.[48] One such issue was whether the particular companies involved in the case were engaged in business and, thereby, subject to the corporate tax provisions.[49] In defining the term "business" the Court referred to the ordinary dictionary definition of the term and stated that " '[b]usiness' is a very comprehensive term and embraces everything about which a person can be employed. [It is] [t]hat which occupies the time, attention and labor of men for the purpose of a livelihood or profit."[50] Based upon this definition, the Court held that the managing of property constituted carrying on a business, and as such, the taxpayer was subject to the corporation tax.[51]

In 1935, the Supreme Court addressed the trade or business question in the context of a securities trader in *Snyder v. Commissioner*.[52] *Snyder* involved an individual who regularly traded on

---

expense must be incurred while carrying on a trade or business. *See* I.R.C. § 162(a) (1982). A deduction is not permitted unless all three requirements are met. Boyle, *supra* note 1, at 738 n.8. The "paid or incurred" requirement determines when the expense may be deducted. *Id.* The "ordinary and necessary" requirement permits a deduction for an expense only if it is both "ordinary," in the sense that the expense is typical or common for the business environment within which it is incurred, and "necessary," in the sense that the expense is required to further some appropriate business purpose. *See* Welch v. Helvering, 290 U.S. 111, 113-15 (1933). Only when it is determined that the "paid or incurred" and the "ordinary and necessary" requirements have been met is the trade or business issue addressed. Boyle, *supra* note 1, at 738 n.8. When deciding this question, all of the taxpayer's related activities are considered together to determine if a trade or business exists. *Id.*

45 *See* Groetzinger v. Commissioner, 771 F.2d, at 271 (citing 1 B. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 20.1.2 (1981)).

46 220 U.S. 107 (1911).

47 *See id.* at 171. *Flint* was decided prior to the enactment of all current income tax laws and upheld the constitutionality of the Corporation Tax of 1909 which imposed an "excise tax on doing business in corporate form." Boyle, *supra* note 1, at 740 n.27.

48 *See Flint*, 220 U.S. at 112-13; *see also supra* note 1 (discussing Corporation Tax Law of 1909, ch.6, § 38, 36 Stat. 11, 112-17 (1909)).

49 *See Flint*, 220 U.S. at 171.

50 The Supreme Court in *Flint* used the definition of the term "business" as contained in both Black's Law Dictionary and Bouvier's Law Dictionary. *See id.* (citation omitted).

51 *Id.*

52 295 U.S. 134 (1935).

margin in the stock of one particular company for the purpose of increasing his holding in that company.[53] The Commissioner issued a deficiency assessment against the taxpayer for failure to pay the tax due on the capital gains from the margin trading.[54] In upholding the deficiency assessment, Justice Brandeis, writing for the court, held that an investor who merely seeks to increase his holdings in a particular stock is not engaged in a trade or business.[55] Justice Brandeis observed that the board of tax appeals previously had held that a taxpayer who spends a substantial portion of his time as a trader on the stock exchanges may treat losses incurred as those sustained in the course of that taxpayer's trade or business.[56] He further noted, however, that the taxpayer in *Snyder* did not show sufficient facts to establish that his activities should be "characterized as a 'trader on an exchange who makes a living in buying and selling securities.' "[57] Therefore, in refusing to classify the taxpayer's activities as a trade or business, the *Snyder* Court had distinguished between an active trader in securities and an ordinary investor.[58]

In 1940, the Supreme Court again addressed the trade or business issue in *Deputy v. du Pont*.[59] In *du Pont*, the taxpayer, a member of the du Pont family, owned a sixteen-percent interest in the stock of E.I. du Pont de Nemours and Company.[60] The du

---

53 *See id.* at 135-36.

54 *Id.* at 136. Due to the method used to account for his stock sales the taxpayer did not report profits on any of his stock transactions during the year. *See id.* at 136-37. The taxpayer would match the sales price of the stock sold with the price of his last acquired stock which, due to the appreciated value of the stock, would produce minimal or no gain. *See id.* The Commissioner concluded, however, that the taxpayer should have matched the sales price of the stock sold to purchases made in earlier years consistent with the so-called "first-in-first-out" regulations in existence at that time. *See id.* at 136. This produced a large amount of unreported gains resulting in the Commissioner's deficiency assessment. *See id.*

55 *Id.* at 138-39. The taxpayer in *Snyder* argued that the first-in-first-out regulation, for determining gains or losses on sales of securities, should not be applied "to sales made in the course of a 'business of trading on the stock exchange.' " *Id.* at 137-38.

56 *Id.* at 139.

57 *Id.* (citing Bedell v. Commissioner, 30 F.2d 622, 624 (2d Cir. 1929); Mente v. Eisner, 266 F. 161 (2d Cir. 1920)).

58 *See id.* 137-39. Subsequent cases have distinguished an active trader in securities from the full-time investor, holding that the active trader is engaged in a trade or business. *See, e.g.*, Moller v. United States, 721 F.2d 810 (D.C. Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984); Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976); Fuld v. Commissioner, 139 F.2d 465 (2d Cir. 1943); Levin v. United States, 597 F.2d 760 (Ct. Cl. 1979).

59 308 U.S. 488 (1940).

60 *Id.* at 490.

Pont Company decided that for business reasons their new key executives should own an equity interest in the company.[61] Due to legal and economic restrictions, however, the company was unable to make a direct sale of its stock to these executives.[62] As a result, the taxpayer chose to sell the stock to the key executives himself, but because he did not own the required number of shares, he borrowed the shares from other shareholders.[63] As part of the agreement with the other shareholders, the taxpayer agreed to pay the lenders cash in the amount of the dividends paid on the shares for the period of time the shares were on loan.[64] During the tax year in question, the taxpayer expended almost $648,000[65] to carry out this plan and deducted this amount as an "ordinary and necessary" business expense.[66]

The Court initially assumed for the sake of argument that the taxpayer's activities of "conserving and enhancing his estate" constituted a trade or business.[67] The majority, however, disallowed the deduction because the payments were not "ordinary

---

61 *Id.* For business reasons the du Pont Company wanted to give 9000 shares of its common stock to nine men comprising the newly formed executive committee. *Id.*

62 *Id.* The du Pont Company did not hold a sufficient amount of shares in its treasury to complete the transaction and was unable to issue new shares without implicating the preemptive rights of existing shareholders. *Id.* at 490 n.1. In addition, the required number of shares could not be purchased on the market without causing a substantial rise in the price per share. *Id.*

63 *Id.* at 490-91. The taxpayer directly owned 74 shares, which was insufficient to cover the required sale of 9000 shares. *Id.* at 491 n.2. In addition, the taxpayer owned a "reversionary interest in two trusts which held 24,000 shares" of du Pont stock and 38% interest in the stock of a company which held 183,000 du Pont shares. *Id.* Since the taxpayer only had access to 74 shares, he borrowed the 9000 shares from other shareholders and then proceeded to sell 1000 shares to each of the nine key executives. *Id.* at 491.

64 *See id.* at 492.

65 *Id.* This amount included $567,648 which represented dividends received by the taxpayer during the loan period and $80,064 in federal income tax imposed on the lender as a result of the dividend payment received by them. *Id.* In accordance with the loan agreement, the taxpayer was required to pay the sum of these two amounts to the lender. *Id.*

66 *Id.* at 489. The taxpayer sought to claim the deduction under section 23(a) of the Revenue Act of 1928, the predecessor of the current Code section 162(a). *Id.* at 489-90. *See generally* Revenue Act of 1928, ch. 852, § 23(a), 45 Stat. 791, 799 (current version at I.R.C. § 162(a) (1982)). Section 23(a) provided that a reduction shall be allowed in computing net income for "[a]ll ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." *Id.* The taxpayer contended that the payments made to complete the stock sales were ordinary and necessary expenses incurred in connection with the business of "conserving and enhancing his estate." *See du Pont*, 308 U.S. at 489-90.

67 *du Pont*, 308 U.S. at 493.

and necessary."[68] In a concurring opinion, Justice Frankfurter disagreed with the majority's rationale.[69] The Justice posited that the taxpayer's deduction should have been disallowed because he was not engaged in a trade or business.[70] Justice Frankfurter stated that the carrying on of a trade or business "involves holding one's self out to others as engaged in the selling of goods or services."[71] According to Justice Frankfurter, the taxpayer did not hold himself out as such in this case.[72]

A year later, in 1941, the Supreme Court was squarely faced with the trade or business question in *Higgins v. Commissioner*.[73] In *Higgins*, the taxpayer spent a substantial portion of his time managing his extensive investments in real estate and securities.[74] To assist him in overseeing his investment interests, the taxpayer hired a staff and rented office space.[75] He deducted the salaries and other costs associated with the management of his investments as ordinary and necessary expenses associated with a trade or business.[76] The Commissioner conceded that the activities relating to the real estate investments constituted a business, but contended that the expenses relating to the securities were not incurred in the pursuit of a trade or business.[77]

The Court observed that the term trade or business has never been defined by Congress or the Treasury and rejected the broad definition of "business" established in *Flint*.[78] The *Higgins* Court concluded that in determining "whether the activities of a

---

68 *See id.* The Court found that the claimed deduction failed for two reasons. *See id.* First, the payments were not made in connection with the taxpayer's business of enhancing his estate but were directly related to the business of du Pont. *Id.* at 494. The Court stated that the stock transactions originated from the company's desire to increase its management efficiency, and the taxpayer offered to supply the required amount of stock because the company could not legally effectuate the sale. *Id.* Second, the payments were not "ordinary," because a shareholder engaged in the business of "conserving and enhancing his estate" does not ordinarily finance a stock purchase plan for the executives of his company. *Id.* at 494-96.

69 *See id.* at 499 (Frankfurter, J., concurring).

70 *See id.*

71 *Id.*

72 *Id.*

73 312 U.S. 212 (1941).

74 *Id.* at 213.

75 *Id.* at 213-14.

76 *Id.* In *Higgins*, the taxpayer claimed the deduction under section 23(a) of the Revenue Act of 1932. *Id. See generally* Revenue Act of 1932, ch. 209, § 23(a), 47 Stat. 169 (current version at I.R.C. § 162(a) (1982)).

77 *See Higgins*, 312 U.S. at 214.

78 *Id.* at 215-17. The *Higgins* Court stated that the definition of "business" articulated by the Court in *Flint* applied solely to determine whether certain corporations were taxed under the corporation tax law and was "not controlling in this

taxpayer are 'carrying on a business' requires an examination of the facts in each case."[79] Applying the "facts and circumstances" test, the Court determined that the facts [of this case] were not sufficient as a matter of law to allow the taxpayer to claim his activities as a trade or business.[80] The Court held that the expenses incurred in managing one's personal investment activities are not deductible as expenses incurred as a trade or business.[81]

Subsequent cases have demonstrated the Court's unwillingness to revert back to Justice Frankfurter's "goods or services" test.[82] It was not until 1974, in *Snow v. Commissioner*,[83] that the Supreme Court once again addressed the "goods or services test" in defining a trade or business.[84] The narrow issue

---

dissimilar inquiry." *Id.* at 217. *See supra* notes 48-53 and accompanying text (discussing *Flint*).

79 *Higgins*, 312 U.S. at 217.

80 *Id.* at 218.

81 *Id.* More specifically, the *Higgins* Court held that "[n]o matter how large the estate or how continuous or extended the work required may be," the taxpayer's activities of managing his personal investments were not legally sufficient to constitute a trade or business. *Id.* Congress, responding to the *Higgins* decision, enacted in 1942 what is currently Code section 212. *See* 88 CONG. REC. 6376 (1942). *See also* I.R.C. § 212 (1982) (permitting a deduction for all ordinary and necessary expenses paid or incurred "for the management, conservation, or maintenance of property held for the production of income."). This statutory change, however, did not broaden the definition of trade or business to include the maintenance and conservation of personal investments. *See* 88 CONG. REC. 6376 (1942). Congress merely intended to remove the inequity caused by the *Higgins* decision by permitting taxpayers to "deduct expenses incurred for the production or collection of income whether or not such expenses are connected with the taxpayer's trade or business." *Id.*

82 *See, e.g.*, City Bank Farmers Trust Co. v. Helvering, 313 U.S. 121 (1941); United States v. Pyne, 313 U.S. 127 (1941). In these two cases, the Court was once again given the opportunity to apply the "facts and circumstances" in determining the deductibility of estate and trust expenses. *See City Bank Farmers Trust Co.*, 313 U.S. at 123-24; *Pyne*, 313 U.S. at 128. In *City Bank Farmers Trust Co.*, the Commissioner did not permit a trust to deduct trustee fees as a business expense. *City Bank Farmers Trust Co.*, 313 U.S. at 124. In *Pyne*, the Commissioner did not allow a business deduction for attorney fees relating to the administration of an estate. *Pyne*, 313 U.S. at 128-29. In these companion cases, the Court held that the expenses relating to the trust and estate were not deductible as expenses incurred while carrying on a trade or business. *See City Bank Farmers Trust Co.*, 313 U.S. at 126; *Pyne*, 313 U.S. at 130-32. The Court, relying on *Higgins*, reasoned that because the activities surrounding the administration of trusts and estates primarily involve the conservation and maintenance of assets, such activities do not constitute a trade or business. *See City Bank Farmers Trust Co.*, 313 U.S. at 125-26; *Pyne*, 313 U.S. at 130-32. It should be noted that while the Court found *Higgins* to be the controlling law, no reference was made to Justice Frankfurter's "goods or services" test. *See City Bank Farmers Trust Co.*, 313 U.S. at 121; *Pyne*, 313 U.S. at 127.

83 416 U.S. 500 (1974).

84 *See id.* at 502-03.

presented by *Snow* was whether the taxpayer could deduct research and development costs as trade or business expenses under Code section 174.[85] The taxpayer was a partner in a partnership formed for the purpose of developing and marketing a special purpose invention.[86] In the year of formation, the partnership did not attempt any sales activity but incurred substantial expenses that were claimed as deductible under section 174.[87] The Commissioner disallowed the deduction on the ground that since no sales activity had been attempted, the partnership expenses were not incurred in connection with a trade or business.[88] Although the tax court and the Sixth Circuit had upheld the Commissioner's determination,[89] the Supreme Court reversed.[90]

After reviewing the legislative history, the Court maintained that Congress enacted section 174 with the intent of broadening the concept of a trade or business beyond that expressed by Justice Frankfurter in his *du Pont* concurrence.[91] The Court further stated that by broadening the concept of a trade or business under section 174, Congress sought to achieve its purpose of encouraging the research and development of new products.[92] With this legislative history as a backdrop, the Court concluded that the partnership's failure to attempt sales activity was irrelevant, and held that the research and development expenses were deductible under section 174.[93]

In *Gentile v. Commissioner*,[94] the tax court was faced with defining a trade or business in the context of the self-employment tax.[95] *Gentile* involved the imposition of the self-employment tax

---

85 *Id.* at 501. Section 174 permits a deduction for research and development expenses incurred in a trade or business. *See* I.R.C. § 174 (1970) (current version at I.R.C. § 174 (1982) *as amended by* I.R.C. § 174 (Supp. IV 1986)).

86 *Snow*, 416 U.S. at 501-02.

87 *Id.*

88 *See* Snow v. Commissioner, 58 T.C. 585, 593-94 (1972), *aff'd*, 482 F.2d 1029 (6th Cir. 1973), *rev'd*, 416 U.S. 500 (1974). The Tax Court determined that due to the partnership's lack of sales activity, it was not holding itself out as selling goods or services to others and, therefore, was not engaged in a trade or business. *Id.* at 596-97.

89 *Snow*, 416 U.S. at 501.

90 *Id.* at 504.

91 *See id.* at 502-04.

92 *Id.* at 503-04.

93 *See id.* at 504.

94 65 T.C. 1 (1975).

95 *Id.* at 3. *Gentile* involved the application of Code section 1401, as it existed in 1971. *See id.* Section 1401 imposed a tax on the "self-employment income" of individuals. *See* I.R.C. § 1401 (1970) (current version at I.R.C. § 1401 (Supp. IV

on a taxpayer whose total reported earnings were derived from gambling activities.[96] The sole issue presented to the tax court was whether the gambling activities of the taxpayer constituted a trade or business, thereby subjecting his gambling winnings to the self-employment tax.[97] A major portion of the taxpayer's gambling winnings was derived from horse racing.[98] He would visit various racetracks from one to four times per week and would spend a substantial portion of his time away from the track studying racing forms.[99] He never placed bets for others or received compensation for placing bets, nor did he operate a gambling establishment.[100] He gambled solely for his own benefit.[101]

The taxpayer argued that his gambling activities did not constitute a trade or business because he did not hold himself out to others as offering goods or services.[102] The Commissioner contended that the taxpayer was engaged in a trade or business and argued that the definition of a trade or business should not be confined to "the offering of goods or services to others."[103] Instead, the Commissioner maintained that the term should be defined as "an individual's everyday effort to earn a living, characterized by continuity, regularity, and profit motive."[104] The tax court agreed that the Commissioner's definition included some elements of "carrying on a trade or business," but that these elements alone were insufficient.[105] The tax court noted that the Supreme Court, in *Snow*, had reaffirmed the application of the "goods or services" test as a determinative factor in defining

---

1986)). Section 1402(b) defined "self-employment income" as "net earnings from self-employment," which was specified in section 1402(a), as "gross income derived by an individual from any 'trade or business.' " I.R.C. § 1402(a)-(b) (1970 & Supp. I 1971) (current version at I.R.C. § 1402 (1982), *as amended by* I.R.C. § 1402 (Supp. IV 1986)). Section 1402(c) defined the term "trade or business" and provided that "the term 'trade or business,' when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 (relating to trade or business expenses)." I.R.C. § 1402(c) (1970) (current version at I.R.C. § 1402(c) (Supp. IV 1986)).

96 *Gentile*, 65 T.C. at 1-3.

97 *Id.* at 3.

98 *Id.* at 2. The taxpayer engaged in various gambling activities including racetrack betting and wagering on a variety of other sporting events. *Id.*

99 *Id.*

100 *Id.*

101 *Id.*

102 *Id.* at 3.

103 *Id.*

104 *Id.*

105 *Id.* at 4.

whether an activity is a trade or business.[106]

The tax court held that the taxpayer was not engaged in a trade or business because the Commissioner failed to demonstrate that Gentile's activities constituted holding himself out to others as offering goods or services.[107] As a consequence, Gentile's gambling winnings "were not subject to the self-employment tax."[108] Moreover, the court pointed out that Gentile's gambling activities were analogous to the managing of one's own investment portfolio, an activity that clearly did not constitute a trade or business.[109]

The tax court in 1983, in *Ditunno v. Commissioner*,[110] reconsidered the continued use of the "goods or services" test in defining a trade or business.[111] In *Ditunno*, where the application of the minimum tax provision was at issue the tax court examined whether a full-time gambler was engaged in a trade or business.[112] For each of the years 1977 through 1979, the taxpayer reported gambling winnings of approximately $60,000 and de-

---

106 *Id.* at 5.

107 *See id.* at 6. The tax court concluded that by merely "stepping up to the betting window, [the taxpayer] was not holding himself out as offering goods or services to anyone." *Id.*

108 *Id.*

109 *Id.* (citing *Higgins*, 312 U.S. at 218). The tax court, relying on *Higgins*, found that the activities of a full-time gambler were analogous to the activities of one who manages his own personal investments or estate, and that clearly such activities do not constitute a trade or business. *Id.*

110 80 T.C. 362 (1983).

111 *See id.* at 366-67.

112 *Id.* at 364-66. The minimum tax provisions in effect for the years in question, 1977 through 1979, imposed a minimum tax on certain deductions defined as "items of tax preference." *See* I.R.C. §§ 56(a), 57(a)(1), 57(b)(1) (1976 & Supp. I 1977) (current version at I.R.C. §§ 55, 56, 57 (Supp. IV 1986)); I.R.C. §§ 56(a), 57(a)(1), 57(b)(1) (1976 & Supp. II 1978) (current version at I.R.C. §§ 55, 56, 57 (Supp. IV 1986)); I.R.C. §§ 55(a), 55(b), 57(a)(1), 57(b)(1) (1976 & Supp. III) (current version at I.R.C. §§ 55, 56, 57 (Supp. VI 1986)). Items of tax preference for each of the years in question included many deductions allowable under the Code, but did not include deductions allowable in computing adjusted gross income under Code section 62. *See id.* Adjusted gross income is defined under section 62 as gross income less certain deductions. I.R.C. § 62 (1976 & Supp. I 1977) (current version at I.R.C. § 62 (Supp. IV 1986)); I.R.C. § 62 (1976 & Supp. II 1978) (current version at I.R.C. § 62 (Supp. IV 1986)); I.R.C. § 62 (1976 & Supp. III 1979) (current version at I.R.C. § 62 (Supp. IV 1986)). The deductions relevant to the facts in *Ditunno* are the trade or business deductions specified under Code section 62(1), which permits deductions only if they are "attributable to a trade or business carried on by the taxpayer. . . ." I.R.C. § 62(1) (1976 & Supp. I 1977) (current version at I.R.C. § 62(1) (Supp. IV 1986)); I.R.C. § 62(1) (1976 & Supp. II 1978) (current version at I.R.C. § 62(1) (1986 & Supp. IV)); I.R.C. § 62(1) (1976 & Supp. III 1979) (current version at I.R.C. § 62(1) (Supp. IV 1986)). Therefore, if the taxpayer's only deductions for the taxable year were those allowable under Code section

ducted gambling losses for nearly the same amount.[113] Based upon the tax court's decision in *Gentile*, the Commissioner contended that the taxpayer's gambling activities did not constitute a trade or business.[114] The Commissioner argued that because the taxpayer was not engaged in the trade or business of gambling, his gambling losses were not deductible under Code section 62(1) in arriving at his adjusted gross income.[115] Instead, the Commissioner maintained that the gambling losses should have been characterized as itemized deductions, which would have subjected the losses to the minimum tax on tax preference items.[116]

Upon reconsidering the "goods or services" test as applied by the tax court in *Gentile*, the *Ditunno* court determined that the test was "overly restrictive."[117] The tax court recognized that the *Gentile* court's reliance on *Snow*, as reaffirming the "goods or services" test, was misplaced.[118] The *Ditunno* court further noted that the reference made to Justice Frankfurter's "goods or services" test by the Supreme Court in *Snow* did not indicate that Court's approval of this definition.[119] The tax court concluded that *Snow* was merely referring to the "goods or services" test as an example of a restrictive definition of a trade or business.[120] The *Ditunno* court held that the proper test to determine whether a taxpayer is engaged in a trade or business is the test established by the Supreme Court in *Higgins*.[121] The court observed that the test established in *Higgins* "requires an examination of all the facts and circumstances in each case."[122]

In applying the "facts and circumstances" test the tax court concluded that Ditunno's gambling activities constituted a trade or business.[123] To support this conclusion, the court distinguished Ditunno's gambling activities from the activities of the taxpayer in *Higgins*.[124] The court noted that Ditunno, unlike the

---

62(1), then he would not be subject to the minimum tax provisions under Code section 56 or 55. *Ditunno*, 80 T.C. at 365 & 365 n.5.

113 *Ditunno*, 80 T.C. at 364.

114 *Id.* at 366.

115 *Id.*

116 *Id.*

117 *Id.*

118 *Id.* at 371.

119 *Id.* at 370.

120 *See id.*

121 *See id.* at 370-71.

122 *See id.*

123 *Id.* at 372.

124 *Id.* at 371-72.

taxpayer in *Higgins*, was not a passive investor but rather an active gambler who devoted his full time to gambling-related-activities.[125]

The Second Circuit, in *Gajewski v. Commissioner*,[126] was given the first opportunity to consider the tax court's rejection of the "goods or services" test.[127] *Gajewski* involved the same issue as *Ditunno*, whether a full-time gambler is engaged in a trade or business, thereby excluding his gambling losses from the minimum tax provision.[128] Relying on the "goods or services" test to dispose of the issue, the Second Circuit held that full-time gambling activities did not constitute a trade or business.[129] The Second Circuit posited that the Supreme Court in *Snow* had implicitly adopted the "goods or services" test.[130] Moreover, the court observed that the tax court and other circuits have either implicitly or explicitly approved the "goods or services" test.[131] The Second Circuit viewed the "goods or services" test as the appropriate minimum standard for determining whether a taxpayer's activities constituted a trade or business.[132] The court labeled the "facts and circumstances" approach as a "non-test" because it did not establish a legal standard for identifying which "facts and circumstances" were sufficient to determine the existence of a trade or business.[133] The Second Circuit concluded that in order for a taxpayer to prove that his activities constitute a trade or business he must show, at a minimum, that he held "himself out to others as offering goods or services."[134] The

---

125 *Id.* at 371. The court concluded that the full-time gambling activities of Ditunno were in sharp contrast with the taxpayer who invested his money in relatively stable, long-term investments and whose only activity is the collection of dividends and interest. *Id.*

126 723 F.2d 1062 (2d Cir. 1983).

127 *See id.* at 1065-67.

128 *Id.* at 1063.

129 *Id.* at 1067.

130 *Id.* at 1065.

131 *Id.* at 1066. *See, e.g.*, Weiberg v. Commissioner, 639 F.2d 434, 437 (8th Cir. 1981); Stanton v. Commissioner, 399 F.2d 326, 329 (5th Cir. 1968); McDowell v. Ribicoff, 292 F.2d 174, 178 (3d Cir. 1961); Daily Journal Co. v. Commissioner, 135 F.2d 687, 688 (9th Cir. 1943); Helvering v. Highland, 124 F.2d 556, 561 (4th Cir. 1942); Helvering v. Wilmington Trust Co., 124 F.2d 156, 158-59 (3d Cir. 1941), *rev'd on other rounds*, 316 U.S. 164 (1942).

132 *Gajewski*, 723 F.2d at 1066.

133 *Id.* The court described the "facts and circumstances" test as merely a "predicate for [the] application of a legal test." *Id.* The Second Circuit stated that "[o]ne must first find the 'facts and circumstances' in every case before applying the proper [legal] standard to those facts." *Id.*

134 *Id.* at 1067.

Second Circuit added that the taxpayer must also show that the activity in question is a commercial activity from which he seeks to earn a living.[135] The court asserted that this would be a more reasonable standard for defining a trade or business than the amorphous "facts or circumstances" test.[136]

In *Estate of Cull v. Commissioner*,[137] the Sixth Circuit addressed the trade or business issue under facts similar to *Ditunno*.[138] The Sixth Circuit held that one who gambles full time for his own benefit is not engaged in a trade or business because he has not held himself out as offering goods or services to others.[139] The Sixth Circuit agreed with the Second Circuit's conclusion in *Gajewski*, that the "facts and circumstances" test is a "non-test" because it failed to identify what "facts or circumstances" were necessary to define the taxpayer's activity as a trade or business.[140] The court posited, however, that the "facts and circumstances" test and the "goods or services" test were clearly in harmony with one another.[141] The court explained that the *Higgins* "facts and circumstances" test stood for the general proposition that the determination of what constitutes a trade or business is merely a question of fact while the "goods or services" test established a minimum standard to determine which facts are sufficient to find that a trade or business exists.[142]

As prior law reflects, conflict existed among the various lower courts regarding the proper standard to be applied in deciding whether a full time gambler is engaged in a trade or business.[143] *Commissioner v. Groetzinger* marks the Supreme Court's most recent attempt to clarify the appropriate standard in deciding the trade or business issue.[144] In addressing this issue, the Court flatly rejected Justice Frankfurter's "goods or services" test.[145]

Writing for the majority, Justice Blackmun traced the judicial history behind the Supreme Court's attempt at establishing the

---

135 *See id.* at 1066.
136 *Id.* at 1067.
137 746 F.2d 1148 (6th Cir. 1984).
138 *See id.* at 1149-50.
139 *See id.* at 1152.
140 *See id.* at 1151.
141 *Id.*
142 *Id.*
143 *See Groetzinger*, 107 S. Ct. at 983.
144 *See generally id.* at 980.
145 *Id.* at 987.

appropriate standard for defining a trade or business.[146] The Justice observed that the Court's prior cases provided little guidance for deciding whether the activities of a full-time gambler should be afforded the status of a trade or business.[147] The Court concluded that although an activity that would satisfy Justice Frankfurter's "goods or services" test would certainly qualify as a trade or business, this test was "not an absolute prerequisite."[148] The Justice added, that such a test would only breed litigation over the definition of "goods or services" and the meaning of "holding one's self out"[149] as engaged in such an activity. Accordingly, Justice Blackmun formally rejected the "goods or services" test which he found was never adopted by the Court.[150]

In rejecting the "goods or services" test, Justice Blackmun concluded that to constitute a trade or business, the taxpayer's activities must be pursued with continuity and regularity and with the primary purpose of earning a living.[151] A mere hobby or occasional activity is not sufficient.[152] To resolve this issue, the majority chose to adhere to the familiar formulation established by the Supreme Court in *Higgins*, which "requires an examination of

---

146 *See id.* at 983-96. The Court, while discussing the *Higgins* decision, made several interesting observations. *See id.* at 985. The Court pointed out that Justice Frankfurter, who was a member of the *Higgins* Court, did not write a separate opinion and Justice Reed, who joined in Justice Frankfurter's *du Pont* concurrence, authored the *Higgins* opinion. *Id.* Additionally, the Court noted that the *Higgins* Court did not cite to the *du Pont* opinion, and concluded that the Court did not consider Justice Frankfurter's *du Pont* concurrence in deciding the trade or business issue. *Id.* The *Groetzinger* Court also noted that if Justice Frankfurter's "goods or services" test was adopted, *Higgins* would have been disposed of "automatically." *Id.*

147 *Id.* at 986. The Court found Justice Frankfurter's "goods or services" test to be nothing more than a passing remark made by a minority of the Court, which never has been adopted as controlling law. *Id.* The Court also found that the "facts and circumstances" test, announced in *Higgins*, does not provide a helpful standard. *Id.*

148 *Id.* at 987.

149 *Id.* Justice Blackmun also stated that besides gambling, practically every other activity would satisfy the "goods or services" test. *Id.* The Court observed that all of the gambling cases which held that a trade or business did not exist adopted the "goods or services" test. *Id.* at 987 n.14 (citations omitted). Moreover, the Court noted that these same courts never referred to the "goods or services" test in non-gambling cases. *Id.* The Court noted that this trend indicates that these courts were carving out a separate set of rules for full-time gamblers not warranted by the Code. *Id.*

150 *Id.* at 987.

151 *Id.*

152 *Id.*

all the facts in each case."[153]

In reaching its conclusions, the Court refused to provide a uniform definition of the term trade or business that could be applied broadly.[154] The Court stated that the difficulty in providing one all-encompassing definition is in the pervasiveness of the term throughout the Code and in the variety of contexts in which the term is used.[155] Justice Blackmun concluded that establishing one broad definition that would apply in all situations would produce uncertainty regarding the overall integrity of the Code.[156]

Justice White joined by Chief Justice Rehnquist and Justice Scalia, filed a dissenting opinion.[157] The Justice asserted that Congress implicitly accepted the Tax Court's holding in *Gentile*, that full-time gambling does not constitute a trade or business, when it amended the Code in 1982 to exclude gambling losses from the minimum tax provision.[158] The dissent reached this conclusion because it found that when computing the minimum tax, under the 1982 amendments, a double deduction for gambling losses would result if gambling losses were characterized as trade or business deductions.[159] The dissent further reasoned that because Congress did not intend to permit this double deduction, gambling losses could not be characterized as trade or business expenses.[160] Accordingly, the dissent concluded that

---

153 *Id.* at 988.

154 *See id.*

155 *Id.*

156 *Id.* The Court stated: "We leave repair or revision, if any be needed, which we doubt, to the Congress where we feel, at this late date, the ultimate responsibility rests." *Id.*

157 *Id.* at 988 (White, J., dissenting).

158 *Id.* at 988-89 (White, J., dissenting). *See also supra* notes 96-111 and accompanying text (discussing *Gentile*). Under the 1982 amendments, the total amount of income subject to the minimum tax is equal to adjusted gross income, reduced by certain specified amounts, including gambling losses, and increased by items of tax preference. *See* I.R.C. §§ 55(b), 55(e)(1)(A) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)); I.R.C. § 165(d) (1982).

159 *Groetzinger*, 107 S. Ct. at 988 (White, J., dissenting). The Court explained that if full-time gambling is considered a trade or business, then the gambling losses incurred would be characterized as trade or business expenses deductible from gross income to arrive at adjusted gross income, but only to the extent of gambling winnings. *Id. See also* I.R.C. § 62(1) (1982); I.R.C. § 165(d) (1982). The Court noted that by permitting a second deduction from adjusted gross income for gambling losses when computing the amount of income subject to the minimum tax provision, would allow the full-time gambler a double deduction for purposes of computing the minimum tax. *Groetzinger*, 107 S. Ct. at 988 (White, J., dissenting). The Court concluded that this "was certainly not Congress' intent." *Id.* (footnote omitted).

160 *Groetzinger*, 107 S. Ct. at 988-89 (White, J., dissenting).

this, therefore, implied that Congress accepted the conclusion that gambling is not a trade or business.[161]

Although gambling under the 1982 amendments is not a trade or business, the dissent conceded that it could be argued that gambling was a trade or business in 1978, the tax year in question.[162] The dissent concluded, however, that under the 1982 amendments it was not the intention of Congress to alter the trade or business status of gambling.[163] Instead, Justice White noted that Congress only intended to rectify a perceived inequity that had developed primarily because gambling did not have the status of a trade or business.[164]

The Supreme Court's decision in *Groetzinger* provides little guidance for determining whether a particular activity is a trade or business. By expressly adopting the *Higgins* "facts and circumstances" approach, the Court chose not to formulate a uniform definition of the term "trade or business" that could be applied in all contexts.[165] The Court's choice, however, was made easier by the enactment of the 1982 amendments, which eliminated the specific statutory context in which the trade or business question arose in *Groetzinger*.[166] The major impact of the Court's decision was to settle a conflict among the various circuit courts regarding the narrow issue of whether a full-time gambler is engaged in a trade or business, for purposes of applying the minimum tax provision.[167]

---

161 *Id.*

162 *Id.* at 989 (White, J., dissenting).

163 *Id.*

164 *Id.* The perceived inequity referred to by the Court is the imposition of a minimum tax in a case like *Groetzinger* where the taxpayer has realized no economic profit. *See id.* at 987-88 n.15. Under the 1978 minimum tax provision, "the more [the full-time gambler loses] the more minimum tax he has to pay." Boyle, *supra* note 1, at 754.

165 *See Groetzinger*, 107 S. Ct. at 988.

166 As a consequence of the 1982 amendments excluding gambling losses from the minimum tax base, the specific trade or business issue decided in *Groetzinger*, which was decided in the context of the minimum tax provision, could not arise subsequent to 1982. *See id.* However, the Supreme Court's holding and the standard established to decide whether a trade or business exist will have a significant impact on the determination of the elusive trade or business question in any one of the numerous statutory contexts in which the issue may arise. *See, e.g.*, Uhlfelder, *High Court's Groetzinger Decision Could Affect Deductibility of Some Construction Expenses*, 34 TAX NOTES 856, 856 (1987); August & Levine, *Goods and Services Test for Trade or Business Rejected by Supreme Court*, 66 J. TAX'N 298, 298-302 (1987); Mundstock, *Taxation of Business Intangible Capital*, 135 U. PA. L. REV. 1179, 1215 n.175 (1987); Note, *A Holding Company's Stock in a Subsidiary: A Capital or Ordinary Asset?*, 65 TEX. L. REV. 1029, 1050-53 (1987).

167 *See Groetzinger*, 107 S. Ct. at 983, 988. *See also* August, *supra* note 166, at 302.

The Court, although aware that the amorphous "facts and circumstances" approach does not provide much help in solving the trade or business issue, expressed some doubt as to whether the Court or Congress should step in and provide one uniform definition.[168] In the Court's view, a universal definition would provide little guidance and that one definition could not possibly cover the variety of statutory contexts in which the term is employed.[169] In any event, it is Congress that should supply the appropriate definition in each of the specific statutory contexts, and not the courts.[170]

The dissent's contention that Congress impliedly recognized that gambling did not constitute a trade or business by enacting the 1982 amendments to the minimum tax provision, is of questionable validity. A closer reading of the applicable statutes reveals that regardless of whether gambling losses are characterized as trade or business deductions, a double deduction will not result. The statutory language specifically provides that if a gambling loss has already been deducted once as a trade or business expense, it will not be allowed as a deduction a second time when computing the minimum tax.[171] By its own internal operation,

---

168 *See Groetzinger*, 107 S. Ct. at 988.

169 *See id.*

170 *See id.*

171 The minimum tax provision in effect under the 1982 amendments, imposed a minimum tax (called the "alternative minimum tax" in 1982) on "alternative minimum taxable income." *See* I.R.C. § 55(a), 55(b) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)). "Alternative minimum taxable income" is defined as "the adjusted gross income . . . of the taxpayer for the taxable year" reduced by certain specified items, including an amount designated as the "alternative tax itemized deduction," and increased by the items of tax preference. I.R.C. §§ 55(b), 55(b)(1)(B) (current version at I.R.C. § 55 (Supp. IV 1986)). "Alternative tax itemized deductions" is further defined as an amount equal to the sum of certain specified deductions, which include gambling losses (but only to the extent of gambling winnings). *See* I.R.C. § 55(e), 55(e)(A) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)); I.R.C. § 165(d) (1982). These deductions which include gambling losses, are, however specifically excluded from the amount designated "alternative tax itemized deductions" if these deductions were already included in the computation of adjusted gross income. *See* I.R.C. § 55(e) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)). The relevant sections of the 1982 minimum tax provision read:

> § 55. Alternative minimum tax for taxpayers other than corporations
> (a) Tax imposed
> In the case of a taxpayer other than a corporation, there is imposed (in addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of —
> (1) an amount equal to 20 percent of so much of the alternative minimum taxable income as exceeds the exemption amount, over
> (2) the regular tax for the taxable year.

the minimum tax provision prevents the very double deduction that the dissent was concerned would result if gambling losses were characterized as trade or business deductions. Because the 1982 minimum tax provision precluded such a double deduction, it is illogical to reason that Congress was concerned with the characterization of gambling losses as a trade or business expense.

The Supreme Court, in *Groetzinger*, in addition to settling a conflict that had developed among the circuit courts and the Tax Court, finally established the "facts and circumstances" test as the appropriate standard to apply in deciding the trade or business issue.[172] This is firmly advanced by the Court's express rejection of Justice Frankfurter's "goods or services" test.[173] In establishing such a broad standard, the Court has succeeded in shedding little light on the definition of a trade or business and

---

(b) Alternative minimum taxable income

For purposes of this title, the term "alternative minimum taxable income" means the *adjusted gross income* (determined without regard to the deduction allowed by section 172) of the taxpayer for the taxable year—

(1) reduced by the sum of —

. . . .

(B) the *alternative tax itemized deduction* plus

. . . .

(2) increased by the amount of items of tax preference.

. . . .

(e) Alternative tax itemized deductions

For purposes of this section—

(1) In general

The term "alternative tax itemized deductions" means an amount equal to the sum of any amount allowable as a deduction for the taxable year (*other than a deduction allowable in computing adjusted gross income*) under—

(A) section 165(a) for losses described in subsection (c)(3) or *(d) of section 165*.

. . . .

§ 165. Losses

. . . .

(d) Wagering Losses

Losses from wagering transactions shall be allowed but only to the extent of the gains from such transactions.

I.R.C. § 55(a), 55(b)(1)(b)-(b)(2), 55(e)(1)(A) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)); I.R.C. § 165(d) (1982) (emphasis added). Therefore, under section 55(e) a second gambling loss deduction, for purposes of computing the minimum tax in 1982, would not be permitted if such gambling losses were characterized as trade or business expenses deductible in computing adjusted gross income. *See id.* § 55(e)(1)(A) (1982) (current version at I.R.C. § 55 (Supp. IV 1986)); I.R.C. § 62(1) (1982) (current version at I.R.C. § 62(1) (Supp. IV 1986)).

172 *See Groetzinger*, 107 S. Ct. at 988.

173 *See id.* at 987.

has chosen instead to leave the job of defining this term to Congress.[174] Therefore, until Congress or the Treasury decides to provide a uniform definition, if indeed one exists, the Court must continue to resolve the trade or business issue by analyzing all the facts in each case to determine if the taxpayer's activity is sufficiently substantial and regular and entered into for the purposes of earning a living.

Michael F. Bodrato

---

174 *See id.* at 988.