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State of Minnesota  
In Supreme Court

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Estelle Busch,

Relator,

vs.

Commissioner of Revenue,

Respondent.

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RELATOR'S BRIEF AND APPENDIX

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STATEMENT OF LEGAL ISSUES

- I. Whether there is federal resolution that Relator's gambling activity of slot machine playing can be a trade or business.

Tax Court held: In the negative.

Most Apposite Cases

Alberico v. Commissioner of Internal Revenue,  
T.C. Memo 1995-542

Commissioner of Internal Revenue v. Groetzing  
480 U.S. 23 (1987)

Kochevar v. Commissioner of Internal Revenue,  
T.C. Memo 1995-542

Lutz v. Commissioner of Internal Revenue, T.C. Memo  
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Praytor v. Commissioner of Internal Revenue,  
T.C. Memo 2000-282

- II. Whether one can have an unreasonable or unrealistic expectation of profit in a trade or business.

Tax Court Held: In the negative

Most Apposite Cases

Filios v. Commissioner, 224 F.3d 16 (1st Cir. 2000),  
affg. T.C. Memo 1999-92

Ranciato v. Commissioner of Internal Revenue,  
52 F.3d 25 ((2nd Cir. 1995)

Tinnell v. Commissioner of Internal Revenue,  
T.C. Memo 2001-106

Section 1.183-2(a), Income Tax Regs.

- III. Whether the Internal Revenue Service has taken any action on Relator's federal returns for the years at issue.

Tax Court Held: In the negative

Most Apposite Cases

DeBoer v. Commissioner of Revenue, Dkt. No. 6712  
(Minn. Tax Ct. October 27, 1997)

Yocum v. Commissioner of Revenue, Dkt. No. 5497  
(Minn. Tax Ct. January 22, 1992)

IV. **Whether the Commissioner's orders are no longer  
prima facie correct or valid.**

Tax Court Held: In the negative

Most Apposite Cases

Groth v. Commissioner of Revenue, Dkt. No. 6909  
(Minn. Tax Ct. May 24, 1999)

Yocum v. Commissioner of Revenue, Dkt. No. 5497  
(Minn. Tax Ct. January 22, 1992)

STATEMENT OF CASE

This matter is before the Court pursuant to a Writ of Certiorari dated and filed April 1, 2005. Review is sought of an Order for Judgment dated March 2, 2005, and amended March 18, 2005, by the Minnesota Tax Court. The Honorable Sheryl A. Ramstad issued the Order.

The primary issue is whether Relator's (Busch) gambling activity of playing the slot machines was a trade or business. The years at issue are 1999, 2000, and 2001.

There is no dispute that Busch devoted at least 40 to 60 hours a week to the gambling activity, the gambling activity was not sporadic but continuous and regular, Busch had no other employment and kept a detailed account of the gambling activity.

There is no dispute Busch gambled for income or profit and honestly believed it would be profitable. There is no dispute that Busch applied the skill of discerning which machines would give pay-outs. Finally, the gambling income and loss/expense as reported are also not disputed.

The Commissioner issued Audit Reports/Orders for the years in issue denying Busch's gambling to be a trade or business because:

1. The gambling activity of playing slot machines is excluded as an activity that can be a trade or business.
2. A gambler has to make a living off of a gambling activity in order for the activity to be a trade or

business.

The Commissioner denied Busch's Administrative Appeal and Busch appealed to the Tax Court.

During the Tax Court trial the Commissioner's witness waffled on the determinations set out in the Audit Reports/Orders. The witness testified that, although the position of the Commissioner had not changed, in order for an activity to be a trade or business, there had to be a realistic expectation of profit and there was none with gambling on slot machines. Further, the witness conceded the activity could even have a loss, not a living income, and still be a trade or business if there was a realistic expectation of profit.

The Tax Court said that the Commissioner could reasonably conclude that Busch was not engaged in the trade or business of gambling because playing slot machines was strictly a matter of chance with no realistic expectation of profit.

However, in affirming the Commissioner's orders, the Tax Court's concluded that Busch had not overcome the presumptive validity of the Commissioner's determination. This was because the IRS had not taken any action on Busch's federal returns for the years in question completely disregarding the IRS's thorough and in-depth audit of Busch's 2001 year return. And, also, there had been no federal resolution of the issue before the Court. This is

incorrect. The United States Supreme Court case of Commissioner of Internal Revenue v. Groetzinger 480 U.S. 23 (1987) is just one of many examples. Consequently the Commissioner was not barred from determining that Busch was liable for alternative minimum income taxes and interest for the years at issue.

## STATEMENT OF THE FACTS

1. Relator's (Busch) gambling activity was the slot machines. Busch gambled at Mystic Lake Casino in Prior Lake, Minnesota. Busch's gambling activity was not sporadic but continuous and regular. She devoted at least 40 to 60 hours a week to the gambling activity, had no other employment and kept a detailed account of the gambling activity. Busch gambled for income and she honestly believed it would be profitable. Previously, Busch had never gambled recreationally either as a hobby or as an amusement diversion. The Commissioner does not dispute any of the above. The gambling income and loss/expense is not disputed by the Commissioner either.

2. When Busch was filling out both her taxable years 1999 and 2000 tax returns she encountered both the complexity and the understanding of the tax law in how to treat her gambling activity as her trade or business. Busch did not even know what forms were to be filled out and filed. Internal Revenue Service (IRS) representatives and accountants gave different and confusing answers.

3. What made it more difficult was at the time the 1999 tax returns were due Busch's father had just passed away. And at the time the year 2000 tax returns were due Busch's "husband" had just passed away.

4. In order to timely file both the 1999 and 2000 years

tax returns, Busch included her gambling income in her adjusted gross income and deducted her gambling loss/expense off as an itemized miscellaneous on Schedule A of her Federal returns. (A. 17-22,32-34) For the year 2001, upon the advice of the IRS, Busch put her gambling activity on Schedule C of her Federal return. (A. 35-44)

5. On August 4, 2002, the Commissioner issued an Audit Report/Order for Busch's year 1999 State return. The Commissioner applied the Alternative Minimum Tax (AMT) to Busch's gambling loss/expense that Busch had reported as a itemized miscellaneous deduction on Schedule A of her Federal return. (A. 23-27)

6. On October 8, 2002, Busch sent the Commissioner an Audit Appeal Notice. Busch disagreed with the Commissioner's Order and advised that her year 1999 Federal and State amended returns were in process. (A. 18) The Commissioner, in a October 16, 2002, letter, requested that the amended year 1999 returns be sent to them within 30 days. (A. 29)

But in a November 9, 2002, letter, Busch informed the Commissioner that Busch's amended year 1999 returns would not be sent at that time because of tax preparer error and because of Busch's scheduled lung surgery November 11, 2002. The Commissioner granted an extension to January 31, 2003, to file the amended year 1999 returns. (A. 31)

7. On December 4, 2002, the Commissioner issued Audit Reports/Orders to Busch for her years 2000 and 2001 State tax returns. For the year 2000 the Commissioner applied the AMT on Busch's gambling loss/expense which had been reported as a itemized miscellaneous deduction on Schedule A of the Federal return.

For the year 2001, the Commissioner disallowed Busch's filing of her gambling activity as a business or trade on Schedule C of her Federal return. The Commissioner adjusted the Federal return so that the gambling income was included in the adjusted gross income and the gambling loss/expense reported as a itemized miscellaneous deduction on Schedule A. The Commissioner then applied the AMT to the gambling loss/expense. (A. 45, 51-58)

8. The Commissioner's Audit Reports/Orders disallowed Busch's gambling activity as a trade or business for the following reasons:

a. The gambling activity of playing slot machines is excluded as an activity that can be a trade or business.

b. A gambler has to make a living off of a gambling activity in order for the activity to be a business or trade. (A. 48,53)

9. In a January 27, 2003, letter, Busch disagreed with the Commissioner's Orders and asked for legal authority substantiating the Orders. (A. 59,60) The Commissioner never provided any. However, in a February 20, 2003,

letter, the Commissioner wrote Busch "...it would be helpful if [Busch] could cite court cases, regarding slot machine players, specifically, in support of your position."

(A. 64)

10. The "audit" and the preparation and procedures of an Administrative Appeal were confusing to Busch. (A. 63)

At this time Busch was recuperating from lung surgery which was directly followed with pneumonia. However, Busch filed an Administrative Appeal. (A. 65-68)

11. The Commissioner denied Busch's Administrative Appeal March 7, 2003, and affirmed the Commissioner's Orders. The Commissioner stated that Busch's filing history did not indicate that gambling had ever been Busch's livelihood or means of support or that a profit expectation was Busch's primary purpose for engaging in the gambling activity. Therefore, although Busch did not have a history of recreational gambling either, the Commissioner determined Busch's gambling activity was a recreational hobby and the Orders were valid. The Commissioner attached the case of Commissioner of Internal Revenue v. Groetzinger 480 U.S. 23 (1987) indicating it was pertinent to the Commissioner's position. (A. 69-76)

The IRS had previously referred the Groetzinger case to Busch. The IRS had advised Busch to amend her years 1999 and 2000 returns and file as a trade or business on

Schedule C for year 2001. Even then Busch was not made aware that a gambling activity's loss/expense could not exceed the gambling income.

12. On June 5, 2003, Busch filed a Notice of Appeal of an Order of the Commissioner of Revenue to the Tax Court disagreeing with the Commissioner's Orders. (A. 104) In the year 2003 Busch recuperated from lung surgery, had pneumonia twice, one time requiring hospitalization, a respiratory virus twice, diabetes requiring a trip to the hospital, diagnosed with high blood pressure, glaucoma, spinal stenosis and a painful case of shingles. The Tax Court trial date was changed twice because of Busch's health problems and to allow her time to prepare for trial.

13. Finally, in the year 2004, Busch amended her years 2000 and 2001 tax returns. The Statute of Limitations foreclosed the pursuit of her year 1999 tax return. For the year 2000, Busch's amended return removed her gambling activity to Schedule C, reportable as a trade or business, of the Federal return. Busch's State tax return was also amended. (A. 77-85) The IRS approved this amended return and returned to Busch \$1,256.00 plus interest of \$241.58. (A. 95,96)

For the year 2001, Busch amended her tax return only to decrease the loss/expense on Schedule C to be no more than the gambling income per Section 165(a) of the Internal Revenue Code. (A. 95)

14. On September 14, 2004, the IRS audited Busch's year 2001 return. The primary focus of this thorough and in-depth audit was Busch's gambling activity, i.e. the income and loss/expense and the reasons why the gambling activity was being reported as a trade or business on Schedule C. The IRS approved Busch's gambling activity as a trade or business. The audit resulted in no taxable change.  
(A. 98-103)

Busch informed the Commissioner's attorney of the IRS's determination of both the amended returns and the audit. Busch also mailed copies of these determinations to the Commissioner's attorney. Busch also told the Commissioner's attorney the case names that were relevant to the gambling of slot machines. The Commissioner cited the case law, although misleading, in its pre-trial memorandum.

15. The Tax Court heard this case December 22, 2004. Both Busch and the Commissioner submitted pre-trial memorandums as requested by the Court. (A. 110-136, 137-143) Busch also responded to the Commissioner's pre-trial memorandum with a pre-trial reply memorandum. (A. 144-149) The Commissioner waived its right to file a pre-trial reply memorandum. (A. 150)

16. The Tax Court affirmed the Commissioner's Order(s). The Tax Court held that "[Busch] has not overcome the

presumptive validity of the Commissioner's determination that she was not engaged in the trade or business of gambling during the years at issue". Because (1) "... the IRS has taken no action on her federal returns for those years" and (2) "[t]here has been no federal resolution of the issue now before us". Therefore, "[t]he Commissioner is not barred from determining that [Busch] is liable for alternative minimum income taxes and interest for the 1999, 2000, and 2001 taxable years".... (A. 9)

Many of the Court's findings are erroneous. Never did Busch argue that the IRS's approval of her 2000 and 2001 amended 1040's foreclosed the Commissioner's assessments for those years. (A. 6)

Never did the Commssioner examine Busch's bank account. (A. 7,8)

And even more important, contrary to the Court's findings, there was an IRS audit of the issue before the Court for the year 2001. The IRS did a thorough and in-depth audit of Busch's gambling activity for the year 2001 and Busch's gambling activity was allowed as a trade or business. The evidence of this audit is in the record. (A. 98-103, T. 15,53)

## STANDARD OF REVIEW

The Tax Court's Order for Judgment is clearly against both the evidence and established law. The Court's decision was made without proper consideration of the facts and the law. Because of the discretion allowed the Trial Court, when a court does not apply the correct law or the court rests its decision on a clearly erroneous finding of a material fact the standard for review is Abuse of Discretion. Maxfield v. Maxfield, 452 N.W.2d 219, 221 (Minn. 1990) Relator's Notice of Review raises mixed questions of fact and law.

1. Findings of fact, if clearly erroneous, may be set aside. Minn. R. Civ. P. 52.01, First Trust Co., Inc. v. Union Depot Place Ltd. P'ship, 476 N.W.2d 178, 181-82 (Minn. App. 1991), review denied (Minn. Dec. 13, 1991)
2. Questions of law are reviewed on a de nova basis without deference to the trial court's decision. London Const. v. Roseville Townhomes, 473 N.W.2d 917, 919 (Minn. Ct. App. 1991)

## ARGUMENT

### Introduction

The Tax Court affirmed the Commissioner's Orders that (1) the gambling activity of playing slot machines is excluded as an activity that can be a trade or business and (2) a gambler has to make a living off of a gambling activity in order for the activity to be a trade or business. (A. 48, 53)

The Tax Court's conclusion was Busch had not overcome the presumptive validity of the Commissioner's determination. This was because the IRS had not taken any action on Busch's federal returns for the years in question completely disregarding the IRS's thorough and in-depth audit of Busch's 2001 year return. And, also, there had been no federal resolution of the issue before the Court. (A. 9) The Tax Court's conclusion is neither true or reasonable. It was arrived at without a proper consideration of the applicable law and a clearly erroneous finding of material facts.

Busch's gambling activity for the years at issue was her trade or business. Both the IRS and the United States Tax Court allow the gambling activity of slot machine playing to be a trade or business. In order for an activity to be considered a trade or business, it must be pursued for income or for profit. However, the expectation of a profit can be unreasonable or unrealistic. Moreover, the IRS's

audit of an issue is conclusive for Minnesota State tax purposes, i.e., the IRS's audit of Busch's 2001 year return. (A. 99-103) Finally, there is a federal resolution through the applicable law.

**The Commissioner's Orders Are Not Prima Facie Valid.  
Busch's s Gambling Activity Was A Trade Or Business.**

"Where a taxpayer's federal return is not audited by the IRS, the Commissioner is not foreclosed from making an independent state audit and redetermination of state taxes. Yocum v. Commissioner of Revenue, Dkt. No. 5497 (Minn. Tax Ct. January 22, 1997) citing Spector v. Commissioner, 308 N.W.2d 806 (Minn. 1981) The Commissioner's order is prima facie correct and valid. Minn. Stat. s271.06, subd. 6 and s289A.35 However, the prima facie validity of the Commissioner's order may be rebutted by testimony or evidence. at Yocum Although Busch's taxable year 2001 was audited by the IRS, Busch's taxable years 1999 and 2000 were not audited by the IRS.

The Commissioner attached to the order denying Busch's Administrative Appeal a copy of the United States Supreme Court case Commissioner of Internal Revenue v. Groetzinger, 480 U.S. 23 (Feb. 24, 1987) as pertinent to the issue in this case.

The issue in Groetzinger was whether a full-time gambler who made wagers solely for his own account was

engaged in a trade or business for purposes of computing the taxpayer's liability for the alternative minimum tax. Taxpayer Groetzinger's gambling was on parimutuel wagering of the dog races. Taxpayer Groetzinger's gambling winnings were \$70,000 on bets of \$72,032. He had a net gambling loss of \$2,032.

He devoted 40 to 60 hours each week to his "gambling-related endeavors", had no other employment and kept a detailed account of his gambling. He did receive other income of \$6,498 in the form of interest, dividends, capital gains and salary earned before the termination of his job.

The IRS had determined that the (1) \$70,000 gambling winnings were to be included in the taxpayer's gross income, and (2) that, pursuant to 26 U.S.C. s165(d), the taxpayer was allowed a deduction for his gambling winnings only to the extent of taxpayer's gambling gains. The IRS had also determined that the \$70,000 allowed as a gambling loss deduction was an item of "tax preference" for purposes of the alternative minimum tax under 26 U.S.C. 56(a). Under the alternative minimum tax provisions in effect at that time, items of "tax preference" were reduced by specific deductions attributable to any trade or business of a taxpayer.

The United States Supreme Court in Groetzinger did a careful analysis of previous cases related to a trade or

business. The Court in noting too that federal and state legislation and court decisions have been unfavorable to gambling endeavors said:

Today, however, the vast majority of States permit some form of public gambling. The lottery, bingo, parimutuel betting, jai alai, casinos, and slot machines easily come to mind.

Groetzinger, footnote 11

Further, the Court in Groetzinger found:

We accept the fact that to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify....[I]f one's gambling activity is pursued full time, in good faith, and with regularity, to the production of income for a livelihood, and is not a mere hobby, it is a trade or business within the meaning of the statutes ....

Groetzinger at 35-36

The Court found that taxpayer Groetzinger, although his gambling had a less-than- successful result - a loss, was in the trade or business of gambling. The Court found that his gambling was not a hobby or a passing fancy or an occasional bet for amusement. The Court found that taxpayer Groetzinger had exerted a constant and a large scale effort and had applied the required skill. at Groetzinger

The Commissioner coined the exerted effort or the application of skill the Court found of taxpayer Groetzinger as a "maximization of profits" task. The Commissioner argued that in the gambling context there is this

"maximization of profits" tax. Ordinarily, the Commissioner further argued, the only effort or skill a slot machine player can employ to accomplish the task is to discern which machine will produce the best pay-outs, (A. 142)

But Auditor Paul Makousky, the Commissioner's witness, testified that "...I wouldn't say that [gamblers] would have to maximize profit...." (T. 46)

The Tax Court found "...the only skill or effort [Busch] employed in playing slot machines involved attempting to discern which machine produced the best pay-outs". (A. 3) And Busch did employ this skill in discerning which machine would produce a pay-out as taxpayer Groetzinger did in applying the skill of discerning which dog would win a race. There is no dispute that Busch's gambling income increased from \$26,266 in 1998 to \$972,980 in 2001. (See Commissioner's Exhibit A, A. 169)

And like taxpayer Groetzinger, there is no dispute that Busch devoted 40 to 60 hours each week to her "gambling related endeavors", had no other employment and kept a detailed account of her gambling. (A. 3)

Busch exerted a constant and large scale effort and applied the required skill. But, like taxpayer Groetzinger, Busch had a less-than-successful result - a loss.

And like taxpayer Groetzinger, Busch received other income for the years 1999, 2000 and 2001. Interest

of \$14,843, \$9,635 and \$2,087 respectively. (Comm. Ex. A, A. 169) Like taxpayer Groetzinger not a large income for each of the years. Auditor Makousky testified that Busch's gambling activity was both prevalent and regular. But Makousky speculated he "felt" that, without the money he speculated Busch had in a bank, Busch's gambling activity would not be as regular. However, Makousky testified that he felt that was not an issue. (T. 39) Nor should it have been. The issue is was Busch's gambling activity continuous and regular. It was and the Commissioner has not disputed this.

The Tax Court found that Busch "...did no background reading, study or travel related to learning how to play slot machines...." (A. 7) This finding is incorrect. Although Busch did not travel or profess to be a slot machine mechanic, Busch acquired knowledge of slot machines through study of the machines, employees, other players and reading a lot of articles. (T. 23-28) Because of this Busch acquired the skill of discerning which machines played would result in pay-outs. True, as the Tax Court stated, Busch could not remember the names of the publication she read. (A-9) Busch had read the articles 3 to 4 years prior to the Tax Court trial.

In Groetzinger, the United States Supreme court addressed the issue of gambling as a whole in regard to a trade or business. The Court did not exclude the gambline

activity of slot machines that could be a trade or business. In fact the Court noted that the gambling activity of playing slot machines had to be considered as well as the parimutual betting taxpayer Groetzinger was involved in. (See Groetzinger, footnote 11) The Commissioner arbitrarily selected only gambling activities as thoroughbred horse racing, parimutuel wagering on greyhound races, blackjack, poker or sports betting as only the gambling endeavors that can be considered a trade or business. (A. 48, 69) Yet Auditor Makousky testified that in his 21 years with the Department of Revenue he had not seen anyone approved to be in the trade or business of gambling. Particularly because of the alternative minimum tax. (T. 42)

The Commissioner determined that Busch's gambling was a recreational hobby" because based on Busch's filing history, gambling had never been Busch's livelihood. (A. 69) But Busch had no history of gambling as a "recreational hobby". If the Commissioner does not allow a slot machine player to be engaged in the trade or business of gambling what validity does a history have.

The Groetzinger case supports Busch's position. The Tax Court found "[a]t the outset, Busch argues that the IRS' "approval" of her 2000 and 2001 amended 1040's forecloses the Commissioner's assessments for those years". (A. 6) Never has Busch argued that her amended returns and the approval of them foreclosed the Commissioner's assessments. This finding was deduced from the Commissioner's

pre-trial memorandum in which the Commissioner asserts that the IRS's approval of the amended returns meant no determination had been made. The Commissioner stated that [i] in the instant case, therefore, Appellant seeks to bar the Commissioner from basing an assessment on a claim with respect to which the IRS has taken no action". (A. 138, 139)

True, Busch did amend her taxable years 2000 and 2001 returns. (A. 77-94) For the taxable year 2000, the IRS did make a determination and took action by approving Busch's change of gambling activity to Schedule C of her Federal return and returned to her \$1,497.58 which included interest of \$241.58.

For the taxable year 2001, Busch's gambling activity had been reported originally on Schedule C of her Federal return. Busch amended the return to only comply with 26 U.S.C. s165(d) by decreasing her gambling loss/expenses to be no more than the gambling income. The IRS approved this but then no determination was necessary. (A. 95,96)

But, although Busch disagrees with the Commissioner, that the IRS's approval of the amended returns meant the IRS had not made a determination, Busch made it clear in her reply to the Commissioner's pre-trial memorandum this was not her position. Replying to the Commissioner, Busch stated that "[t]his argument is ludicrous. First, [Busch] amended her tax returns well after she appealed the Commissioner's Orders". (A. 145,146)

Obviously, there was a lack of careful consideration of the Tax Court in failing to see that Busch's taxable year 2001 had been audited by the IRS. This was discussed in Busch's pre-trial memorandum (A. 133) and Busch's Exhibit 19 (A. 98-103) of the IRS's audit was entered into the record.

Busch's position is that under Groetzinger and other ample legal authority there has been a Federal resolution of the issue in this case. The gambling activity of slot machine playing can be a trade or business and a gambler does not have to make a living off of the gambling activity in order for it to be a trade or business. And, in applying the facts of Busch's situation to the applicable legal authority, Busch's gambling activity of playing the slot was, indeed, a trade or business.

The Internal Revenue Service And The United States Tax Court Both Allow The Gambling Activity Of Slot Machine Playing To Be A Trade Or Business

Busch's choice of gambling was the slot machines. Like Taxpayer Groetzinger Busch had a less-than-successful result - a loss. The Commissioner disallowed Busch's gambling activity as a trade or business because:

- (1) the gambling activity of playing slot machines is excluded as an activity that can be a trade of business and
- (2) a gambler has to make a living off of a gambling

activity in order for the activity to be a trade or business. (A. 48,53)

Busch requested that the Commissioner provide her with legal authority substantiating the above reasons. (A. 59,60) Revenue Tax Specialist Eric Eide referred Busch to Auditor Makousky. (A. 61)

Busch never received any legal authority substantiating the Commissioner's position. But Tax Specialist Eide wrote Busch February 20, 2003, that "...it would be helpful if you could cite court cases, regarding slot machine players, specifically, in support of your position". (A. 64) Obviously this contradicted the Commissioner's determination that the gambling activity of playing the slot machines was excluded as an activity that could be a trade or business. At this time Busch was too ill to do this.

Although Tax Specialist Eide had referred Busch to Auditor Makousky for legal authority, at the trial Auditor Makousky testified that it was Tax Specialist Eide's responsibility to provide the legal authority. Makousky testified his job was just to audit. He was not an attorney. (T. 40,41) Neither one wanted the responsibility of providing legal authority that would substantiate the Commissioner's determination.

Further, Auditor Makousky testified that it was Tax Specialist Eide who made the determination that Busch's

gambling activity was not a trade or business but a recreational or leisure activity:

Yeah, that was his determination. I guess he agreed with what was on my audit report, that it didn't constitute a trade or business, that it was a recreational or leisure activity.  
(T. 41-42)

Again, obviously, Auditor Makousky, who was not an attorney, made the determination. Tax Specialist Eide just agreed with the determination. Makousky testified that his determination was based on the type of gambling Busch was involved in - slot machines. (T. 40)

Makousky testified that the Commissioner's position had not changed in that (1) the gambling activity of playing slot machines is excluded as an activity that can be a trade or business and (2) a gambler has to make a living off of a gambling activity in order for the activity to be a trade or business. (T. 45,46)

Makousky testified that, because of his job with the Department of Revenue, he had been involved with hundreds of gamblers. And he had also had the experience of playing a slot machine one time. So one of the considerations was the unrealistic expectation of profit. (T. 35,36) Makousky testified, in fact, a person involved in a trade or business could probably have a loss if "...if there was any realistic expectation they could make a profit". (T. 41)

Particularly because of the alternative minimum tax, Makousky further testified that in his 21 years of employment with the Department of Revenue no one had been approved to

be in the trade or business of any type of gambling. (T. 42)

Obviously Auditor Makousky was waffling in his testimony. Auditor Makousky testimony was that if one has an unrealistic expectation of profit in an activity the activity can not be a trade or business. Therefore, in the gambling context, the Commissioner applies the "unrealistic expectation of profit" test and excludes the gambling activity of slot machine playing allowed as a trade or business.

But more important, Auditor Makousky's testimony puts the Department of Revenue's position in a more proper perspective. Regardless of legal authority, not only the activity of playing the slot machines but of all gambling activities, never in his 21 years of employment with the Department of Revenue has any taxpayer been approved to be the trade or business of gambling. Particularly because of the alternative minimum tax. (T. 42)

Contrary to the Tax Court's conclusion there has been no Federal resolution of the issue before the court, there has been Federal resolution.

Reiterating, in Groetzing, the United States Supreme Court addressed the issue of gambling as a whole in regard to a trade or business. Taxpayer Groetzing was involved in parimutual wagering. The Court equally considered the playing of slot machines, as well as other types of gambling. (see Groetzing, footnote 11) And the Court did not

require that either a trade or business provide a living or have a realistic expectation of profit.

Both the IRS and the United States Tax Court allow the gambling activity of slot machine playing to be a trade or business.

1. In Praytor v. Commissioner of Internal Revenue, T.C. Memo 2000-282, the taxpayer played the slot machines and described himself as a "Professional Gambler" who was in the trade/business of gambling and reported the gambling income on Schedule C of his Federal return. The IRS allowed the taxpayer slot machine playing to be a trade/business. The dispute before the United States Tax Court was whether the taxpayer could take losses in excess of gain. Section 165(d) of the Internal Revenue Code restricts gambling losses to gambling winnings.

2. In Kochevar v. Commissioner of Internal Revenue, T.C. Memo 1995-607, the taxpayers again filed a Schedule C stating they were in the business of being professional slot machine players. The IRS accepted the taxpayers' position. Again the United States Tax court disallowed gambling losses above gambling gains.

3. In Alberico v. Commissioner of Internal Revenue, T.C. Memo 1995-542, the United States Tax Court found taxpayer to be a professional gambler. Petitioner gambled at dog racing tracks and played the slot machines. It was the taxpayer's record keeping that was an issue in this case.

4. In Lutz v. Commissioner of Internal Revenue, T.C.

Memo 2002-89, taxpayers played the slot machines but did not claim to be in the trade or business of gambling. However, the Court, in its opinion, did indicate that a slot machine player is not excluded as being allowed to be in a trade or business of gambling. The primary issue in this case is the taxpayers' record keeping in regard to their recreational gambling.

5. And whereas, pursuant to Internal Revenue Code Section 7463(b), a summary opinion may not be treated as a precedent, the United Tax Court in both Neymeyer v. Commissioner of Internal Revenue, T.C. Summary Opinion 2002-120 and Erbs v. Commissioner of Internal Revenue, T.C. Summary Opinion 2001-85 taxpayers were slot machine players and the Court considered the issue whether taxpayers' gambling activity constituted a trade or business.

6. Lastly, the Internal Revenue Service has approved Busch's gambling activity as a trade or business for the taxable years 2000 and 2001.

It is clear that the gambling activity of slot machine playing is a gambling activity that can be a trade or business. It is also clear that, like taxpayer Groetzinger, one does not have to make a living off of a gambling activity to be a trade or business. None of the taxpayers in the above cases made a living from their gambling activity.

In an attempt to cooperate and settle the issue whether

the gambling activity of playing the slot machines could be a trade or business; Busch gave the Commissioner's attorney the names of the Praytor, Kochevar and Neymeyer cases.

(See also Busch's Exhibit 13, A. 64 where the Commissioner requested the cite of cases involving slot machine players)

The Commissioner cited these cases in its pre-trial memorandum as examples that "No recent federal decision considering these issues has adopted the position urged by [Busch]. In varying contexts, most of these cases have upheld the Commissioner's disallowance of claimed gambling losses." (A. 142) The Commissioner presented to the court an analysis of the cases that was incorrect and intended to mislead the court.

In Praytor and Kochevar the IRS allowed the taxpayers, slot machine players, to be in a trade or business. The taxpayers were allowed to subtract their losses on Schedule C of their Federal returns but only up to their winnings as per Section 165(d) of the Internal Revenue Code. The issue before the Court was whether gambling losses could be deducted that exceeded the gambling winnings. They could not.

In Neymeyer the taxpayers' loss was not disallowed. But because the taxpayers, again, slot machine players, were found to be recreational slot machine players their loss was not disallowed but deductible as a itemized miscellaneous deduction on Schedule A of their Federal return. (A. 147,

148)

The Commissioner has never provided any legal authority substantiating its position. Even after the Tax Court trial the Commissioner submitted to the Tax Court the case Anderson v. Commissioner of Revenue, No. 7261-R (Minn. T.C. April 25, 2001). The case is not relevant to the issue in this case. The taxpayers challenged on public policy grounds the application of the alternate minimum tax on recreational gambling losses. (A. 151-154)

**Busch's Purpose for Engaging In Her Gambling Activity Was For Income Or Profit**

Busch's gambling activity was for income or profit. The Commissioner does not dispute this. "Ms. Busch did spend considerable time at Mystic Lake, and doubtless hoped that her slot machine play would prove profitable." (A. 141) "She was gambling and she spent time at it and she was hoping to make money at it..." (T. 18)

Auditor Makousky did not dispute that Busch was gambling for a profit. However, Makousky testified that the denial of allowing Busch's gambling of slot machines to be a trade or business was because the Busch's "expectation of profits" was not realistic. Makousky testified that as an auditor for the Department of Revenue he had seen hundreds of taxpayers involved in gambling and typically they reported their losses as an itemized miscellaneous deduction on Schedule A of their Federal return. (T. 36,41)

Makousky testified that, because of the above, and because of his personal experience of only gambling a few times, he knew that he would not profit. And he testified that, although he was not an expert on whether everyone felt that way, he testified they probably did after gambling a few times. (T. 46)

The Tax Court did say that the Commissioner could reasonably conclude that Busch was not engaged in the trade or business of gambling. The Tax Court too expressed its feelings that playing slot machines involved strictly a

matter of chance and the expectation of profit was unrealistic. It was "wishful thinking". (A. 9)

However, the Tax Court concluded that Busch had not overcome the presumptive validity of the Commissioner's determination, not because she had an unrealistic expectation of profit, but because (1) there had been no federal resolution of the issue before the court and (2) because the IRS had not taken any action on Busch's federal returns for the years in question. (A. 9)

But contrary to the Commissioner's position that a realistic expectation of profit is required of a trade or business, "[a]n activity is engaged in for profit if the taxpayer entertained an actual and honest, even though unreasonable or unrealistic, profit objective in engaging in the activity." Ranciato v. Commissioner of Internal Revenue, 52 F.3d 25 (2nd Cir. 1995) (quoting Cambell v. Commissioner, 868 F.2d 833, 836 (6th Cir. 1989))

Further, the United States Tax Court has found that "[t]he taxpayer's expectation of profit need not be reasonable, but it must be bona fide." Tinnell v. Commissioner of Internal Revenue, T.C. Memo 2001-106 (citing Golanty v. Commissioner, 72 T.C. 411, 425-426 (1979), affd. without published opinion 647 F.2d 170 (9th Cir. 1981))

The Internal Revenue Code regulations are also clear that a reasonable expectation of profit is not required.

Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into

the activity, or continued the activity, with the objective of making a profit.  
Section 1.183-2(a), Income Tax Regs.

The taxpayer's expectation of profit need not be reasonable, but he or she must have a good faith objective of making a profit. Allen v. Commissioner, 72 T.C. 28,23 (1979); sec. 1.183-2(a), Income Tax Regs.

There is no dispute that Busch actually and honestly believed that her gambling activity of playing the slot machines would be profitable. When that belief ended Busch's gambling also ended.

While a person may start out with a bona fide expectation of profit, even if it is unreasonable, there is a time when, in light of the recurring losses, the bona fides of that expectation must cease. See Filios v. Commissioner, 224 F.3d 16 (1st Cir. 2000), affg. T.C.Memo 1999-92

Again, the Commissioner did not produce any legal authority for its position that a realistic expectation of profit is required.

Instead the Commissioner ignored case law that contradicted the Commissioner's position. And the Tax Court has followed the same course.

**The IRS's Audit of Busch's Gambling Activity For the Taxable Year 2001 is Conclusive for Minnesota Tax Purposes.**

"Minnesota law is clear that the federal adjusted gross income figure agreed upon between a taxpayer and the IRS after audit is conclusive on the taxpayer." DeBoer v. Commissioner of Revenue, Dkt. No. 6712 (Minn. Tax Ct. October 27, 1997) citing Yocum v. Commissioner of Revenue, Dkt. No. 5497 (Minn. Tax Ct. January 22, 1992); Bonseigneur v. Commissioner of Taxation, Dkt. No. 864 (Minn. Tax Ct. July 9, 1975); Moody, et al v. Commissioner of Taxation, Dkt. No. 1521 (Minn. Tax Ct. Feb. 26, 1975); Dalrymple v. Commissioner of Taxation, Dkt. No. 1481 (Minn. Tax Ct. June 17, 1970); Wahlberg v. Commissioner of Taxation, Dkt. No. 1503 (Minn. Tax Ct. May 13, 1970).

On September 14, 2004, the IRS did a thorough and complete in-depth audit on Busch's taxable year 2001 Federal return. (A. 98-103) The primary focus was Busch's gambling activity, i. e., gambling income of \$972,980, gambling expense of \$1,161,824 and the reasons for treating the gambling activity as a trade or business on Schedule C. (A. 100) With just a minor change, which Busch agreed to, there was no tax liability and the IRS approved Busch's gambling activity as a trade or business and allowed it to remain as reported on Schedule C. (A. 100a-103)

Again, trying to cooperate, Busch informed the Commissioner's attorney of this audit and mailed all the copies of the audit to him. It was ignored.

The Tax Court, also, ignored the IRS's audit of Busch's taxable year 2001 return and concluded:

The Commissioner is not barred from determining that Appellant is liable for alternative minimum income taxes and interest for the 1999, 2000, and 2001 taxable years because the IRS has taken no action on her federal returns for those years. There has been no federal resolution of the issue now before us. Appellant has not overcome the presumptive validity of the Commissioner's determination that she was not engaged in the trade or business of gambling during the years at issue. For these reasons, we affirm the Commissioner's Order. (A. 9)

The IRS did take action on Busch's gambling activity. The IRS did a thorough and in-depth audit of Busch's gambling activity for the taxable year 2001. The Commissioner is barred from determining that Busch is liable for alternative minimum income taxes and interest for the year 2001.

The Tax Court, without careful consideration, merely agreed with the Commissioner and found that Busch argued that the IRS's approval of her 2000 and 2001 amended Federal tax returns foreclosed the Commissioner's assessment for those years. (A. 6) Never was this Busch's argument. The Tax Court neglected the IRS audit of Busch's taxable year 2001 return.

Busch filed her gambling activity on Schedule C as a trade or business on her original 2001 Federal return. Busch's only change on her 2001 Federal amended return was to comply with Internal Revenue Code Section 165(d) that allowed losses from wagering transactions only to the extent

of the gains from such transactions. (A. 86-94)

However, the Commissioner should also be barred from determining that Busch is liable for alternative minimum income taxes and interest for the year 2000. Contrary to the Commissioner's position, which the Tax Court agreed with, that the IRS took no action on Busch's amended return, the IRS did take action. The IRS determined the amended return was correct and Busch was refunded \$1,256.00 plus interest of \$241.58. The IRS is not overly generous.

Furthermore, the IRS audit of Busch's 2001 return is reflective of what the result would be with an IRS audit of Busch's 2000 return. Busch has also shown through both the facts and law that her 2000 year amended return was correct.

### Conclusion

The Tax Court affirmed the Commissioner's orders that Busch, whose gambling activity was playing the slot machines, was not allowed to be in the trade or business of gambling. The Commissioner's orders said (1) the gambling activity of playing the slot machines was excluded as an activity that could be a trade or business and (2) a gambler had to make a living off of the gambling activity in order for the activity to be allowed as a trade or business.

During the Tax Court trial Auditor Makousky testified there had to be a realistic expectation of profit and there was none with playing slot machines. Auditor Makousky further testified that, particularly because of the alternate minimum tax, no one, in his 21 years of employment with the Department of Revenue, had been approved to be the trade or business of gambling.

The Commissioner's Orders are prima facie correct and valid. Minn. Stat. s271.06, subd. 6 and s289A.35 and the burden is on the Relator to establish that the amounts on the Orders are incorrect. Minn. Stat. s289A.37, subd. 3. An Appellant, by introducing substantial proof, may overcome the prima facie validity of the amounts shown in the Order. The Court's determination is then based on the preponderance of the evidence. Groth v. Commissioner of Revenue, Dkt. No. 6909 (Minn. Tax Ct. May 24, 1999) (citing Ista v.

Commissioner of Revenue, Dkt. No. 6731 (Minn. Tax Ct. Nov. 26, 1997))

In affirming the Commissioner's Orders, the Tax Court concluded that Busch had not overcome the presumptive validity of the Commissioner's determination. The IRS had not taken any action on Busch's federal returns for the years in question. And, there had been no federal resolution of the issue before the Court. The Tax Court's conclusion was made without the proper consideration of the facts and the law and without impartiality.

Busch did introduce substantial proof which the Tax Court neglected and which should have overcome the presumptive validity of the Commissioner's determination.

First, the IRS did take action on Busch's 2001 Federal return. The IRS did a thorough and in-depth audit of Busch's gambling activity - the issue before the court. Not only was the evidence of this audit put in the record but the Commissioner was also aware of this audit. Contrary to the Tax Court's belief, which merely reflected the Commissioner's belief, the IRS did take action on Busch's 2000 amended return. The IRS made a determination that Busch's gambling activity was allowed as a trade or business reportable on Schedule C and refunded to Busch \$1,256.00 plus interest of \$241.58.

Second, there has been a federal resolution of the gambling issue before the court. Busch's pre-trial

memorandum specifically referred to legal authority that allows the gambling activity of slot machine playing to be a trade or business and that does not require a gambler make a living off of a gambling activity in order for it allowed as a trade or business. Further, Busch specifically provided legal authority that allows one to have an unrealistic or unreasonable expectation of profit of an activity and the activity is still allowed as a trade or business.

The Commissioner has ignored and arbitrarily refused to follow applicable law in not allowing Busch's gambling activity to be a trade or business particularly because of the alternate minimum tax.

The Tax Court followed the course of the Commissioner. The Court did not properly consider the case at issue by disregarding evidence and applicable law.

Relator, Estelle Busch, respectfully requests that this Court Reverse the Tax Court's Order for Judgment against Relator.

Respectfully submitted this 15<sup>th</sup> day of July 2005.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).