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State of Minnesota
In Supreme Court

Estelle Busch,

Relator,

v.

Commissioner of Revenue,

Respondent.

RELATOR'S REPLY BRIEF

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TABLE OF CONTENTS

Table of Contents.....	i
Table of Authorities.....	ii
Relator's Reply to Respondent's Statement of Facts.....	1
Relator's Reply to Respondent's Argument That:	
I. The IRS's action do not foreclose the Commissioner's assessment in this case.	4
Relator's Reply to Respondent's Argument That:	
II. The Tax Court correctly affirmed the Commissioner's disallowance of gambling losses in computing Relator's Minnesota AMT liability.	7
Conclusion	10

TABLE OF AUTHORITIES

<u>STATUTES</u>	<u>Page No.</u>
<u>State</u>	
Minn. Stat. s271.06, subd. 6	10
Minn. Stat. s289A.35	10
Minn. Stat. s289A.37, subd. 3	10
<u>Federal</u>	
I.R.C. s165(d)	9
<u>MINNESOTA CASES</u>	
<u>Bond v. Commissioner of Revenue,</u> 691 N.W.2d 831 (Minn. 2005)	6
<u>DeBoer v. Commissioner of Revenue, Dkt. No. 67712</u> (Minn. Tax Ct. October 27, 1997)	5,7
<u>Groth v. Commissioner of Revenue, Dkt. No. 6909</u> (Minn. Tax Ct. May 24, 1999)	11
<u>Ista v. Commissioner of Revenue, Dkt. No. 6731</u> (Minn. Tax Ct. Nov. 26, 1997)	11
<u>Specktor v. Commissioner of Revenue,</u> 308 N.W.2d 806 (Minn. 1981)	6
<u>Weed v. Commissioner of Revenue,</u> 550 N.W.2d 285 (Minn. 1996)	6
<u>Yocum v. Commissioner of Revenue, Dkt. No. 5497</u> (Minn. Tax Ct. January 22, 1992)	5,7
<u>UNITED STATES SUPREME COURT</u>	
<u>Commissioner of Internal Revenue v. Groetzinger</u> 480 U.S. 23 (1987)	7,8,12
<u>UNITED STATES TAX COURT</u>	
<u>Erbs v. Commissioner of Internal Revenue,</u> T.C. Memo 1995-607	10
<u>Kochevar v. Commissioner of Internal Revenue,</u> T.C. Memo 1995-607	9

<u>Neymeyer v. Commissioner of Internal Revenue,</u> <u>T.C. Summary Opinion 2002-120</u>	10
<u>Panages v. Commissioner of Internal Revenue,</u> <u>T.C. Summary Opinion 2005-3</u>	10
<u>Praytor v. Commissioner of Internal Revenue,</u> <u>T.C. Memo 2000-282</u>	9

RELATOR'S REPLY TO RESPONDENT'S STATEMENT OF FACTS

1. Respondent (Commissioner) states that Paul Makousky, who conducted the audit on Relator's (Busch) returns determined that Busch's gambling activity of playing the slot machines was a hobby or recreation. (Resp. brief 7) Makousky testified he is not an attorney (Tr. 40) and it was not job to make the determination. (Tr. 41)

Q. Who wrote up the determination, you or Mr. Eide:

A. Mr. Eide wrote up the determination.

Q. So, basically, you just audited it, then?

A. Yeah, the two are distinctly different jobs within the department. (Tr. 40,41)

Based on his personal experience of playing slot machines a couple of times, (Tr. 46) Makousky felt that there was an unrealistic expectation of profit in playing the slot machines and, therefore, the gambling activity of playing slot machines could not be a trade or business. (Tr. 41)

The Audit Reports/Orders disallowed Busch's gambling activity as a trade or business for two reasons:

1. Playing slot machines is excluded as a gambling activity of a professional gambler.

2. A professional gambler is only one who makes a living off of a gambling activity. (Rel. A 45-58)

Makousky testified the Commissioner's above position had not changed. (Tr. 45)

2. Busch did not testify in her behalf at the Tax Court trial. (Tr. 5,6) The court did not encourage this and stated it was familiar with Busch's position through her pre-trial memorandum. The trial then was commenced with the Commissioner's cross examination of Busch. (Tr. 6) After the Commissioner concluded a brief cross examination of Busch and rested (Tr. 16-18) the court encouraged the Respondent to further cross exam Busch. (Tr. 18,19) Busch was then cross examined about her knowledge about slot machines and what articles she had read. (Tr. 23-31) Busch was confused about the relevancy of the questions and said "I guess you're asking about this -- is it your position now that a slot machine player can be in the trade or business? Have you invalidated your previous position?" (Tr. 27,28) This response was "I hope we haven't done that. (Tr. 28)

The Commissioner stated in his statement of facts that Busch testified that she read "some" published material concerning slot machine play, produced no examples, could not remember where they were read. (Resp. Brief 5) In fact Busch testified she had read "many" articles (Tr. 28) and never testified that she could not remember where they were read.

3. On September 14, 2004, the IRS did a thorough and in-depth audit on Busch's taxable year 2001 return. (Rel. A 98-103) The primary purpose of the audit was Busch's gambling activity and the reasons why Busch was

treating the gambling activity as a business and reporting it on Schedule C of her Federal return. (App. A 100) Busch informed and sent copies of this audit to the Commissioner. Busch included this audit information in her pre-trial memorandum (Rel. A. 133-135) The audit information was put into the record as Exhibit 19 (Tr. 16)

Until now the Commissioner has been silent about this audit. The Commissioner was silent about it in his pre-trial Tax Court memorandum. The Commissioner was silent about the audit at the Tax Court trial and did not raise any questions concerning this audit at the Tax Court trial.

4. The Commissioner states in his statement of facts that the Tax Court upheld the Commissioner's determination that Busch's gambling activity was not a trade or business. But contrary to what the Commissioner states as the reason:

Typically, a taxpayer's carrying on of a trade or business coincides with the taxpayer's expenditure of skill or effort to accomplish a particular task. ... In the gambling context, this task is the maximization of profits. ... [A]nyone who goes out and gambles does so with the expectation---or at least the hope---she will win. But being engaged in a trade or business involves more than wishful thinking; the expectation of making a profit must be a realistic one. Appellant's use of slot machines, however, involved strictly a matter of chance. (Resp. brief 8)

The Tax Court's conclusion was:

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. (Rel. A 9)

This conclusion could only be arrived at by the Tax Court's complete disregard of both Busch's pre-trial memorandum, Exhibit 19, i.e., the IRS's audit of Busch's tax year 2001, as well as the applicable legal authority.

RELATOR'S REPLY TO RESPONDENT'S ARGUMENT THAT:

I. The IRS's actions do not foreclose the Commissioner's assessment in this case.

The Commissioner argues that Busch seeks to "...bar the the Commissioner from basing an assessment on a claim with respect to which the IRS has taken no action." (Resp. brief 12) The Commissioner's argument is preposterous. The IRS did a thorough and in-depth audit of Busch's taxable year 2001 return. The primary issue in this audit was Busch's gambling activity and the reasons why the gambling activity was reported as a trade or business on Schedule C of Busch's Federal return. (Rel. A 100) The IRS approved this area of its audit and no change was necessary.

In an attempt to bolster its position, the Commissioner attempts to deny, or at the most minimize, the IRS's audit of Busch's gambling activity. Busch has not, as the Commissioner argues, significantly overstated the audit. The audit was indeed thorough and in-depth. (Resp. brief 12) Obviously, as the Commissioner states, "[t]he IRS auditor raised at one point the question of whether Ms.

Busch could justify her claim to be in the business of gambling." (Resp. brief 13) And obviously the auditor concluded that Busch did justify her claim to be in the business of gambling because the auditor accepted that Busch's gambling activity was reportable on Schedule C of her federal return and no change was required.

The Commissioner argues that the IRS took "no action" on Busch's gambling winnings or losses and there has been no federal resolution - administrative or judicial - of the issue before this court. The Commissioner is incorrect. The IRS took action through the audit of this this issue and made a decision that Busch's gambling activity was correctly reported.

Yocum v. Commissioner of Revenue, Dkt. No. 5497 (Minn. Tax Ct. January 22, 1992) and DeBoer v. Commissioner of Revenue, Dkt. No. 67712 (Minn. Tax Ct. October 27, 1997) are both applicable to this case. The resolution of an issue audited by the IRS, if agreed upon by the taxpayer, is conclusive for Minnesota tax purposes.

The Commissioner's argument that because a gambling activity is no longer affected by the Federal AMT, the IRS has no occasion to determine whether the gambling activity is a trade or business or recreational (Resp. brief 12) is absurd. This was not the case in Busch's IRS audit. (Rel. A 98-103) The IRS and the United Tax Court does not hesitate to deny a taxpayer to be in the trade or business

of gambling if in fact the taxpayer does not qualify.

The Commissioner's argument is ludicrous.

Finally, the Commissioner argues "[t]he principles of Bond, Weed, and Specktor control this aspect of the case at bar." (Resp. brief 12) Although the Bond case is recent the principle of the case is not recent. Bond v. Commissioner of Revenue, 691 N.W.2d 831 (Minn. 2005) citing Specktor v. Commissioner of Revenue, 308 N.W.2d 806 (Minn. 1981) and Weed v. Commissioner of Revenue, 550 N.W.2d 285 (Minn. 1996)

The taxpayer in Barr claimed to have set up an individual Social Security trust. The taxpayer's Federal return, let alone the trust issue, had not been audited by the IRS. Therefore there had been no Federal resolution. Consequently, the Commissioner was not collaterally estopped from doing its own independent investigation of the taxpayer. The Bonn court in rejecting that federal gross income was controlling followed Spector authority that a taxpayer's federal return not audited by the IRS does not foreclose an independent state audit and redetermination of state taxes.

The court held in Barr that the taxpayer's purported Social Security trust had no basis in law or fact. The purpose of the trust was to avoid tax liability and the taxpayer's return was frivolous.

However the Barr case is not authority for the arbitrary assessment of taxes on a legitimate claim that

does have a basis in law or fact. Nor does the Barr case overrule the legal authority of Yocum and DeBoer. The federal resolution of an issue through audit by the IRS, if agreed on by the taxpayer, is conclusive for Minnesota tax purposes.

RELATOR'S REPLY TO RESPONDENT'S ARGUMENT THAT:

II. The Tax Court correctly affirmed the Commissioner's disallowance of gambling losses in computing Relator's Minnesota AMT liability.

Oveiously the pertinent case in regard to treating a gambling activity as a trade or business is Commissioner of Internal Revenue v. Groetzinger 480 U.S. 23 (1987). The Commissioner argues that Busch's assertion that her gambling activity meets all the criteria to qualify her gambling activity as a trade or business is not valid.

First, although the Commissioner has agreed that Busch's gambling activity was for profit, (Resp. brief 15) the Commissioner now attempts to argue that because Busch's gambling activity was not profitable, she was not earning a livelihood from her gambling activities. Therefore, the Commissioner argues that Busch was not in the trade or business of gambling. (Resp. brief 14,15)

True Busch's gambling activity was less than successful as was taxpayer Groetzinger's gambling activity. Consequently neither Busch nor taxpayer did earn a livelihood from their respective gambling activities. Nor have other

taxpayers found to be in the trade or business of gambling by the IRS and the United States Tax Court.

The Commissioner continues to argue that the gambling activity of playing slot machines can not be a trade of business. (Resp. brief 15) The Commissioner refuses to accept the applicable legal authority. Perhaps, better said, the Commissioner refuses any type of gambling activity to be a trade or business. In response to the question to auditor Makousky "[s]o, in 21 years, [of his employment with the Department of Revenue] no one has been approved, supposedly, from the Department of Revenue to be in the trade of business [of gambling]." Makousky answered "[n]ot that I've seen. And particularly because of the alternative minimum tax" (Tr 42)

Never as the Commissioner offered any legal authority for his position. The Commissioner is either unaware of or refuses to accept or follow legal authority that allows the gambling activity of playing the slot machines to be a trade or business. The Supreme court in Groetzinger in deciding the issue of a gambling activity as a trade or business not only was considering taxpayer Groetzinger's parimutuel wagering on dog races but also specifically in its footnote 11 not only noted parimutuel betting but slot machines as well.

The United States Tax Court and the IRS both accept that the gambling activity of playing the slot machines

can be a trade or business. The Commissioner argues that:

None of the recent federal decisions on which Relator relies (Rel. Br. 26-28) supports her position. In varying contexts, these cases have upheld the IRS's disallowance of claimed losses. (Resp. Br. 15,16)

Contrary to the Commissioner's assertion and the Tax Court's dicta, these cases do support Busch's position. The taxpayers in all of these cases were slot machine players. In both Praytor v. Commissioner of Internal Revenue, T.C. Memo 2000-282 and Kochevar v. Commissioner of Internal Revenue, T.C. Memo 1995-607, the IRS found the taxpayers to be in trade or business of gambling. The United States Tax Court only disallowed deductions of loss above gambling income per I.R.C. s165(d). The IRS only disallowed the taxpayers' losses in excess of the gambling incomes. And these taxpayers did not earn a living from their gambling activities.

The Commissioner would like the court to believe that the IRS had no occasion to make a determination of whether Busch was in the trade or business of gambling. The Commissioner argument is that "[u]nder current federal law, the question whether a taxpayer is engaged in the trade or business of gambling has no general effect on the taxpayer's federal AMT liability". (Resp. brief 12)

Contrary to this argument of the Commissioner, the IRS did "take the occasion" to determine whether Busch's gambling activity was a trade or business. (Rel. A 100) The IRS also did "take the occasion" to determine whether

the taxpayers in Erbs v. Commissioner of Internal Revenue, T.C. Summary Opinion 2001-85, Neymeyer v. Commissioner of Internal Revenue, T.C. Summary Opinion 2002-120 and Panages v. Commissioner of Internal Revenue, T.C. Summary Opinion 2005-3. (Resp. brief 16) The IRS's audits of these taxpayers' returns resulted in the IRS's denial of the taxpayers' claims that they were in the trade or business of gambling. However, as the Commissioner asserts, the taxpayers were not disallowed to take their gambling losses. The losses were deductible as a miscellaneous deduction on Schedule A of their federal returns.

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 were (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 for the activity to be allowed as a trade or business.

The Commissioner's Orders are prima facie correct and valid. Minn. Stat. s271.06, subd. 6 and Minn. Stat. s289A.35. The burden is on the taxpayer 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 facia 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 Tax Court concluded there had not been 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 issue on the appeal is whether the Tax Court properly held that Relator had not overcome the presumptive validity of the Commissioner's assessment." (Resp. brief 13)

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

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 this court. The Commissioner was aware of this audit. This audit was also put into the record through Busch's pre-trial memorandum and Exhibit 19. And contrary to the Tax Court'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 to be reported as a trade or business and approved the change of the loss deduction reported on Schedule A, as a miscellaneous Deductions, to Schedule C as a business..

However, if as the Commissioner argues, the IRS's approval of Busch's taxable year 2000 is merely "inaction", Busch's claim of being the the trade or business for the taxable year is still correct. All the requirements of Groetzinger have been met. The facts are not in dispute. The issue is whether there is applicable law to support the facts.

Busch has provided the applicable legal authority both in her initial brief and this reply brief. The Commissioner has ignored and arbitrarily refused to follow the applicable legal authority and the Tax Court followed the course of the Commissioner either as an oversight or 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 26th day of August 2005.

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