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INTERNAL REVENUE SERVICE MAKES DETERMINATION REGARDING TAX LIABILITY FOR DAILY FANTASY SPORTS OPERATORS AND POTENTIAL WRITE-OFFS FOR PLAYERS

by Taylor A. Anello and Peter J. Kulick

In recent months, the Office of Chief Counsel of the Internal Revenue Service (“IRS”) has published guidance concluding that Daily Fantasy Sports (“DFS”) contests are wagering transactions for U.S. federal tax law purposes. The IRS conclusions were not surprising, based on long-standing federal tax law authorities. On July 23, 2020, the IRS issued Legal Advice by Associate Chief Counsel (the “Memorandum”) addressing the applicability of wagering excise taxes to DFS operators. In the Memorandum, the IRS concluded:

1. A DFS operator is liable for the excise tax on wagers under Section 4401 of the Internal Revenue Code of 1986, as amended (“IRC”).
2. A DFS operator is liable for the wagering business occupational excise tax of IRC § 4411 and is required to register as a person liable for the excise tax on wagers under IRC § 4412.
3. The rate of tax IRC § 4401(a) imposes on wagers accepted by a DFS operator depends on whether the wager is accepted in a state in which the wager is authorized. The rate of occupational tax IRC § 4411 imposes on a DFS operator depends on whether the DFS operator accepts only state-authorized wagers under IRC § 4401(a)(1).
4. Relying on IRC § 4401(a) and common law, the IRS construed the DFS entry fees to constitute both “wagers” with respect to a sports event or contest and a “wager” placed in a “wagering pool” with respect to a sports event or contest.

On October 16, 2020, the IRS released Chief Counsel Advice dated September 14, 2020 (CCA 202042015, Oct. 16, 2020), addressing the deductibility of DFS entry fees paid by contest participants. The deductibility of an expense is subject to a variety of limitations and requirements under the federal income tax law. Courts had previously limited the deductibility of gambling losses to gambling gains for those in the “business of” wagering. Non-wagering expenses of a gambling business were not subject to the limitation. Upon the enactment of the Tax Cuts and Jobs Act of 2017, Congress expanded the limitation of the deduction for gambling losses to include all losses from “wagering transactions.” Faced with the question of whether DFS entry fees were amounts paid for “wagering transactions,” the IRS

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readily concluded in the affirmative. CCA 202042015 took the analysis a step further by thoroughly analyzing whether DFS was, in fact, gambling for federal tax law purposes. The IRS applied the typical three-part test for “gambling” (chance, consideration, and prize). The IRS rejected the notion that DFS was, alternatively, a game of skill or a game predominantly of skill. The IRS observed that whatever skill may be involved with selecting players, “the taxpayer’s skill has no impact on the players’ live performance.” Thus, chance dominates the outcome of the contest.

For DFS contest participants, CCA 202042015 means that any DFS entry fees will be subject to the limitations on deductions of IRC § 165(d). More broadly, CCA 202052015 represents the IRS view that DFS is a gambling business.

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