

Supreme Court reconfirms gambling and lottery expenses are not deductible from winnings 3/37/24



Consultant, Tax, PwC Latvia
Aleksandrs Afanasjevs



Senior Consultant, Tax, PwC Latvia
Madara Hmelevska

The end of the summer saw the Supreme Court rule on cases concerning the tax treatment of income from various entertainment services. Just like income from live streaming of video games, winnings from participation in games of chance are high on the agenda when it comes to interpreting the relevant tax rules, which is causing disputes with the tax authority. One of these disputes involved the State Revenue Service (SRS) deciding to charge personal income tax (PIT) and late fees on an individual's unreported winnings from a company organising games of chance. The taxpayer sued the tax authority, and his appeal eventually landed in the Supreme Court. This article continues our MindLink series on Supreme Court rulings concerning the tax treatment of income from recreational activities and looks at a recent Supreme Court ruling.

Background

On 27 August 2024 the Supreme Court heard Administrative Case No. A420144321 concerning a petition from an individual (the "petitioner") to overturn the SRS decision of 16 February 2021 charging PIT and late fees. The SRS found the petitioner had failed to report his winnings paid by Optibet SIA, a gaming operator, on his annual tax return for 2019 and failed to pay PIT.

The petitioner challenged the decision, claiming that the SRS had wrongly assessed tax on the total amount the operator had paid into the petitioner's bank account (EUR 38,315.96). The petitioner said the total amount paid into the account included a participation fee, which does not qualify as the gambler's income. So the appeal said that for PIT purposes the SRS should have deducted the petitioner's participation fee from the total amount and taxed the net or actual income only.

The petitioner also mentioned that the SRS had not used details of winnings paid into the petitioner's gaming account on the operator's digital platform. Because the petitioner had initially paid participation fees into his gaming account, from which he could afterwards pay into his bank account any money left unused as well as his winnings, the petitioner questioned the SRS's finding that the total amount paid into the bank account matched the money the petitioner had received from the operator in winnings.

The Supreme Court's opinion

The court agreed with arguments put forward in the Administrative Court's ruling and noted several key aspects that confirm the taxation of winnings under the PIT Act.

The definition of winnings and the PIT treatment

In its ruling the Supreme Court explains that the Gambling and Lotteries Act defines winnings as an amount of money the gaming operator pays out to the gambler under the rules of the game. So there is no dispute about all amounts received by gamblers being taxable. In this context the court also noted that a

set of rules that for tax purposes gave the right to deduct from winnings any expenses associated with participation in games, would not achieve the goal set by sections 8(3)(20.4) and 9(1)(5) of the PIT Act – to minimise the risk of addiction to gambling and lotteries. Allowing gamblers to deduct their participation fees and thus pay less or no tax would make games of chance more attractive and would not deter potential gamblers. The Supreme Court's opinion was also based on a negative fiscal effect, which along with less tax due would reduce revenues collected by the central and local government, and therefore the legitimate goal set by the law would not be achieved.

The Supreme Court reconfirmed that the net principle (income less expenses) is not applicable to income from gambling and lotteries in the light of the PIT Act's goals. The court refuted the petitioner's argument that the current rules can create a situation that is unfair to taxpayers, with the gambler having to pay tax on the money he has paid to take part in games of chance even if he receives no winnings or suffers a loss. The Supreme Court pointed out that gamblers should be aware of the likelihood of their real gains (winnings) being small or even less than their investment, as the payout structure should be specified in game rules available for everyone to read before they take part in those games. The Supreme Court effectively states that gamblers should expect to be taxed under the PIT Act even if they actually make a loss (the fee for taking part in the game is higher than the amount won).

Does the amount paid out comprise winnings only?

The ruling mentions that money gained from a game of chance was accumulated in the gaming account and paid into the gambler's bank account at his request. It was therefore crucial to determine during the hearing whether all the money paid out had been used to take part in games of chance.

Having evaluated the parties' arguments, the Supreme Court held that the SRS had wrongly treated the entire amount as taxable, because the SRS had not checked all the available data on the movement of funds and had ignored the fact that the gambler might also have received some money he never used to take part in games of chance.

The Supreme Court agreed with the petitioner that the SRS and the Regional Administrative Court had failed to provide sufficient evidence for their finding about the size of the taxable base, which the Supreme Court recognised as grounds for overturning the regional court's ruling and sending the case back for a new hearing.

Takeaways

The Supreme Court's ruling again provides clear guidelines for the taxation of gambling and lottery winnings. Although many gamblers are still unhappy about PIT not being charged on their real gains, the legal system has established the principle that gambling and lottery winnings are fully taxable, with any related expenses being ignored, and must be duly reported on the annual tax return in full.