

**Office of Chief Counsel
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Memorandum**

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subject: Applicability of Section 165(d) to Daily Fantasy Sports Transactions

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Does the amount paid by a daily fantasy sports player to participate in a daily fantasy sports contest constitute an amount paid for a wagering transaction under § 165(d) of the Internal Revenue Code?

CONCLUSION

The amount paid by a daily fantasy sports player to participate in a daily fantasy sports contest constitutes an amount paid for a wagering transaction under § 165(d).

STATEMENT OF FACTS

Daily fantasy sports (DFS) are a type of fantasy sports game that evolved over the last decade into a multi-million dollar industry. A traditional fantasy sports league is comprised of participants that select players from professional sports teams to create a “fantasy” team. The selection of professional players occurs during a “draft” held at the beginning of the season. Each professional player can only be selected once during the draft, but participants may drop, add, or trade players as they become available throughout the season. A schedule is created and each week fantasy teams compete

head to head. The winner of the match up depends on the statistical performance of each professional player in their respective real-life sports games that week.

DFS modified the traditional fantasy sports model to offer more flexible and fast paced competitions. Under the DFS model, participants are given a salary cap with which to select their fantasy team. Multiple participants can select the same professional players so long as they do not exceed the salary cap. Instead of drafting professional players for an entire season, the fantasy team exists for a single day or a single week. Once participants have created their teams, they may select from a variety of competitions including head to head competitions, cash games, guaranteed prize pools, and 50/50 competitions:

- Head to head competitions allow two players to challenge each other with the winner receiving the entire pool.
- Cash games include transactions within a league that identifies winners based on the best performing teams.
- Guaranteed prize pools are games that have a set entry fee to compete in a fixed prize pool, regardless of the number of entrants.
- 50/50 competitions involve a transaction in which the top 50% of performers nearly double their returns on investment while the other half receive nothing.

Each of these contests are structured as pay to play, with the participant submitting an entry fee for each contest, and the host website taking a commission from fees collected. Participants receive points based on the live performance of their selected players. The points for each player on the fantasy team are compiled for a final fantasy score that determines the winners of the match up.

LAW AND ANALYSIS

Section 165(d) allows taxpayers a deduction for losses from wagering transactions during a taxable year, but only to the extent of wagering gains. See also § 1.165-10 of the Income Tax Regulations. There is no statutory or regulatory definition for “wagering transactions” in § 165(d).

In the absence of a statutory or regulatory definition, a term’s “plain, obvious, and rational meaning” must be applied. See Liddle v. Commissioner, 103 T.C. 285 (1994); Boyd v. United States, 762 F.2d 1369 (9th Cir. 1985). In Tschetschot v. Commissioner, T.C. Memo 2007-38, for purposes of applying § 165(d), the Tax Court examined dictionary definitions of wager, including Random House College Dictionary’s definition of “something risked or staked on an uncertain event; bet; the act of betting,” in ultimately holding a poker tournament is a wagering activity. The Court also considered the following definition of wager from Black’s Law Dictionary:

Money or other consideration risked on an uncertain event; a bet or gamble. 2. A promise to pay money or other consideration on the occurrence of an uncertain event.

The Court stated that wagering, when used in the Internal Revenue Code (the Code), is synonymous with gambling. Id.

State courts note the definition of wager requires two or more parties, having mutual rights in respect to the money wagered, having a chance to win or lose upon the outcome of an uncertain event. See Las Vegas Hacienda, Inc. v. Gibson, 77 Nev. 25, 27, (1961); see also Robertson v. United States, 343 U.S. 711(1952); Toomey v. Penwell, 76 Mont. 166 (1926). In this way, a wager is distinguishable from a prize. Unlike a wager, State courts have found that a prize or reward is compensation for an act done. See Las Vegas Hacienda, 77 Nev. at 27 (The court held an offer to pay \$5,000 for shooting a hole in one to any golfer paying a small fee is a prize, not a wager); Toomey v. Penwell, 76 Mont. at 172-173 (Requiring owners to pay entry fees to enter their horses in a race does not constitute a wager, and the purse money awarded to the winner is a prize).

DFS transactions meet the definition of wager as interpreted by the Tax Court and State courts because there is an uncertain event (such as the live performance of individual players), winnings if the event resolves in participant's favor, and consideration is lost if the event does not resolve in participant's favor. Each DFS transaction is a pay to play competition with predetermined winnings for a certain number of participants. The outcome of the competition turns on the overall statistical performance of live professional players assembled into the fantasy team. The winning participant receives a return of his or her initial bet along with wagering gains, while the losing participant walks away empty handed. This is consistent with the courts' interpretation of the term "wager."

It may be argued that DFS is not wagering because it is a contest of skill. As a general rule, a contest in which a prize is offered based on the mental or physical skill of the contestant is not considered gaming. The fact that each contestant is required to pay an entrance fee does not make the payment a bet or gaming transaction unless the entrance fees alone consist of the winnings to be won by the successful contestant. See Rev. Rul. 57-521, 1957-2 C.B. 779. Revenue Ruling 57-521 examined a puzzle contest in which contestants submitted solutions with a fee per submission to play and concluded that the puzzle game was not a wagering pool or lottery under the excise tax provisions of § 4421 because the outcome relied entirely on the contestant's skill in completing the puzzle. The Service later distinguished this type of contest as a game of skill from poker tournaments which are considered wagering. See Tschetschot v. Commissioner, T.C. Memo 2007-38; see also Gustafson v. Alloyd Co., 513 U.S. 561, 570 (1995) (Generally, an Act of Congress should not be read as a series of unrelated and isolated provisions); Atl. Cleaners & Dyers v. U.S., 286 U.S. 427, 433 (1932) (There is a presumption that identical words used in different parts of the same act are intended to have the same meaning; however, this is not absolute, and the same term may be interpreted differently

when reasonably warranted). DFS transactions are similar to poker and other wagers in which a player's skill is a component of the game but it does not dictate the outcome. As such, the argument that DFS transactions are excluded from wagering as a game of skill are unpersuasive.

It may also be argued that the DFS pay to play transactions are entrance fees for their team, comprised of players selected by the taxpayer based on knowledge and skill, to compete. However, the test is not whether there is an element of chance or skill, but which is the dominating element that determines the result of the game. See People ex rel. Ellison v. Lavin, 71 N.E. 753, 755 (N.Y. 1904). While skill may be involved in drafting the players of a team, the taxpayer's skill has no impact on the players' live performances. Further, DFS is not unlike pari-mutuel betting, long considered wagering, in which an individual uses knowledge and skill to choose which players or horses to select. See Lakhani v. Commissioner, 142 T.C. 151, 154 (2014) (pari-mutuel wagering is an event of chance). Although skill may be an element of the transaction, chance dominates the outcome of the transactions. See Mayo v. Commissioner, 136 T.C. 81, 91 (2011) (a wager is where a taxpayer stands to win or lose on the basis of chance); Rev. Rul. 83-130, 1983-2 C.B. 148 (a raffle ticket is a wager because it is the disposal by chance of a single prize among purchasers of single chances). Any argument a DFS transaction is not wagering because it is based on skill must fail because elements of chance beyond the participant's control ultimately determine the outcome of the transaction.

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Please call Elizabeth Boone at (202) 317-4677 if you have any further questions.