The State of New Hampshire

MERRIMACK, SS **SUPERIOR COURT**

David P. Eby, Leonard Willey and
All Others Similarly Situated

v.

State of New Hampshire

NO. 217-2010-CV-300

ORDER

This case is a putative class action brought by David Eby and Leonard Willey against the State of New Hampshire. Petitioners seek certification of a class that would presumably have two sub-classes; those who paid a gambling tax and those who are professional gamblers who paid a gambling tax. However, the parties have agreed to defer this issue of class certification until liability is decided. Both parties have moved for summary judgment. For the reasons stated in this Order, the State's motion is GRANTED in part and DENIED in part, and the Petitioner's motion is DENIED.

I.

Petitioners Eby and Willey seek declaratory relief, challenging the constitutionality of RSA 77:38, *et seq.* (Supp. 2010) (repealed effective May 23, 2011) (hereinafter "Gambling Winnings Tax"), which imposed a tax of 10 percent on gambling winnings. Petitioners seek a declaration that the statute is unconstitutional on its face and as applied to Petitioners, and seek a refund of taxes they have paid under the statute.

Certain facts are not in dispute. Effective July 1, 2009, the State of New

Hampshire instituted a gambling winnings tax. The statute provided for a tax of 10 percent on gambling winnings of New Hampshire residents from anywhere derived and gambling winnings of non-residents of New Hampshire derived from New Hampshire entities. RSA 77:39. The statute defines gambling winnings as "winnings from lotteries and games of chance including, but not limited to, bingo, slot machines, keno, poker tournaments and other gambling winnings subject to federal income tax withholdings." RSA 77:38, III. In 2011, the Gambling Winnings Tax was repealed, effective May 23, 2011.

The parties have not submitted affidavits in support of their motions for summary judgment, but rely upon the agreed statement of facts the parties submitted on their request for an interlocutory transfer, which this Court approved but the New Hampshire Supreme Court rejected. According to that statement, Mr. Leonard Willey is a retired individual, who, for the past three years, derived almost all of his earned income from gambling. All of his gambling winnings since the New Hampshire Gambling Winnings Tax became effective on July 1, 2009 have been derived from out-of-state casinos. Mr. Willey owed no federal income tax on his gambling winnings for 2009, as his gambling losses exceeded his gambling winnings. However, because the New Hampshire Gambling Tax does not allow for an offset of losses against winnings, Mr. Willey was required to report, and did report, to the New Hampshire Department of Revenue $184,700 in gambling winnings for 2009. Mr. Willey then paid $18,470 in Gambling Winnings Tax liability.

Mr. Eby is a resident of New Hampshire who purchased a "Cherry Doubler" lottery ticket on May 13, 2011. "Cherry Doubler" is the name of a scratch ticket that the

New Hampshire Lottery Commission offers. Petitioner Eby derived $10 in gambling winnings as a result of the winning through his "Cherry Doubler" lottery ticket. Because he had taxable gambling winnings prior to May 23, 2011, the date the Gambling Winnings Tax was repealed, he is required to pay a 10 percent gross tax on his gambling winnings.

The issue in this case is whether the Gambling Winnings Tax violates the state and federal constitutions. The parties in this case move for summary judgment based upon an agreed statement of facts, contained in the interlocutory appeal statement that the New Hampshire Supreme Court rejected.

II

In ruling on cross-motions for summary judgment, the Court "consider[s] the evidence in the light most favorable to each party in its capacity as the nonmoving party and, if no genuine issue of material fact exists, [the Court] determine[s] whether the moving party is entitled to judgment as a matter of law." N.H. Ass'n of Counties v. State, 158 N.H. 284, 287-88 (2009); see also RSA 491:8-a, III (2010). "An issue of fact is 'material' for purposes of summary judgment if it affects the outcome of the litigation under the applicable substantive law." VanDeMark v. McDonald's Corp., 153 N.H. 753, 756 (2006). To defeat summary judgment, the non-moving party "must set forth specific facts showing that there is a genuine issue [of material fact] for trial." Panciocco v. Lawyers Title Ins. Corp., 147 N.H. 610, 613 (2002). Alternatively, summary judgment is not appropriate where the facts are undisputed but, nevertheless, the moving party is not entitled to judgment as a matter of law.

The many decisions concerning the legislature's taxing power were recently

distilled by the New Hampshire Supreme Court:

> Three provisions of the New Hampshire Constitution work in conjunction to ensure the fairness of any scheme of taxation enacted by our legislature. Smith v. New Hampshire Department of Revenue Administration, 141 N.H. 681, 685 (1997). First, part I, article 12 establishes that "[e]very member of the community has a right to be protected by it, in the enjoyment of his life, Liberty, and property; he is therefore bound to contribute his share in the expense of such protection." This article requires that a given class of taxable property be taxed at a uniform rate and that "taxes must be not merely proportional, but in due proportion, so that each individual's just share, and no more, shall fall upon him." Id. at 685-86 (quotations and brackets omitted). This provision literally imposes a requirement of proportionality of a taxpayer's portion of public expense, "according to the amount of his taxable estate" and requires that similarly situated taxpayers be treated the same. Id. at 686 (quotations omitted).
>
> Second, part II, article 5 authorizes the general court "to impose and levy proportional and reasonable assessments, rates and taxes, upon all the inhabitants of and residents within, the . . . state." This section requires that all taxes be proportionate and reasonable, equal in valuation and uniform in rate and just. Id. Third, part II, article 6 grants the legislature broad power to declare property to be taxable or non-taxable based upon a classification of the property's kind or use, but not based upon a classification of the property's owner. Id. These three constitutional provisions require that taxation be just, uniform, equal, and proportional. Id. A tax must be in proportion to the actual value of the property subject to tax and it must operate in a reasonable manner. Id. at 687.

First Berkshire Bus. Trust v. Comm'r, N.H. Dep't of Revenue Admin., 161 N.H. 176, 183-84 (2010).

Over the years, many cases relating to New Hampshire's taxing power can be distilled into "fairly simple and precise terms without the cascade of overlapping multifarious and redundant terms that have accumulated over two centuries." Marcus Hurn, State Constitutional Limits on New Hampshire's Taxing Power: Historical Development and Modern State, 7 Pierce Law Review 251, 324 (2009). In summarizing the rules, Hurn notes:

> While the legislature has great discretion in selecting the objects and methods of taxation, all tax legislation must meet the requirements of public purpose, equality, and reason. The term proportional in part II, article 5 means that every tax must be *ad valorem*, which requires a uniform rate applied to a uniform valuation for everyone paying the tax. Classification for taxation has two aspects—it must be applied to property, and it must be rational. So long as it is applied to property, classification under part II, article 6 need only meet the public purpose, equality, and reason standard. However, classification based on personal characteristics of the taxpayers unrelated to the defining characteristics of the property is not authorized. A narrow classification of property that fails to include similar property defined by the same characteristic event is possible but may fail as either insufficiently distinct or as an excise.

Id.

Petitioners argue that the Gambling Winnings Tax lacks uniformity and is unconstitutionally disproportional, unjust, and unreasonable. They reason that the tax is a tax on gross income akin to the tax on interest and dividends, and therefore the rate must be uniform. The Court disagrees. The crux of Petitioners' argument is that:

> Like the I&D tax, the Gambling Winnings Tax is a tax upon gross income. Expressed legislative indicia of meaning confirmed that both taxes operate upon gross income . . . To the extent the gambling winnings and I&D taxes, both operate upon the same class of property taxed, their rate must be uniform. The New Hampshire Supreme Court has made clear that income taxes fall within two classifications; gross income and net income. Opinion of the Justices, 111 N.H. 136, 140 (1971).

Petitioners' Memorandum in Support of Motion for Summary Judgment p. 10-11.

Petitioners fail to note, however, that the New Hampshire Supreme Court has made distinctions beyond gross and net income and has held that different types of income may be taxed at different rates. In Opinion of the Justices, 117 N.H. 512, 516 (1977), the Court specifically held that, considering the difference between capital gains and interest and dividends, the Legislature "may find a rational basis for taxing capital gains at a higher rate." On the other hand, in Opinion of the Justices, 131 N.H. 640, 642

(1989), the Court held that the Legislature could not create a scheme which resulted in taxpayers paying different rates under the business profits tax, reasoning that the Legislature cannot create a scheme which results in taxpayers paying different rates of tax on essentially the same class of property, business income.

What is apparent from these two cases is that the Legislature has distinguished beyond gross and net income to income derived from capital gains, dividends, and business profits. Thus, at least with respect to non-professional gamblers, the tax on gambling winnings did not violate the constitutional requirement of uniformity.

III

The New Hampshire Supreme Court has made it clear that part II, articles 5 and 6 allow classification of property for tax purposes if classification is supported by "just reasons." Cagan's v. N.H. Dep't of Revenue Admin., 126 N.H. 239, 245 (1985). "A just reason is the equivalent of a rational basis.' Id. at 246. The "constitution demands that classifications be made between types of property, not taxpayers." Smith, 141 N.H. at 686; see, Opinion of the Justices, 131 N.H. at 642-643 (holding a proposed amendment to the proposed business profits tax unconstitutional because it created two classifications of taxpayers: business organizations that compensate individual employees in excess of $100,000 and those which do not); Opinion of the Justices, 106 N.H. 202, 206 (1965) (holding unconstitutional proposed legislation that would tax income from personal services performed by workers receiving wages or salaries from an employer).

The Legislature could rationally choose to tax gambling winnings at a higher rate than interest and dividends. Gambling does not involve only the ordinary transactions

of private life but rather "presents a social problem properly coming under the exercise and jurisdiction of the police power of the State and which requires strict regulation and supervision." Ratti v Hinsdale Raceway, 109 N.H. 270, 272 (1969). The New Hampshire Supreme Court has approved legislative distinctions based upon the social value of the product. For example, the Court has held that cigarettes may be taxed, but not other tobacco products because "[cigarettes] are not a necessity and their taxability is made to depend upon an easily recognized event, a sale . . . .Finally, cigarettes . . . are the subject of statutes which forbid sales and gifts to minors." Opinion of the Justices, 97 N.H. 543, 545 (1951). The relation of taxation imposed on gambling income and taxes on cigarette sales is plain. The Legislature has broad power to declare property to be taxable or non-taxable based on a classification of the property's kind or use but not based on a classification of the property's owner. North Country Envtl. Serv's vs. State, 157 N.H. 15, 22 (2008); Hurn, 7 Pierce Law Review at 318, 319. Gambling could rationally be perceived as a social evil by the Legislature and the Court cannot say that the Legislature's actions in passing a 10 percent tax, or even, in effect, imposing a higher tax, by refusing to allow losses to be set off against winnings, violates the New Hampshire constitution.

The Petitioners also argue that the statute violates the interstate Commerce Clause of the federal constitution. "The Supreme Court has defined discrimination" with respect to the Commerce Clause "to mean differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." Smith, 141 N.H. at 693 (quotations and citations omitted). The Gambling Winnings Tax imposes a tax of 10 percent on both residents and non-residents alike, whether the winnings occur

in-state or out-of-state. RSA 77:39, I. Petitioners argue that the gambling tax is unconstitutional because it taxes gambling winnings received from out-of-state casinos and "the State has expended no sums in support or as a consequence of that activity." Petitioner's Memorandum at 22. However, the Gambling Winnings Tax falls on individuals who reside in New Hampshire and therefore receive the benefit of State services, or on out-of-state individuals who gamble in New Hampshire. The tax is measured by the amount of gambling winnings and set at a reasonable percentage to raise revenue. Under these circumstances, the Commerce Clause is not offended. Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 199, 200 (1995). It follows that the State's Motion for Summary Judgment must be granted, and Mr. Eby's Motion denied.

IV

A more difficult question is presented by the allegations that Mr. Willey is a professional gambler. Petitioners argue that the tax is unconstitutional because the Gambling Winnings Tax allows no offset for gambling losses. Petitioner's argument with respect to the offset merges with its argument that the statute is a proscribed occupation tax. The argument has no relevance to Mr. Eby who does not allege that he is a professional gambler. As to Mr. Willey, the bare record does not support the allegation that he is a professional gambler. Thus, on this issue, neither party is entitled to summary judgment.

It is fundamental that the requirement of equality is violated if the state taxes occupations. See, e.g., Opinion of the Justices, 111 N.H. 131, 135 (1975), quoting Opinion of the Justices, 97 N.H. 546, 548 (1951); Hurn, 7 Pierce Law Review at 317. If an

individual is engaged in the business of gambling, he is presumably required to pay taxes under the Business Profits Tax, and presumably allowed to deduct ordinary and necessary business expenses. To the extent the gambling statute would forbid Petitioner Willey from doing so, it would fall afoul of settled New Hampshire law. In Opinion of the Justices, 131 N.H. at 640, the Court held that a proposed amendment which would create a maximum deduction for compensation under the Business Profits Tax would be unconstitutional. The Court noted that the Legislature cannot create a scheme that results in taxpayers paying different rates of tax on essentially the same class of income, business income. Id. at 642. While some inequity in taxing is permissible, such inequality cannot exist when the income is precisely from the same source, a legal business. See Opinion of the Justices, 111 N.H. 136, 139, 140 (1971) (holding that a proposed statute of taxing three percent of personal income while six percent on business profits is permissible.).

However, the Court cannot find based on the record before it that Mr. Willey is in fact engaged as a professional gambler. There is no New Hampshire case that discusses the requisites of being found a professional gambler. Persuasive authority is found in the decision of the United States Supreme Court in Comm'r of Internal Revenue v. Groetzinger, 480 U.S. 23, 35 (1987). In that case, the Supreme Court set forth a helpful framework to determine when a person is engaged in gambling as a trade or business: to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and 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. The Court emphasized that to make the determination of whether one

is engaged in a trade or business "requires an examination of the facts of each case." Id. at 37.

The Minnesota Supreme Court adopted a thoughtful approach to this issue in Busch v. Comm'r of Revenue, 713 N.W.2d 337 (Minn. 2006). The Minnesota Court noted that "[t]he main factors considered by the Supreme Court in Groetzinger were the regularity of Groetzinger's gambling, the effort he exerted, the skill he applied, and his intent to produce a livelihood via gambling." Id. at 347. The Busch Court noted that the IRS has set forth a number of non-exclusive factors to be considered when determining whether a taxpayer's activity constitutes a trade or business for tax purposes:

> These factors include: (1) the manner in which the taxpayer carries on the activity (e.g., keeping records in a businesslike way); (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

Id. Given the fact based nature of the inquiry, and the multitude of factors which must be considered to make the factual determination, the Court believes that based on the bare record here, no determination can be made on whether or not Mr. Willey is a professional gambler.

Petitioner asserts that the State is estopped from asserting that Mr. Willey is not a professional gambler because it agreed that he is a professional gambler for purposes of interlocutory appeal to the New Hampshire Supreme Court. Judicial estoppel "prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase" of the litigation. Cohoon v. IDM Software, Inc., 153 N.H. 1, 4 (2005) (citations and quotations omitted). The New

Hampshire Supreme Court has stated that while the circumstances under which the doctrine is applicable may vary, "the following three factors typically inform the decision whether to apply the doctrine:

> (1) Whether the party's later position is clearly inconsistent with its earlier position; (2) whether the party has succeeded in persuading a court to accept that party's earlier position; and (3) whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.

In re Carr, 156 N.H. 498, 502 (2007) (citations omitted).

While the first criterion is likely satisfied, it is not clear that merely agreeing to send a dispute to an appellate court, which rejects the interlocutory appeal, constitutes "persuading a court to accept that party's position." More importantly, the State has obtained no unfair advantage if the State is not estopped. Based on the Court's analysis of the law, it is not clear that the Supreme Court would accept the stipulation on appeal because at its heart the stipulation of whether a person is a "professional gambler" requires an application of unsettled law to facts. Moreover, even if the Court were to find on the spare record before it that Mr. Willey is a professional gambler, in order to determine whether or not a class could exist and whether or not he could be a class representative, a definition of "professional gambler" consistent with the law would need to be developed.

Under these circumstances, it appears that a genuine issue of material fact exists as to whether Mr. Willey is a professional gambler and neither party is entitled to summary judgment on this issue.

SO ORDERED.

10/20/11
DATE

RBM/mrs

Richard B. McNamara,
Presiding Justice