# Prediction Markets: Is It Gambling and How Are Your Winnings Taxed

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**Start Here:** Prediction markets allow you to put money behind your expectations about future events, but how the resulting gains and losses should be taxed remains unsettled. Depending on the contract, prediction-market activity could potentially be treated as wagering or as an investment transaction, with very different tax consequences. Here, we explain the possible federal tax treatments, including why new wagering-loss limits taking effect in 2026 make the distinction especially important. We also cover what records to keep and what you may want to discuss with your tax planning partner while the IRS has yet to provide specific guidance.

You'd be hard pressed to miss the television, radio, podcast, and online advertisements for prediction markets. Platforms such as Kalshi, Polymarket, and FanDuel Prediction Markets (aka FanDuel Predicts) have leaned heavily on celebrity endorsements.

These include such notables as record producer Rick Rubin, basketball player Giannis Antetokounmpo, actor Timothee Chalamet, golfer Bryson DeChambeau, and soccer player Lionel Messi.

It's almost as if the prediction markets themselves are betting that star power will attract more customers willing to parley. These wagers target everything from political races and moon landings to interest-rate cuts, inflation, and breakthroughs in cancer research.

Of course, wagering on future events is nothing new. People have been putting money behind their predictions for centuries. What is new is the ability to pull out your phone, open an account, and buy a contract based on whether an event will happen.

And that's where things get interesting from a tax perspective.

Prediction markets may look and feel like gambling. Legally, however, some prediction-market contracts are structured and regulated as financial derivatives. That leaves taxpayers with a surprisingly difficult question:

- When you make money in a prediction market, did you win a bet, earn a capital gain, profit from a futures contract, or something else entirely?

Right now, the answer isn't as clear as you might expect.

## First Things First: What's a Prediction Market?

A prediction market allows people to trade contracts based on the outcome of a future event. Suppose a contract asks whether the Federal Reserve will cut interest rates at its next meeting. You believe it will, so you buy a "yes" contract.

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Prediction-market contracts commonly trade between $0 and $1. If the “yes” contract trades for $0.70, you can think of the market as roughly pricing a 70 percent probability that the event will occur. If it happens, the winning contract generally settles for $1. If it doesn’t, the contract settles for nothing.

While that certainly sounds like a bet, there is an important difference to which you must be aware.

With traditional sports betting, you’re generally placing a wager under odds established by a sportsbook. With a prediction market, you’re buying or selling a standardized contract in a marketplace where other participants are also trading.

In prediction markets, prices move as traders change their expectations and new information becomes available, and you may also be able to sell your position before the underlying event occurs rather than waiting to see whether your prediction comes true.

The Commodity Futures Trading Commission (CFTC) calls an event contract (aka a prediction contract), a *derivative contract* with a payoff depends on a specified event, occurrence, or value.

> **Derivative Contract:** A derivative is a financial agreement whose value is tied to the performance of an underlying asset or group of assets. Investors and traders use derivatives to reduce exposure to financial risk, make bets on future price changes, or increase the potential impact of a position.

So, is it gambling or trading? For federal tax purposes, that’s the million-dollar question.

## The IRS Has Yet to Give Us a Clear Answer on Prediction Markets

As of August 2026, the United States Internal Revenue Service (IRS) has not issued specific guidance telling taxpayers how gains and losses from prediction-market event contracts should be classified for federal income tax purposes. That leaves several possibilities.

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Depending on the particular contract and the applicable law, taxpayers may need to consider whether a transaction should be treated as:

- A wagering transaction
- A transaction involving a capital asset
- A qualifying Section 1256 contract
- Another type of transaction based on the contract's particular terms and circumstances

Those classifications aren't interchangeable and each can produce a substantially different tax result. And beginning in 2026, that distinction matters even more.

## What Happens If It's Gambling?

In our view, prediction markets have many of the economic characteristics we normally associate with wagering. You put money at risk based on an uncertain event, and the outcome determines whether you make or lose money. If prediction-market activity constitutes wagering for federal income tax purposes, IRC Section 165(d) comes into play. Congress changed that section beginning with taxable years after Dec. 31, 2025.

Under the 2026 federal rule, the deduction for wagering losses is generally limited to 90 percent of those losses, and the allowable deduction cannot exceed gains from wagering transactions. That can produce a strange result.

### Imagine Breaking Even and Still Owing Tax

Suppose that during 2026 you have:

- Prediction-market gains: $100,000
- Prediction-market losses: $100,000

Economically, you broke even.

If those transactions are treated as wagering transactions subject to Section 165(d), however, only 90 percent of the $100,000 of wagering losses, or $90,000, may be deductible.

That potentially leaves you with $10,000 of taxable income even though you didn't make $10,000.

The above example isn't simply an interpretation. Congress amended Section 165(d), and the IR has proposed regulations incorporating the new 90 percent limitation into the existing wagering-loss regulations.

For someone occasionally making a small prediction on of the prediction platforms, the difference may not attract much attention. For an active participant trading hundreds or thousands of contracts, it could become significant very quickly.

## California Gets Involved Too

California taxpayers have another layer to consider. The California Franchise Tax Board (FTB) currently states that — for tax years beginning on or after 2026 — gambling losses are deductible up to 90 percent of gambling winnings.

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So, if prediction-market transactions are ultimately treated as gambling for tax purposes, California taxpayers could face similar loss limitations at the state level. Again, though, everything begins with classification. Calling something a “prediction market” doesn’t tell us how it must be treated on a tax return.

## But Aren’t Prediction Markets Financial Derivatives?

Here is where the issue gets more complicated. The CFTC describes event contracts as derivatives, and qualifying prediction markets can operate within the federal commodities regulatory system. In June 2026, the CFTC proposed new rules for determining how certain event contracts should be treated under the Commodity Exchange Act. Among the subjects addressed by the proposal is “gaming.”

That has also contributed to disputes between federal regulators and states over whether states can apply their gambling laws to federally regulated prediction markets.

It’s tempting to draw a tax conclusion from all of this. If the federal government regulates an event contract as a derivative rather than a conventional sportsbook wager, shouldn’t it be taxed like an investment? Maybe. But one set of federal rules doesn’t necessarily answer a question arising under another.

The Commodity Exchange Act determines how these markets and contracts are regulated. The Internal Revenue Code determines how income, gains, and losses are taxed. A contract’s status as a CFTC-regulated derivative therefore doesn’t automatically mean that its profits qualify for capital-gain treatment. It also doesn’t automatically make the contract a Section 1256 contract.

> **Section 1256 Contract:** A Section 1256 contract is an investment category recognized under the Internal Revenue Code (IRC) that includes certain futures, foreign currency contracts, options, and securities futures. At the end of each tax year, any open Section 1256 contracts are treated as though they were sold at their current market value. Any resulting profit or loss is then classified for tax purposes as a mix of short-term and long-term capital gain or loss.

## Could a Prediction Market Profit Be a Capital Gain?

Selling or disposing of a capital asset can produce capital gain or loss. That treatment comes with its own rules governing holding periods, the netting of gains and losses, and limitations on capital losses. A prediction-market contract arguably has characteristics that resemble an investment contract. You purchase an asset, its market value can fluctuate, and in some markets you can sell the contract to another participant before the underlying event occurs.

But that doesn’t settle the issue.

The tax treatment would depend on the legal nature of the contract and whether another part of the IRC governs the transaction. Until the IRS or courts provide more definitive guidance, capital treatment shouldn’t simply be assumed because the contract is bought and sold on an exchange.

## What About the Special 60/40 Tax Treatment for Futures?

You may have heard that certain futures and other financial contracts receive special treatment under IRC Section 1256. A qualifying Section 1256 contract is generally marked to market at the end of the tax year. Gain or loss is generally treated as:

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- 60 percent long-term capital gain or loss
- 40 percent short-term capital gain or loss

That treatment applies regardless of how long the taxpayer actually held the contract. And while that sounds attractive, there's a catch. The Internal Revenue Code specifically defines which contracts qualify under Section 1256. The list includes certain regulated futures contracts, foreign currency contracts, nonequity options, dealer equity options, and dealer securities futures contracts.

A regulated futures contract must also satisfy statutory requirements involving mark-to-market treatment and trading on, or subject to the rules of, a qualified board or exchange. In other words: *derivative* does not automatically mean Section 1256 contract.

Whether a particular prediction-market contract qualifies requires an analysis of the actual contract and exchange. The fact that the CFTC regulates a marketplace doesn't, by itself, answer the Section 1256 question.

## Why the Gambling Versus Investment Debate Matters

At first glance, all of this may sound like accountants arguing over labels. It's not. Consider two taxpayers who each make the same economic profit trading event contracts. If one transaction is subject to the wagering rules, Section 165(d) may restrict losses. If another is a capital transaction, the capital gain and loss rules apply. If a contract qualifies under Section 1256, mark-to-market accounting and the special 60/40 character rules may apply.

Those differences can affect:

- How much income you report
- Whether and when losses are deductible
- The character of your gains and losses
- Which tax forms you use
- Ultimately, how much federal and California income tax you pay

That's why the answer shouldn't begin with whichever tax treatment produces the smallest tax bill. It should begin with the contract.

## Keep Better Records Than You Think You'll Need

Until the tax rules become clearer, anyone actively participating in prediction markets should maintain detailed records. Don't assume that a year-end account balance or tax document from the platform will contain everything you and your CPA or tax planning partner may eventually need.

Consider retaining your complete transaction history, including:

- The amount paid for each contract
- Proceeds received when contracts are sold or settled
- Fees
- Open positions at year-end
- Copies of any tax forms or account statements provided by the platform

It can also be helpful to retain information identifying the particular exchange and type of contract you traded. That's because determining that you made $20,000 is only part of the tax calculation. Your CPA

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may also need to determine what kind of $20,000 it was.

## So, Are Prediction Markets Gambling?

For everyday purposes, you may look at a contract predicting the winner of a football game and reasonably say, “Of course that’s gambling.” Federal income tax law requires a more careful answer.

Prediction-market contracts occupy an unusual intersection between wagering, investing, derivatives trading, federal commodities regulation, and state gaming regulation. As of August 2026, the IRS hasn’t given taxpayers a prediction-market-specific rule that neatly resolves those competing characteristics.

That means we cannot confirm with high certainty that all prediction-market contracts should receive one particular federal income tax treatment. The structure of the contract matters. The exchange may matter. How you trade may matter. And future IRS guidance, U.S. Department of Treasury regulations, Commodity Futures Trading Commission rules, federal and state legislation, or court decisions could change the analysis.

One thing is already clear, though. With the new 90 percent limitation on wagering losses taking effect in 2026, the difference between making an investment and making a wager can have very real tax consequences.

So, before you bet on how the IRS will eventually answer the prediction-market question, keep good records and talk with your tax professional about how your particular transactions should be reported.

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