

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-104234-03/CC:TEGE:EOEG:EO2

May 20, 2003

Director, Appeals

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No.:

Taxable Periods:

Conference Held:

Legend:

X =

A =

ISSUE:

Is the purchase of pull-tabs sold by X exempt from the definition of a wager as provided in § 4401 of the Internal Revenue Code by reason of § 4421(2)(A)?

CONCLUSION:

The purchase of pull-tabs sold by X are not exempt from the definition of a wager as provided in § 4401 by reason of § 4421(2)(A).

FACTS:

X is an organization described in section 501(c)(8) that is exempt from income tax under section 501(a). X holds a charitable gaming license issued by state A. Pursuant to that license, X conducts bingo sessions and sells pull-tabs to its members

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as well as to members of the general public attending these sessions. Uncompensated volunteer members run both the bingo and pull-tab operations.

In general, pull-tabs are single-folded or branded tickets or cards the faces of which are hidden from view. The player purchases a pull-tab and opens it to immediately determine if he or she is a prize winner. X purchases pull-tabs from the manufacturer in series of less than 2,500 tickets. Under X's operations, winners of the pull-tabs are identified during the gaming sessions and prizes are generally distributed to the winners at that same gaming session. No pull-tabs in a series are carried over to the next gaming session.

#### LAW AND ANALYSIS:

Section 4401(a)(1) imposes on any wager authorized under the law of the state in which accepted an excise tax equal to 0.25 percent of the amount of such wager.

Section 4401(c) provides that each person who is engaged in the business of accepting wagers shall be liable for and shall pay the tax under § 4401 on all wagers placed with him. Each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax under this subchapter on all wagers placed in such pool or lottery.

Section 4411 imposes a special tax to be paid by each person who is liable for the tax imposed under section 4401 or who is engaged in receiving wagers for or on behalf of any person so liable.

Section 4421(1)(C) defines "wager" to include any wager placed in a lottery conducted for profit.

Section 4421(2) defines the term "lottery" as including the numbers game, policy, and similar types of wagering. That section provides two specific exclusions from this broadly-defined term. First, § 4421(2)(A) provides that the term does not include any type of game in which usually all wagers are placed, the winners are determined, and the distribution of prizes or other property is made in the presence of all persons placing wagers in that game. Second, § 4421(2)(B) provides that the term lottery does not include any drawing conducted by an organization exempt from tax under sections 501 and 521, if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual.<sup>1</sup>

Section 44.4421-1(b)(1) of the Wagering Tax Regulations provides that, in

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<sup>1</sup> The exclusion provided in § 4421(2)(B) is not addressed in this memorandum. Technical advice was requested, and is hereby provided, only on the issue of the applicability of § 4421(2)(A) to the facts above.

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general, a lottery conducted for profit includes any scheme or method for the distribution of prizes among persons who have paid or promised a consideration for a chance to win such prizes, usually as determined by the numbers or symbols on tickets as drawn from a lottery wheel or other receptacle, or by the outcome of an event, provided such lottery is conducted for profit. The term also includes enterprises commonly known as “policy” or “numbers” and similar types of wagering where the player selects a number, or a combination of numbers, and pays or agrees to pay a certain amount in consideration of which the operator of the lottery, policy, or numbers game agrees to pay a prize or fixed sum of money if the selected number or combination of numbers appears or are published in a manner understood by the parties. For example, the winning number or combination of numbers may appear or be published as a series of numbers in the payoff prices of a series of horse races at a certain race track, or in the United States Treasury balance reports, or the reports of a stock or commodity exchange. This description is not intended to be restrictive; hence, the substitution of letters or other symbols for numbers, or a different arrangement for determining the winning number or combination of numbers, does not alter the fundamental nature of a game which would otherwise be considered a lottery. The operation of a punchboard or a similar gaming device for profit is also considered to be the operation of a lottery.

Revenue Ruling 57-258, 1957-1 C.B. 418, concludes that a small card with thirteen pull-tabs was a lottery within the meaning of § 4421(2). Similarly, in The Chickasaw Nation v. United States, 208 F.3d 871 (10<sup>th</sup> Cir. 2000), the court considered whether the sale of pull-tabs manufactured in series of 24,000 tickets constituted a lottery within the meaning of § 4421(2). The court concluded that the sale of these pull-tabs was a lottery and that the purchase of those pull-tabs by the customer constituted a wager within the meaning of § 4401.

For purposes of the wagering taxes, the term “wager” includes any wager placed in a lottery conducted for profit. X argues that its method of conducting pull-tab games meets the exclusion from the term lottery in § 4421(2)(A). That section provides that the term does not include any type of game in which usually all wagers are placed, the winners are determined, and the distribution of prizes or other property is made in the presence of all persons placing wagers in that game exempts it from the § 4401 tax. X purchases pull-tabs in series of less than 2,500 tickets and sells pull-tabs only to those who attend its charitable gaming sessions. Winners are identified at the session, with no pull-tabs carried over to another session. Generally, prizes are distributed to the winners at that same gaming session. However, none of these particular characteristics of X’s gaming operation alter the basic nature of the pull-tab activity. It is the nature of the activity itself, and not the method of conducting the operation, that is determinative of whether the activity constitutes a wager and is therefore subject to the § 4401 tax. Section 44.4421-1(b)(1) of the regulations provides that a punchboard or a similar gaming device is considered to be the operation of a lottery. Rev. Rul. 57-258 holds that pull-tabs are a form of punchboard. As the court in The Chickasaw Nation concluded regarding pull-tabs, “[t]he winners are determined at the time the series is

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manufactured, and thus, the winners are predetermined outside the presence of any persons placing wagers in such game.” 208 F.3d, at 877 (citation omitted). Pull-tabs, whether considered in the form of a single small card with thirteen pull-tabs as in Rev. Rul. 57-258, or in the large series of 24,000 tickets at issue in The Chickasaw Nation, are lotteries within the meaning of § 4421 and the purchase of those pull-tabs is subject to the § 4401 tax on wagering.

CAVEATS:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent. Under § 6110(c), names, addresses, and identifying numbers have been deleted.