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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No.:

Years Involved:

Conference Held:

Legend

x =
y =
z =

"This document may not be used or cited as precedent. Section 6110 (i) (3) of the Internal Revenue Code."

**Issue**

Whether the $1 wager made to play a progressive jackpot component (PJC) of the card game Caribbean Stud is a taxable wager for purposes of § 4401(a) of the Internal Revenue Code.

**Conclusion**

The PJC of Caribbean Stud is not subject to the wagering tax imposed by § 4401(a) because (1) it is not a wagering pool, and (2) it is excluded from taxation as a lottery by virtue of the exclusion provided under § 4421(2)(A).

Facts

The Taxpayer owns and operates a casino in which it offers its customers a card game called Caribbean Stud, which is played against the casino. The game commences with players at a special card table making their initial (ante) bets in order to play in the underlying five card stud poker game. If a player chooses to participate in the optional PJC of Caribbean Stud, the player

must make an additional $1 wager in the electronic coin acceptor (equipped with a readout to indicate when a PJC wager is placed) at his seat prior to the dealing of the cards. The computer for the coin acceptor mechanism computes the increase to a progressive jackpot. This jackpot is originally funded by the Taxpayer with its own money. The games are linked to one another, so that a coin played on any of the tables within the casino increases the common jackpot. For each $1 wager in the PJC, the computer increments visible progressive meters at the casino tables x% and hidden meters y%. The portions of wagers allocated to hidden meters are used by the Taxpayer to refund the common jackpot. Z% of the $1 wager goes directly to the casino as profit. Once all of the PJC bets are made, the dealer presses a button so that each $1 bet drops down to a drop bucket and is added to the common jackpot.

The cards are then dealt and the player decides whether or not to play the hand. If the player decides not to play (the player folds), the cards are returned to the dealer and the player loses the ante bet and is also ineligible to win the PJC. If the player decides to continue play and eventually beats the dealer in the stud poker game, the casino pays the player even-money on the ante bet. Any winnings from the additional bets (call bets) wagered by the player in the stud poker game are paid out by the casino based on a predetermined bonus payout schedule.

Provided the player makes the $1 PJC wager and decides to remain in the game when it is time to make the additional call bet, the player can qualify for a progressive payout. The player need not have a better hand than the dealer to win a progressive payout. The player wins in the PJC according to the following payout schedule:

| Hand | Payout |
|---|---|
| Royal Flush | 100% of progressive jackpot |
| Straight Flush | 10% of progressive jackpot |
| 4 of a kind | $500 |
| Full House | $100 |
| Flush | $50 |

PJC payouts are disbursed after verification of the winner and usually within 30 to 45 minutes after the winning hands are revealed to the dealer.

The Taxpayer argues that (1) § 4421(2)(A) applies to the PJC to exclude it from taxation as a lottery, (2) the PJC does not

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fall within the definition of a wagering pool, and (3) the PJC qualifies for the § 4402(2) exemption as a coin-operated gaming device.

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 on all wagers placed with him. Each person who conducts any wagering pool or lottery shall be liable for and shall pay the tax on all wagers placed in such pool or lottery.

Under § 4421(1), the term "wager" includes any wager placed in a wagering pool, if such pool is conducted for profit, and any wager placed in a lottery conducted for profit.

Section 44.4421-1(c)(1) of the Wagering Tax Regulations provides that a wagering pool conducted for profit includes any scheme or method for the distribution of prizes to one or more winning bettors based upon the outcome of a sports event or contest, or a combination or series of such events or contests, provided that such wagering pool is managed and conducted for the purpose of making a profit.

Under § 44.4421-1(c)(3), a contest includes any type of contest involving speed, skill, endurance, popularity, politics, strength, appearances, etc., such as a general or primary election, the outcome of a nominating convention, a dance marathon, a log-rolling, wood-chopping, weight-lifting, corn-husking, beauty contest, etc.

Rev. Rul. 57-521, 1957-2 C.B. 779, states that a wagering pool is a gaming transaction where the wagers alone comprise the prize to be won by the successful contestant.

Section 4421(2)(A) provides that the term "lottery" includes the numbers game, policy and similar types of wagering, but does not include any game of a type in which usually, (i) the wagers are placed, (ii) the winners are determined, and (iii) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game.

Section 44.4421-1(b)(1) provides that the term "lottery" includes the numbers game, policy, and similar types of wagering. In 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 number or symbols on tickets 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 appear 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 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. The 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 otherwise would 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.

Section 44.4421-1(b)(2)(i) provides that § 4421 specifically excludes from the term "lottery" any game of a type in which usually (a) the wagers are placed, (b) the winners are determined, and (c) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game. Thus, for example, no tax would be payable with respect to wagers made in a bingo or keno game since such a game is usually conducted under circumstances in which the wagers are placed, the winners are determined, and the distribution of prizes is made in the presence of all persons participating in the game. For the same reason, no tax would apply in the case of card games, dice games, or games involving wheels of chance, such as roulette wheels and gambling wheels of a type used at carnivals and public fairs.

Rev. Rul. 57-521 states that, for wagering tax purposes, the three necessary elements of a lottery are the offering of a prize, the awarding of the prize by chance, and the giving of a consideration for an opportunity to win a prize.

Rev. Rul. 79-146, 1979-1 C.B. 361, holds that basic Nevada Keno, Five Race Keno, and Four way Express Keno meet the requirements for exclusion from the term "lottery" within the meaning of § 4421(2) because tickets are purchased on the casino premises immediately before the game, winnings are required to be collected on the casino premises immediately after the game, and

the time needed to play one game is of short enough duration (the time needed to draw the numbers) so that the players will usually not leave the casino premises during the game. In contrast, the ruling holds that in Two Game Parlay Keno each ticket entitles its holder to play two separate games of Keno. This is a form of advance wagering in which a player can bet on a game that is not to take place immediately. Advance wagering games do not meet the § 4421(2) criteria for exclusion from the term lottery.

Rev. Rul. 57-241, 1957-1 C.B. 419, holds, in part, that the operation of a certain non-coin-operated gaming device is a taxable lottery. It states that the inherent feature of the games to which the exclusion under § 4421(2)(A) applies is that of "group play" as defined by the three criteria set forth in that code section. This feature is not present in the operation of the non-coin-operated gaming device, which is a continual operation rather than a series of games.

Section 4402(2) provides that no tax shall be imposed on any wager placed in a coin-operated device (as defined in § 4462 for years beginning before July 1, 1980), or on any amount paid, in lieu of inserting a coin, token, or similar object, to operate a device described in § 4462(a)(2) (as so in effect).

The initial consideration is whether the PJC is part of the underlying stud poker game. (Stud poker falls within the § 4421(2)(A) exclusion and is not subject to tax.) We do not believe that the PJC is part of the stud game since a $1 optional wager is required to play the PJC, a game which, unlike the underlying stud poker game, the player does not have to beat the dealer's hand to win. Although the PJC is linked to the cards dealt in the stud poker game, we believe the PJC is a separate game.

Since we consider the PJC to be a separate game, it must be determined whether the $1 PJC fee is a wager in a wagering pool or lottery as contemplated by § 4421(1). It is evident that the Taxpayer conducts the PJC for profit.

Under § 44.4421-1(c)(1), a wagering pool includes a plan for the distribution of prizes based on the outcome of a sports event or contest. The PJC is not based on a sports event. Nor is it based on a contest. As indicated by the examples set forth in the regulations, a contest is based on speed, skill, endurance, popularity, etc., and not, as in the PJC, chance. Also, pursuant to Rev. Rul. 57-521, the prize pool must be comprised totally of the participant's wagers. Here, the PJC is funded by the Taxpayer. Thus, the PJC does not come within the definition of a wagering pool.

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It is not disputed that the PJC comes within the broad definition of a lottery provided in § 44.4421-1(b)(1) and that it possesses the necessary elements of a lottery, as enumerated in Rev. Rul. 57-521; that is, the offering of a prize, the awarding of the prize by a chance, and the giving of consideration for an opportunity to win a prize. The question then is whether the PJC fulfills the three requirements of the "group play" exclusion in § 4421(2)(A). The § 4421(2)(A) exclusion requirements are applicable to a "game." Where a wagering activity is based on poker hands drawn from a deck of cards, the odds of winning are predicated on the play at the particular poker table, and not on some predetermined odds, or the play at some other table or at some other time. Thus, in a wagering activity such as the PJC, a "game" equates to a round (each participant at the table receiving a hand of cards). Usually, during a game of PJC the $1 wagers are placed and winners determined in the presence of all participants in the game of PJC. The 30 to 45 minute time lapse to distribute the progressive payouts is not so excessive that the participants in the round of play would not be on the casino premises at the time of distribution of the payout. Also, there is no opportunity to place a wager on a PJC game that is not to take place immediately. Thus, the PJC is unlike Two Game Parlay Keno described in Rev. Rul. 79-146, wherein advance wagering precluded the application of the § 4421(2)(A) exclusion. Nor is the PJC like the non-coin-operated gaming device in Rev. Rul. 57-241, since it is a series of games rather than a continual operation. Thus, the PJC fulfills the requirements for exclusion under § 4421(2)(A).

Inasmuch as the PJC is not subject to wagering tax, the exclusion for coin-operated gaming devices need not be addressed.

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

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