24 T.C. 1156 (1955)

The value of a prize won is taxable income when the recipient's right to participate in the drawing for the prize was associated with consideration, even if the recipient did not personally pay the consideration.

Summary

Clewell Sykes won a car at a club drawing. He received a ticket to the dinner and drawing from a friend who was a club member and paid for the ticket. The IRS determined that the value of the car was taxable income for Sykes. The Tax Court agreed, following the precedent of cases like *Max Silver*. Even though Sykes did not directly pay for the ticket, his ability to participate in the drawing, which led to his winning the car, was connected to the payment made by his friend for the ticket. The court distinguished the case from those where there was no purchase or investment, holding that the consideration paid for the ticket triggered the tax liability.

Facts

Clewell Sykes was invited by a friend to the annual dinner of the Poor Richard Club. The friend, a club member, paid for Sykes' ticket. The ticket granted Sykes entry to the dinner and participation in the drawing where the grand prize was a 1950 Chevrolet. Sykes did not pay for the ticket. Sykes was not a member of the club and attended the dinner to meet prominent people and for business reasons. Sykes won the car in the drawing. He immediately donated the car to charity, and claimed a charitable deduction, but did not report the value of the car as income. The IRS determined that the value of the car ($1,968) was taxable income.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency for the year 1950, adding the fair market value of the car won by Sykes to his gross income. The Tax Court had to decide if the car's value constituted taxable income.

Issue(s)

Whether the value of an automobile won as a prize in a drawing constitutes taxable income to the winner when the ticket entitling the winner to participate in the drawing was purchased by another person.

Holding

Yes, because a consideration was paid for the right of Sykes to participate in the drawing, he realized income measured by the fair market value of the automobile won.

Court’s Reasoning

The court relied on Section 74 of the 1954 Internal Revenue Code, which treats prizes and awards as taxable income. The court referred to prior case law, including *Max Silver* and *Reynolds v. United States*, in which courts held that the value of prizes won were taxable where the right to participate in the drawing was linked to the payment of consideration (e.g., a sweepstakes ticket). Though Sykes did not personally pay for the ticket, the court reasoned that, as a donee of a person who did pay consideration for the ticket, he stood in no better tax position. The court distinguished this situation from cases where there was no such element of purchased right to participate, citing *Pauline C. Washburn*, and *Bates v. Glenn*. The court noted that the entire ticket cost Sykes’ friend $17.50, and although it wasn’t possible to determine how much of that sum was allocable to the lottery, the Commissioner’s determination had to be approved.

Practical Implications

This case highlights that winning a prize is taxable income when participation is made possible through a purchase, even if the winner did not make the purchase. Tax advisors must consider the implications for individuals who receive gifts of tickets or entries to sweepstakes, contests, or raffles. It emphasizes the importance of looking beyond the direct payment made by the recipient. The court’s focus on the “investment” or consideration paid for participation suggests that any situation where an economic benefit is received through a payment, made by someone else, will trigger the tax liability of the recipient of the prize. This case is often cited to clarify what qualifies as taxable prizes and awards.

