Stevens v. Commissioner, 57 T. C. 461 (1971)

Sweepstakes winnings are considered wagering income and are excluded from the benefits of income averaging under the Internal Revenue Code.

Summary

In Stevens v. Commissioner, the Tax Court ruled that winnings from the Irish Hospitals' Sweepstakes constituted wagering income, thus ineligible for income averaging under Section 1302(b)(3) of the Internal Revenue Code. Lillian Stevens, who won $139,555 from the sweepstakes, argued that her winnings should be included in her income averaging calculation. However, the court found that sweepstakes are a form of gambling, aligning with the legislative intent to exclude such gains from income averaging benefits. This decision underscores the broad interpretation of "wagering transactions" and the irrelevance of charitable motivations in such contexts.

Facts

Lillian Stevens, a hostess in a Chicago restaurant, purchased two Irish Hospitals' Sweepstakes tickets for $6 in 1966. The sweepstakes allocated 25% of ticket sales to hospitals, with the remainder funding prizes. Stevens' ticket won, assigning her a horse that won the Cambridgeshire race, resulting in $139,555 in winnings. She and her husband reported these winnings on their joint tax return and attempted to use income averaging to reduce their tax liability, which the IRS challenged.

Procedural History

The IRS determined a deficiency in the Stevens' 1966 income tax, asserting that the sweepstakes winnings were wagering income ineligible for income averaging. The case proceeded to the U. S. Tax Court, where Judge Tannenwald heard the case and issued the opinion.

Issue(s)

1. Whether Lillian Stevens' 1966 Irish Hospitals' Sweepstakes winnings constitute wagering income under Section 1302(b)(3) of the Internal Revenue Code.

Holding

1. Yes, because the Irish Hospitals' Sweepstakes is a form of gambling, and thus, the winnings are excluded from the benefits of income averaging.

Court's Reasoning

The court reasoned that the sweepstakes involved gambling, fitting the legislative intent behind Section 1302(b)(3) to exclude wagering income from income

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averaging. The court referenced the legislative history of Section 165(d), which deals with wagering losses, to interpret “wagering transactions” broadly. The court rejected the Stevens’ arguments that their non-habitual gambling or charitable motivations should exempt the winnings from this exclusion, emphasizing that the nature of the transaction as gambling was determinative. The court likened the sweepstakes to parimutuel betting at racetracks, where participants bet against each other, reinforcing the classification of sweepstakes as wagering.

Practical Implications

This decision clarifies that sweepstakes and similar gambling activities are considered wagering transactions under the tax code, impacting how such winnings should be treated for tax purposes. Tax practitioners must advise clients that lottery and sweepstakes winnings are ineligible for income averaging, potentially affecting tax planning strategies. The ruling also highlights the irrelevance of the participant’s gambling frequency or charitable intent in determining the tax treatment of gambling winnings. Subsequent legislative changes, such as those in the Tax Reform Act of 1969, have modified this rule, but for the relevant period, the decision set a precedent for excluding gambling income from income averaging benefits.

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