E. UPDATE ON EXCISE TAX AND OCCUPATIONAL TAX ON WAGERING

by
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1. Introduction

The purpose of this topic is to discuss excise taxes on wagering activities common to tax-exempt organizations such as bingo, pull-tabs, raffles, wheels, casino nights and punch boards. This topic does not discuss gambling activities such as bookmaking.

The EP/EO (Employee Plans and Exempt Organizations) Division is assuming primary examination responsibility from the Examination function for Form 730, Tax on Wagering, and Form 11-C, Special Tax Return and Application for Registry-Wagering, filed by or that are required to be filed by organizations within the jurisdiction of EP/EO. Effective January 1, 1997, Forms 11-C and 730 processing was centralized at Cincinnati Service Center.

IRC 4401 and 4411 impose excise taxes on the gaming industry.

IRC 4401 imposes an excise tax on wagers.

IRC 4411 imposes a companion occupational tax (sometimes called the special tax) on persons who accept or receive wagers.

Form 730 is used to report wagering taxes and Form 11-C is used to register for wagering activity and to pay the occupational tax on wagering.

Changing the primary examination responsibility for Form 730 and Form 11-C filed by or that are required to be filed by organizations to the jurisdiction of EP/EO function should improve compliance with the wagering tax provisions of the Internal Revenue Code by organizations EP/EO regulates. Improved compliance will not only produce immediate revenue in the year of adjustment, but should result in organizations adopting wagering tax procedures that produce long-range voluntary compliance, and reduce taxpayer burden by resolving tax compliance requirements of exempt organizations in a single contact with the Service.

Organizations that are exempt from income tax under IRC 501 or 521 are not categorically exempt from the excise tax on wagering or the occupational tax. (See sections 7 & 8 below.) Federal wagering tax laws apply to both authorized and unauthorized gaming activities conducted by exempt organizations.

The requirement to report wagering receipts for the excise tax and occupational tax may be misinterpreted by exempt organizations since any organization exempt from income tax under IRC 501 is also exempt from the wagering taxes, provided **no part** of the net proceeds derived from a "lottery" inures to the benefit of any private shareholder or individual. Also, once there is any inurement, the wagering excise tax applies to the entire drawing which is the amount wagered rather than the proceeds of the operation (See Section 8.C), and wagers from some games, for example bingo and gambling wheels are not taxable wagers (See Section 8.B).

In addition, wagering activities may affect the continuing tax-exempt status of an organization.

2. Disclosure of Wagering Tax Information

IRC 4424 provides that no Treasury Department official or employee may disclose, except in connection with the administration or enforcement of internal revenue taxes, any document or record supplied by a taxpayer in connection with the wagering taxes or any information obtained through any such documents or records. Further, certain documents related to the wagering taxes and information obtained through such documents may not be used against the taxpayer in any criminal proceeding except in connection with the administration or enforcement of internal revenue taxes.

Congress enacted IRC 4424 to remove any constitutional impediment to the enforcement of the wagering taxes because of a risk of self-incrimination. Thus no disclosure of the documents or records described above should be made to any person without first consulting the district disclosure office.

3. Excise Tax on Wagering

IRC 4401(a)(1) imposes a 0.25 percent tax on the amount of any wager authorized under the law of the state in which accepted. Thus, if gross wagers were $2,400 the amount of the tax would be $6 ($2,400 x .0025).

IRC 4401(a)(2) imposes a 2 percent tax on the amount of any wager not described in IRC 4401(a)(1) (i.e., those not authorized by state law). Thus, if gross wagers were $2,400 the amount of the tax would be $48 ($2,400 x .02).

Tax is imposed on the gross amount of the wagers received **before any payout for prizes or expenses.**

For example, where the tax applies to an organization selling pull-tabs, the tax would be applied to the gross amount of sales per box. If a box of $1 pull-tabs contained 2,400 cards, and the entire box were sold, the tax would be computed using $2,400 as the gross wagers received.

4. Territorial Limitations

IRC 4404 provides that the tax applies to wagers:

> accepted in the United States, or
>
> placed by a person who is in the United States with a U.S. citizen or resident, or in a wagering pool conducted by a U.S. citizen or resident.

Further, Section 44.4404-1(a) of the Excise Tax Regulations states that all wagers made within the United States are taxable regardless of the citizenship or place of residence of the parties to the wager. Thus, the tax applies to wagers placed within the United States, even though the person for whom or on whose behalf the wagers are received is located in a foreign country and is not a citizen or resident of the United States. Likewise, a wager accepted outside the United States by a citizen or resident of the United States is taxable if the person making such wager is within the United States at the time the wager is made.

5. Who is Liable for the Tax, and When

IRC 4401(c) and Reg. 44.4401-2 describe persons who are liable for the tax on wagers as those who:

- engage in the business of **accepting** wagers;
- conduct any wagering pool or lottery; or
- **receive** wagers for, or on behalf of, another person.

There is a difference between a person who "accepts" a wager and a person who "receives" a wager. The courts have ruled that an "acceptor of a wager" generally designates the "principal" who is liable for both the tax on wagers and the special tax. "Receiver" designates an "agent" who is liable only for the special tax. See United States v. Pepe, 198 F. Supp. 226 (D. Del. 1961).

Therefore, a principal is a person who is in the business of accepting wagers for his or her own account. This is the person who is at risk for the profit or loss depending on the outcome of the event or contest to which the wager was accepted. The employee-agent is the paid employee of the principal who accepts wagers for the principal.

The excise tax on wagers attaches when a person who operates a lottery for profit accepts a wager or contribution. See Reg. 44.4401-3.

6. Taxable Wagers

IRC 4421 and Reg. 44.4421-1(a) provide that a wager is a bet:

- made on a sports event or contest placed with a person in the business of accepting wagers,
- placed in a wagering pool on a sports event or contest, if such pool is conducted for profit, and
- placed in a lottery conducted for profit.

The wagering taxes apply to all race and sports book establishments whether they are authorized or unauthorized. Tip jars, raffles, pull-tabs, and similar games meet the definition of taxable wagers placed in a lottery.

Where a wagering pool or lottery is operated with the expectation of a profit in the form of increased sales, attendance, or other indirect benefits, the event is staged for profit. See Reg. 44.4421-1(c)(4).

Reg. 44.4421-1(c)(1) defines wagering pool. A wagering pool conducted for profit includes any method or scheme for the distribution of prizes to one or more winning bettors based on the outcome of a sports event (see Reg. 44.4421-1(c)(2)), a contest, or a combination or series of such events or contests, if the wagering pool is managed and conducted for the purpose of making a profit.

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

Reg. 44.4421-1(b)(1) provides 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 determined by the numbers or symbols on tickets as drawn from a lottery wheel or other receptacle, or by the outcome of an event. The operation of a punch board or a similar gaming device for profit is also considered to be the operation of a lottery.

Rev. Rul. 57-258, 1957-1 C.B. 418, holds that a pull-tab game is essentially nothing more than a type of punch board game that falls within the meaning of the term "lottery" as used in IRC 4421(2) and, as such, is subject to the wagering taxes imposed by IRC 4401 and 4411.

Most legal wagering conducted by non-profit organizations relates to lotteries.

7. Exemptions From Tax

IRC 4402 and Reg. 44.4402-1 provide three exemptions to the taxes on wagering:

A. Parimutuel Wagering Enterprises Licensed Under Any State Law

No tax shall be imposed on any wager placed with, or on any wager placed in a wagering pool conducted by, a parimutuel wagering enterprise licensed under State law.

> *Example 1. An exempt organization conducts horse racing with parimutuel betting in conjunction with an agricultural fair. The State has licensed the organization to conduct the horse racing with parimutuel wagering during its fair. The wagers are not subject to excise tax.*

B. Coin-operated Devices

No tax shall be imposed on any wager placed in a coin-operated device or on any amount paid, in lieu of inserting a coin, token, or similar object, to operate a device described in former IRC 4462(a)(2).

> Reg. 44.4402-1(b)(1) provides that these devices include so-called "slot" machines that operate by means of the insertion of a coin, token, or similar object and that, by application of the element of chance, may deliver, or entitle the person playing or operating the machine to receive cash,

premiums, merchandise, or tokens; and machines that are similar to slot machines described above and are operated without the insertion of a coin, token, or similar object.

Reg. 44.4402-1(b)(2) provides as examples of wagering machines some pinball type machines that have the features and characteristics of a gaming device. These include so called crane/claw/digger devices; as well as a coin-operated machine that displays a poker hand or delivers a ticket with a poker hand symbolized on it that entitles the player to a prize if the poker hand displayed by the machine or symbolized on the ticket constitutes a winning hand.

The Service has not formally issued guidance as to whether pull-tab dispensing machines and electronically simulated pull-tab games devices are wagering machines within the meaning of Reg. 44.4402-1(b). Therefore, technical advice should be requested where pull-tab dispensing machines or electronically simulated pull-tab game devices are encountered during examination.

C. Sweepstakes, Wagering Pools, or Lotteries Conducted By a State Agency

This topic does not discuss gambling activities conducted by state agencies.

8. Exclusions From Tax

A. Social Bets

A social or friendly bet placed with a person not in the business of accepting wagers is not a wager as defined in IRC 4421 and Reg. 44.4421-1(a). However, according to Reg. 44.4421-1(c)(4), a wagering pool or lottery may be conducted for profit even though direct profit will not inure from the operation. If it is operated with expectation of a profit in the form of increased sales or attendance or other indirect benefits, the wagering pool or lottery is conducted for profit for wagering tax purposes.

Example 2. During the baseball world series, a group of employees in an office each contribute $5 for a chance to win the entire proceeds contributed to the pool. The winner is the person holding the ticket for the inning in which the highest number of runs is scored. This is a social or friendly type of operation because it is not conducted for profit.

B. Games When All Are Present

Bingo games are generally excluded from the application of the wagering tax because they are excluded from the definition of lottery by IRC 4421(2)(B). IRC 4421(2)(A) provides that the term lottery does not include games where the wagers are placed, the winners are determined, and the prizes are distributed in the presence of all persons placing wagers in the game. Reg. 44.4421-1(b)(2)(i) provides, for example, no tax would be payable with respect to wagers made in a bingo or keno game since such 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. Bingo and gambling wheels and perhaps keno are common gaming activities conducted by tax-exempt organizations. However, if bingo is played other than in the traditional manner as described in Reg. 44.4421-1(b)(2)(i) it may be a lottery for the purposes of the wagering excise tax (see section 6. above and the discussion of "instant bingo" below).

C. Exclusions From Lottery for Certain IRC 501 and 521Organizations

> Reg. 44.4421-1(b)(2)(ii) provides in part:
>
> IRC 4421 specifically excludes from the term "lottery" any drawing conducted by an organization exempt from tax under IRC 501 or 521, if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual. See also Rev. Rul. 57-241, 1957-1 C.B. 419. See also G.C.M. 39740 (May 31, 1988).

IRC 527 organizations are **not** exempt from the wagering taxes, since they are not exempt from income tax under IRC 501 or 521.

(1) Inurement Proscription

Generally, gaming revenue from non-member sources taints any presumption that **no part** of the net proceeds derived from the gaming operation inures to the benefit of any private shareholder or individual. To sustain an assertion of tax, however, the facts must show the source and disposition of the net proceeds from wagering. For example, if it is shown that wagers were accepted from nonmember sources and the wagering proceeds were commingled with other revenue, and those proceeds were applied in part to defray operating expenses or to subsidize member benefits and/or services and in part for

charitable purposes, the wagering proceeds have inured to the benefit of members. Thus, inurement can be attributed to the wagering activities and liability for tax arises on the total amount wagered. If, on the other hand, wagering revenue is separately accounted for and is earmarked solely for charitable purposes, no inurement may be attributed to the wagering activities and no liability for tax arises.

The above rules have been applied in several cases. Where participation in the revenue raising activity of gambling was limited to members of a social or fraternal organization, inurement was not established since the financial resources were merely shifted between members of the group. Rochester Liederkranz v. United States, 456 F.2d 152 (2d Cir. 1972). See also Rev. Rul. 74-425, 1974-2 C.B. 373.

Knights of Columbus Council No. 3660 v. United States, 783 F.2d 69 (7th Cir. 1986), concerned an exempt fraternal organization which sold lottery tickets to the general public and held weekly drawings. The court noted that the Council used proceeds from the drawings to defray club operating expenses and to subsidize membership activities, recreational and social functions. Further, the court found that inurement was present because the income from its public ticket sales was used for the general operation of the organization. Without the income, Council members would have had to pay higher membership dues or see the quality and quantity of membership benefits and services substantially reduced. The court concluded that the taxpayer was liable for the wagering taxes imposed by IRC 4401 and 4411 with respect to public ticket sales.

The general rule is that an organization exempt under IRC 501(a) will not be subject to the wagering taxes if **no part** of the pull-tab net proceeds inures to the private shareholder or individual. However, where inurement to a private shareholder or individual exists with regard to any net income from a pull-tab game conducted for profit, the exemption from the wagering taxes provided by section 4421(2)(B) would not be applicable. Whether inurement exists may depend on the particular facts. A volunteer fire department may use wagering proceeds to buy and maintain fire fighting equipment, maintain a firehouse and defray other expenses incident to providing the community fire protection and ambulance and rescue services without inurement occurring. Providing such services has been held to be charitable and also as promoting the common good and general welfare of the community. See Rev. Rul. 74-361, 1974-2 C.B. 159. However, a social club's use of non-member wagering proceeds to subsidize member activities constitutes inurement for purposes of the wagering tax provisions. See Rev. Rul. 79-145, 1979-1 C.B. 360.

Technical Advice Memorandum 9529004 describes a section 501(c)(19) organization that conducts pull-tab drawings for profit. The pull-tabs are sold to anyone who attends its public bingo games, whether member or not. A portion of the net proceeds is used to

pay the operating expenses of the organization and, thus, indirectly inures to the members. The TAM concluded that the taxpayer is liable for the wagering taxes imposed by IRC 4401 and 4411 with respect to sales of pull-tabs even though the sales were made by uncompensated volunteer members.

Technical Advice Memorandum 9509001 found that a drawing conducted by a IRC 501(c)(3) public charity is not a taxable lottery if no part of the net proceeds inures to the benefit of any private shareholder or individual. The organization is a non-stock, non-dues membership corporation. There was no private inurement resulting from the organization's pull-tab operation. The TAM concluded that the taxpayer is not liable for the wagering taxes imposed by IRC 4401 and 4411 with respect to amounts wagered on pull-tab games. See Reg. 44.4421-1(b)(2)(ii).

Although TAM's cannot be cited as authority, the rationale and discussion contained therein can be used.

In T.C.M. 1995-439, aff'd, 98 F.3d 190 (1996), Julius M. Israel Lodge of B'nai B'rith No. 2113, v. Commissioner, the court stated that federal law dictates when and how to tax regardless of state classification. The Tax Court held that "instant bingo" does not satisfy the requirements of IRC 513(f) and the proceeds from instant bingo activities are subject to the unrelated trade or business income tax under IRC 511(a). Therefore, instant bingo is a type of pull-tab game. Rev. Rul. 57-258, supra, holds that a pull-tab game is essentially nothing more than a type of punch board game that falls within the meaning of the term "lottery" as used in IRC 4421(2) and, as such, is subject to the wagering taxes imposed by IRC 4401 and 4411. However, pursuant to Rev. Rul. 54-240, 1954-1 C.B. 254, otherwise taxable punch board type games conducted by an exempt organization may come within the meaning of a "drawing" as that term is used in IRC 4421(2). As such, drawings are exempt from the wagering taxes provided no part of the net proceeds derived from such operation inures to the benefit of any private shareholder or individual of the exempt organization.

Pull-tabs, raffles, and punch boards may be conducted "for profit" even though a direct profit will not inure from the operation of the activity. Drawing or lottery proceeds used for the general operating expenses of an organization constitute inurement to the benefit of members, but only for purposes of determining the application of the wagering tax.

> *Example 3. The Order of ABC, a fraternal organization, conducts a raffle to raise money. The proceeds of the raffle go into the General Fund and are used to pay the general operating expenses of the Order. The wagering tax applies because the members of the Order are receiving a benefit*

from the raffle. Specifically, use of the raffle proceeds to offset the general expenses of the sponsoring organization's social, recreational or fraternal activities, or to reduce the members' dues, constitutes inurement.

Example 4. ABC, exempt under IRC 501(a), sells pull-tabs in its bar. State law provides that organizations exempt under IRC 501(a) may sell pull-tabs through employees. ABC allows members of the public to purchase pull-tabs. Proceeds go to ABC's general account to pay expenses. As the pull-tab drawing is open to the public and pull-tab proceeds are used to pay the organizational operating expenses, an indirect inurement to the members occurs. ABC is liable for the wagering excise tax calculated at 0.25 percent.

Example 5. The same facts as above except ABC does not allow members of the public to purchase pull-tabs. As the wagers accepted by ABC in connection with the pull-tabs are only open to the organization's members and their bona fide guests, it is not subject to the wagering excise tax.

Example 6. ABC Lodge, exempt under IRC 501(c)(10), sells pull-tabs to members of the public across the bar at its Lodge. The proceeds go to its general account to pay operating expenses. The bartenders sell the pull-tabs. The bartenders are paid employees of the Lodge. In X, the state where ABC Lodge is located, the sale of pull-tabs is restricted to tax exempt organizations and must be conducted by volunteer labor. ABC would be liable for the wagering excise tax under IRC 4401 because the pull-tabs are sold to members of the public and the proceeds of the wagers are used to offset the general expenses and social, recreational or fraternal activities of the membership.

Further, the tax rate would be 2 percent, because the wager is not authorized under state law. State law limits the sale of pull-tabs to volunteer labor, and ABC is using paid labor to sell the pull-tabs. Thus ABC is in violation of state law and must pay the higher rate.

Example 7. An IRC 501(c)(19) organization sells pull-tabs using volunteer members during the weekly bingo games held in a rented building. Over 40% of the proceeds from the pull-tab operation were donated to charity. Other expenditures of the pull-tab proceeds were directed to funding the activities related to the exempt purposes of the organization including operating and administrative expenses. In Z, the state where the organization is located, the sale of pull-tabs is restricted to religious, charitable, and veterans organizations and must be conducted by volunteer labor. Because ***part of*** *the proceeds benefits the members, the organization would be subject to the IRC 4401 tax on the* ***full amount wagered*** *at the .25 percent rate.*

(2) Conducted By

Rev. Rul. 69-21, 1969-1 C.B. 290, concludes that a "drawing" that is "conducted by" an organization exempt under IRC 501 must, in fact, be operated by such organization to be excluded from wagering taxes. The term "drawing" as it relates to wagering taxes refers to the physical drawing of a ticket, or its equivalent thereof, such as the use of a wheel or a similar device whereby the winner is conclusively determined by a number, letter, legend, or symbol without reference to any other event, the happening of which is beyond the control of the operator. The ruling held that there is a basic distinction between mere sponsorship of a drawing and actual conduct thereof. In general, "conduct" denotes supervision and control, as distinguished from lending the name of an organization to the activity or endorsing it.

Application of the above principles to specific facts is often difficult. Consider the case of a tax exempt organization that arranges with a carnival operator to conduct a carnival under the tax-exempt organization's auspices. The entire operation is managed and controlled by the carnival operator, including the sale of raffle tickets on an automobile. Under the financial agreement between the two parties, the carnival operator receives a percentage of the amount of raffle ticket sales. The question of whether or not net proceeds are inuring to the benefit of private individuals must be determined not only by the reasonableness of the amount of the commissions paid, but by all other factors

bearing upon the relationship of the parties to each other including whether the exempt organization did in fact control and conduct the operation in question as required by statute, or whether it was really a joint venture with non-exempt organizations or individuals.

Where there are joint ventures with non-exempt organizations or individuals, the exclusion from the wagering tax is defeated not only because the operation is not "conducted by" an exempt organization but also because it follows from the nature of the enterprise that some part of the net proceeds inures to the benefit of the non-exempt organization or individuals involved and the second requirement for exclusion is not met.

9. Returns, Payments, and Records

Reg. 44.6011(a)-1 requires that Form 730 be used to compute and pay the excise tax under IRC 4401.

Form 730 must be filed monthly whether or not liability has been incurred for that month. If the taxpayer does not have any wagers to report for a month, "NONE" shall be written on the return. If the taxpayer ceases operations which make him liable for the tax, the last return shall be marked "Final Return". See Reg. 44.6011(a)-(1)(a).

The Instructions to Form 730 provide additional filing information. An organization may be subject to civil and criminal penalties for failure to file the form or to pay the tax.

Rev. Rul. 77-51, 1977-1 C.B. 346, holds that in view of the enactment of IRC 4420, the delinquency and fraud penalties imposed by IRC 6651 and 6653 (now IRC 6663) may be assessed and collected for failure to file wagering Forms 730 and 11-C and pay the required taxes.

IRC 4422 and Reg. 44.4422-1 provide that paying the wagering tax does not protect a person from prosecution for violation of any federal or state law for engaging in the activity.

Tax assessments are generally self-assessed on a return filed by a taxpayer. Every person required to pay the tax on wagers must keep adequate records. See Reg. 44.6001-1.

IRC 4403 provides that each person liable for the wagering tax shall keep a daily record showing the gross amount of all wagers on which he is so liable, in addition to all other records required pursuant to IRC 6001(a).

Reg. 44.4403-1 provides that every person liable for tax under IRC 4401 shall keep such records as will clearly show as to each day's operations:

(1) The gross amount of all wagers accepted;

(2) The gross amount of each class or type of wager accepted on each separate event, contest, or other wagering medium.

For example, bingo and pull-tab gross wagers should be shown separately.

IRC 4423 provides that notwithstanding IRC 7605(b), the books of account of any person liable for taxes on wagering may be examined and inspected as frequently as may be needful to the enforcement of taxes on wagering.

Reg. 44.6001-1 provides additional provisions relating to general records, records of agent or employee, record of claimants, place for keeping records, and period for retaining records. Rev. Rul. 72-554, 1972-2 C.B. 630, holds that certain documents prepared and used by gambling establishments constitute records within the meaning of IRC 6001 and the regulations and must be retained so long as they may become material to the administration of any tax law.

Reg. 44.6001-1(e) provides that all records required by the regulations shall at all times be available for inspection by internal revenue officers. Further, that the records required by Reg. 44.4403-1 and by paragraph (a) of this section shall be maintained for a period of at least three years from the date the tax became due; records required of agent or employee shall be maintained for a period of at least three years from the date the wager was received; and records required of claimants shall be maintained for a period of at least three years from the date any credit is taken or refund is claimed.

When any person liable for the wagering tax imposed by IRC 4401 or who is engaged in receiving for or on behalf of another person (at any place other than a registered place of business of such other person) wagers of a type subject to the tax imposed by IRC 4401, has failed to maintain sufficient records as required by Reg. 44.4403-1 and 44.6001, a notice on Letter 911 (DO) (Notice of Inadequate Records to Wagering Taxpayers) or Letter 912 (DO)(Notice of Inadequate Records to Agents or Employers of Wagering Taxpayers) may be issued. See IRM 4791. The factors in IRM 4271.21:(4)(b) should be applied in reaching a decision to send a notice of inadequate records.

10. Credit or Refund

If a person overpays the tax imposed under IRC 4401, IRC 6419 and the regulations thereunder provide that the person may either file a claim for refund on Form 8849, Claim for Refund of Excise Taxes, or take credit for such overpayment against the tax due on a subsequent monthly return. However, to perfect a claim for refund under IRC 6419, the person must show that the amount of the tax was not collected from the person that placed the wager, or that the amount of the tax was collected from the person that placed the wager (unless the written consent of the wagerer to the refund is filed with the claim).

A complete statement of the facts involving the overpayment must be attached either to the claim or to the return on which the credit is claimed. See Reg. 44.6419-1.

11. Occupational Tax

The IRC 4411 occupational tax is a companion to the excise tax on wagering. This tax is an annual fee imposed on each person liable for the tax on wagers, or upon any person engaged in receiving wagers for or on behalf of any person so liable. The tax is paid by filing a Form 11-C, which also provides for the registration required by IRC 4412.

The IRC 4411 tax is due from a "principal," that is a person or organization in the business of accepting wagers, as well as from employees/agents of such organization. The latter would include, for example, a paid bartender who sells pull-tabs over a social club's bar. Form 11-C requires use of an employer identification number (EIN); a social security number will not suffice. If the person or organization in the business of accepting wagers, or the employee-agent of such organization does not have an EIN, the taxpayer must complete Form SS-4, Application for Employer Identification Number, and attach it to the Form 11-C when the form is filed.

> *Example 8. XYZ operates a numbers game and arranges for 10 people to receive wagers from the public on XYZ's behalf. XYZ also employs a secretary and a bookkeeper who do not accept wagers. XYZ and each of the 10 persons are liable for the occupational tax. Each must file Form 11-C. The secretary and bookkeeper are not liable for the tax.*

A. Rate and Imposition of Tax

IRC 4411(a) imposes an occupational tax of $500 per year on each person liable for the tax under IRC 4401 on wagers, or upon the person engaged in receiving wagers for or on behalf of any person so liable.

IRC 4411(b) reduces the occupational tax to $50 where liability for the tax under IRC 4401 is determined under IRC 4401(a)(1) (i.e., state authorized wagers) and for persons who are engaged in receiving wagers only for or on behalf of persons so liable.

> *Example 9. ABC Lodge, exempt under IRC 501(c)(10), sells pull-tabs across the bar at the Lodge. The proceeds go to their general account to pay expenses. The bartenders sell the pull-tabs. The bartenders are paid employees of ABC. In X, the state where ABC is located, the sale of pull-tabs is restricted to tax-exempt organizations and must be conducted by volunteer labor. ABC is liable for the wagering excise tax under IRC 4401 at 2% because the proceeds are used to sponsor ABC's fraternal and social activities and the pull-tabs were not sold by volunteer labor. Because ABC is liable for the tax under IRC 4401, ABC and each bartender selling pull-tabs is also subject to the occupational tax under IRC 4411 at $500 because the acceptance of the wager is not operated in accordance with State law.*

B. Partnership Liability

IRC 4902 and Reg. 44.4902-1 provide that only one occupational tax stamp is required of persons in a copartnership.

C. Change of Address

Where there is a change of business or residence address, IRC 4905 and Reg. 44.4905-2 requires the filing of a "Supplemental Return" on Form 11-C.

D. Application of State Laws

IRC 4906 provides that paying the wagering tax does not protect a person from prosecution for violation of any state law. For provisions relating to the applicability of Federal and state laws, see IRC 4422 and Reg. 44.4422.

E. Registration and Penalties

IRC 4901 and Reg. 44.4901-1(a) require that the occupational tax must be paid before anyone engages in any wagering activities. Registration is accomplished by filing a return, with remittance in full, on Form 11-C. After the form is filed and the tax is paid, the Service issues the taxpayer a special tax stamp as evidence of registration and payment.

IRC 4901 provides that for purposes of the occupational tax imposed by IRC 4411, the tax year begins July 1. In the case of a person commencing any trade or business on which the tax applies, the individual shall pay a proportionate part of the annual tax from the first day of the month in which the liability for the tax commences. Reg. 44.4901-1(b)(2) defines "commencing business" as a person's initial acceptance of a wager subject to the tax imposed by IRC 4401. Thereafter, the person must pay the full tax by July 1 of each year. Persons in business for only a portion of a month are liable for tax for the full month, that is, a person first becoming subject to the special tax on, for example, the 20th day of a month, is liable for tax the entire month.

Taxpayers who accept wagers only a few months of the year (For example, on a seasonal basis) are still engaged in the business of accepting wagers all year. They may not reduce the tax imposed by IRC 4411 and must pay the full occupational tax by July 1 of each year. See Rev. Rul. 81-258, 1981-2 C.B. 216.

Rev. Rul. 77-393, 1977-2 C.B. 382, holds that employees hired before the end of a taxable year to replace employees who had been engaged in receiving wagers on behalf of another person, and who had paid the occupational tax imposed by IRC 4411 for the entire taxable year, are also subject to the tax in that taxable year. However, new employees would be liable only for the proportionate part of the tax computed from the first day of the month during which they began receiving wagers to the following June 30th. For example, if D had commenced receiving wagers on A's behalf on April 15, D would have been liable for a special tax of $125 (based on 1/4 of a year) rather than the full $500. In addition, there is no refund available of the occupational tax paid by employees who leave the employ of the person accepting wagers on behalf of another person.

Rev. Rul. 77-51, supra, holds that in view of the enactment of IRC 4424, the delinquency and fraud penalties imposed by IRC 6651 and 6653 (now IRC 6663) may be assessed and collected for failure to file wagering Forms 730 and 11-C and pay the required taxes.

IRC 7262 Violation of occupational tax laws relating to wagering - failure to pay special tax is not an assessable penalty. See Chapter 68 Subchapter B.-Assessable Penalties Part I. General Provisions IRC 6671 - IRC 6715.

F. Form 11-C Tax Period

Although the Form 11-C return has an ending month of June 30, the tax period beginning date (July not June for annual returns or month wagers are first accepted) is shown as the tax period on IDRS, transcripts, notices, and Special Tax Stamps. This is contrary to the normal year ending tax period posting cycle. The tax period for annual returns is entered as July of the applicable year (e.g., Form 11-C for the period from July 1, 1998 to June 30, 1999, has tax period 199807). Where wagers are first accepted in a month other than July, the tax period is determined by that month and year.

Example 10. Taxpayer X begins accepting wagers on September 11, 1998. The Form 11-C tax period September 11, 1998 to June 30, 1999 is shown as 199809. Thereafter, the tax period month is July. Taxpayer X files subsequent annual return for period July 1, 1999 to June 30, 2000. The tax period is 199907.

12. Examination Techniques

An examination of the wagering tax and determination of gaming gross income or unrelated trade or business income tax should be done simultaneously, since the figures used in both examinations, such as gross wagers, are the same. If no records are kept by the taxpayer as to wagering activity or amounts wagered, it will be necessary to reconstruct daily wager play.

Information that would be helpful in reconstructing an average wager daily amount include copies of any available records from local law enforcement officials or gaming regulators. This information may be useful in determining an average daily wager which can be projected between periods that the taxpayer appeared to be in the wagering business.

The Form 11-C should be secured for the period covered by the Forms 730.

Computer generated alphabetical listings for Forms 11-C and Forms 730 are produced in March of each year for the prior calendar year. The listing may be used to determine whether organizations engaged in wagering have filed Forms 11-C and 730.

For a more complete discussion of examination techniques in cases involving gaming activities, see IRM 4700, Excise Tax Procedure and IRM 4235, Techniques Handbook for In-Depth Examinations.

A discussion of examination techniques where fraud is suspected may be found in the Continuing Professional Education Exempt Organizations Technical Instruction Program for FY 1997 at D. Detecting Fraud in Charity Gaming, page 31.

13. Jeopardy Assessment

Where the collection of excise taxes is in jeopardy, appropriate jeopardy assessment action may be taken. The statutory authority for jeopardy assessments in excise tax cases is IRC 6862.

14. Summary

Organizations that are exempt from income tax under IRC 501 or 521 are **not** categorically exempt from the excise tax on wagering or the occupational tax. Federal wagering tax laws apply to both authorized and unauthorized gaming activities conducted by exempt organizations.

Most legal wagering conducted by non-profit organizations relates to lotteries. "Pull-tab" or "instant" games meet the definition of taxable wagers placed in a lottery. Bingo games are generally excluded from the tax. The term "lottery" does not include any wagering conducted by an exempt organization if no part of the net proceeds derived from the activity inures to the benefit of any individual.

Certain gaming activities which are "conducted by" organizations exempt under IRC 501 are not subject to wagering excise and occupational taxes, pursuant to IRC 4421(2)(B).

The facts and circumstances of the types of wagering conducted, as well as the benefits derived therefrom, may have a bearing on whether the wagers are subject to the taxes.

Publication 510, Excise Taxes for 1998 includes a general discussion of the wagering taxes. The publication is updated annually.