The Family (Office) Lottery Pool; Do You have a Written Sharing Agreement?

By Frank L. Brunetti on March 21, 2012

In *Dickerson v. Comm.*, TC Memo 2012-60, The Tax Court has held that a taxpayer's transfer of her interest in a winning lottery ticket to a corporation 49% owned by her and 51% owned by family members resulted in a taxable gift because there was no enforceable contract to share the lottery prize with her family.

Tonda Dickerson worked as a waitress in an Alabama restaurant frequented by a customer who often made gifts of Florida lottery tickets to the workers of the establishment. On Mar. 7, 1999, a customer gave Tonda a winning lottery ticket with a cash payout amount of $5 million (over $10 million if paid out over 30 years). As with many families, Tonda's family was close-knit and generally had a sharing attitude. It had a tradition of buying lottery tickets and often talked about sharing a jackpot if a family member won "the big one." In Tonda's case, however, there was no written sharing agreement to share lottery winnings and she had no documentation to support its existence or terms.

On Mar. 8, 1999, a lawyer prepared incorporation papers for an S corporation called 9 Mill, in which Tonda had a 49% interest, and in which her mother and two siblings each held 17% interests. The percentages were determined by the head of the family, Tonda's father. The articles of incorporation for 9 Mill were signed on Mar. 11, 1999.

On Mar. 9, Tonda learned of her co-workers' claim that she was obligated to share the prize with them under a pre-existing agreement to share lottery proceeds if any of them won. They claimed they were owed 80% of the total prize. On Mar. 12, Tonda and her family members went to Florida to collect on the ticket and Tonda, signing on 9 Mill's behalf, made an election to receive the lottery prize over 30 years. However, lottery officials would not pay out the prize because of the competing claim to the lottery ticket by Tonda's co-workers. In 1999, a state court found in favor of the co-workers, but later, the Alabama Supreme Court reversed and held for Tonda. While the claimants presented sufficient evidence to support a finding that an oral agreement existed, the Court held that under Alabama law, the agreement was unenforceable on public policy grounds because it was "founded on gambling consideration."

In 2007, Tonda filed a gift tax return for 1999, but reported that no taxable gift had been made. On audit the IRS disagreed and claimed that she had made a gift of $2,412,388 as a result of her transfer of the lottery ticket to 9 Mill. It determined a gift tax deficiency of $771,570. IRS's argument was that Tonda's transfer of the lottery ticket to 9 Mill was an indirect gift to the extent that 51% of the shares were, at the time transfer of the lottery ticket took place, owned by her mother, brother, sister, and sister-in-law. On the other hand Tonda argued that no taxable gift occurred because at the time of the lottery ticket transfer there had previously existed and remained in effect a binding and enforceable contract under Alabama law requiring the transfer. Alternatively, she argued that the family members and Tonda were all members of an existing partnership under federal tax law which was the true owner of the lottery ticket or its proceeds.

The Tax Court agreed with the IRS and held that there was no enforceable contract to share the lottery prize among the members of Tonda's family. The "terms" of the so-called family agreement were too indefinite, uncertain, and incomplete, and consisted solely of offhand statements made throughout the years about sharing and taking care of one another if someone came into a substantial amount of money. This wasn't enough, said the Tax Court. There was no requirement that each family member buy lottery tickets, no pattern of buying, no pooling of money, and no predetermined sharing percentages. Additionally, the Tax Court held that the alleged agreement, even if otherwise enforceable under contract principles, would be rendered void under the Alabama antigambling statute.

The Tax Court also held that there weren't enough facts to indicate that a partnership existed among family members and that it was the owner of the gifted lottery ticket. There was no regular and consistent pattern of buying lottery tickets, and the decision of how the ticket proceeds should be split was made by Tonda's father, rather than jointly by all the family members.

Contrast this Tax Court decision with a prior IRS ruling regarding a sharing agreement. In PLR 9217004 two long-time companions (A&B) were in the habit of buying lottery tickets with money taken from a pooled fund. One of the companions was in charge of disbursing the funds from the pool as circumstances arose. One of the tickets was a winner. The partner who was in charge of the funds signed the back of the ticket and kept charge of it. When the two went to claim the money, they were told that under state law the lottery proceeds could be paid to only one recipient.

Consequently, each party represented by independent legal counsel, executed a "Separate Ownership Agreement." The agreement provides, in part:

1. Effective on and before December 2, 1988, B and A had agreed that each of them had an equal and separate interest in any and all proceeds that might result from the purchase of any and all lottery tickets by the parties from their joint funds.

2. The winning lottery ticket purchased December 2, 1988, at the convenience store was purchased with joint funds and B and A each have a separate and distinct interest in one-half of the proceeds and thus the proceeds of such lottery ticket shall be divided as follows:

A 50 percent

B 50 percent

3. The agreement appointed an “agreement manager” to receive the funds and disburse the funds to A and B.

The agreement was submitted to the Lottery Commission and, after the agreement was approved, the initial installment was paid to the agreement manager, in accordance with the Separate Ownership Agreement.

The IRS in its ruling noted that the parties intended and understood that from the time the ticket was purchased that each party equal interests in the ticket and the proceeds. They had made a practice of pooling all of their funds to cover the purchase of food and other necessities. In addition, they also used their pooled funds to purchase lottery tickets. This practice of pooling their funds had been on going for at least 9 months prior to the purchase of the ticket. The funds for the purchase of the ticket came from B’s purse where A and B kept their pooled funds. B was aware at the time that the ticket was being purchased and specifically disbursed funds to A for the purpose of purchasing the ticket. A’s transfer of possession of the ticket to B after it was ascertained that the ticket was a winning ticket and B’s act of signing the ticket were consistent with the manner in which A and B had previously handled their finances; i.e., a pooling of resources, with B in possession of the couple’s funds. The IRS noted that A and B viewed themselves as possessing equal ownership interests in the ticket from the inception.

In the technical advice, the Service ruled that the money obtained by the couple was owned jointly and the federal gift tax does not apply. In its ruling, the Service accepted the ruling by the state lottery commission that the “Separate Ownership Agreement” was legitimate and constituted a recognition of the joint ownership in the lottery ticket.

The “moral of the story” whether it is an office or family pool, is to form a partnership for the purpose of sharing in the cost and winnings of any lottery purchase endeavor or at least have a written sharing or ownership agreement coupled with a pattern of conduct to support such an agreement.