

GAMING PUBLICATION FOR TAX-EXEMPT ORGANIZATIONS



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GAMING PUBLICATION FOR TAX-EXEMPT ORGANIZATIONS

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I N T R O D U C T I O N

The term “gaming” includes activities such as Bingo, Beano, lotteries, pull-tabs, parimutuel betting, Calcutta wagering, pickle jars, punch boards, tip boards, tip jars, certain video games, 21, etc. All exempt organizations conducting or sponsoring gaming activities, whether for one night out of the year or throughout the year, whether in their primary place of operation or at remote sites, must be aware of the federal requirements for: **Income Tax, Employment Tax and Excise Tax.**

QUICK TIPS

- Bingo is gambling
- Pull-tabs are not Bingo
- Gambling is not charitable
- Tax-exempt organizations may be subject to tax:
 - Unrelated Business Income Tax
 - Employment Taxes
 - Excise Taxes
 - Withholding Taxes
- Records of gross revenue & expenses must be maintained

EXEMPT ORGANIZATION & PRIVATE FOUNDATION STATUS



This chapter contains information concerning tax-exempt status for organizations conducting charitable gaming and the private foundation status for organizations recognized as tax-exempt under section 501(c)(3) of the Internal Revenue Code.

ORGANIZATIONS UNDER SECTION 501(C)

Most states require that an organization be recognized by the IRS as exempt from federal income tax before issuing a license to conduct charitable gaming. Many states limit licenses to organizations recognized under specific subsections of Code section 501(c). For further information on specific subsections see, Publication 557 - Tax-Exempt Status for Your Organization. To determine how the discussions in later chapters apply to you, you must know the Code section under which you are exempt.

Section 501(c) contains a list of organizations that are tax-exempt. Organizations most likely to engage in charitable gaming are:

- 501(c)(3) organizations operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, to foster national or international amateur sports competition, or prevention of cruelty to children or animals;
- 501(c)(4) civic leagues, social welfare organizations, and local associations of employees;
- 501(c)(7) social and recreational clubs;
- 501(c)(8) fraternal beneficiary societies, orders or associations;
- 501(c)(10) domestic fraternal societies, orders or associations; and
- 501(c)(19) veterans' organizations and their auxiliary units.

NOTE:

Veterans' organizations are generally either section 501(c)(4) or section 501(c)(19) organizations.

PRIVATE FOUNDATION STATUS

Organizations recognized as exempt under section 501(c)(3) may be classified as public charities or private foundations. Organizations conducting gaming are usually classified as public charities under sections 509(a)(1) and 170(b)(1)(A)(vi) or section 509(a)(2).

Section 509(a)(1) and 170(b)(1)(A)(vi) organizations normally receive a substantial portion of support from a governmental unit or from direct or indirect contributions from the public.

Section 509(a)(2) organizations normally receive more than one-third of support from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources, and not more than one-third of support from gross investment income and the excess of the net unrelated business taxable income after taxes as imposed by section 511. Gross receipts from gaming activities that are not from an unrelated trade or business are counted as "public support."

Gaming that is an unrelated trade or business may adversely affect organizations described as public charities under sections 509(a)(1) and 509(a)(2), as they may be determined to be private foundations. If an organization is determined to be a private foundation because a substantial source of support is from an unrelated trade or business, it may have excess business holdings in a business enterprise within the meaning of section 4943(a)(1), and may have to divest them. Generally, the organization must cease operating its gaming activities.

FOR MORE INFORMATION:

See IRS Publication 578, Tax Information on Private Foundations and foundation Managers.

EXEMPTION & UNRELATED BUSINESS INCOME TAX (UBIT) IMPLICATIONS



This chapter explains the impact of various types of gaming on exempt status. It also discusses whether the organization is subject to Unrelated Business Income Tax (UBIT).

IMPACT OF GAMING

A common misconception is that the conduct of gaming by an exempt organization is a “charitable” activity. There is nothing inherently charitable about gaming. The conduct of gaming is no different than the conduct of any other trade or business carried on for profit. The fact that an organization may use the proceeds from its gaming to pay for the expenses associated with the conduct of its charitable programs will not make the gaming a “charitable” activity.

Section 501(c)(3) organizations must be organized and operated for charitable or other purposes enumerated in the Code. Therefore, the sole purpose of a 501(c)(3) organization cannot be to conduct charitable gaming. In addition, exemption may be jeopardized when the gaming results in inurement or private benefit to individuals, or where funds from the activity are diverted for private purposes.

Section 501(c)(4) organizations may not conduct gaming as a primary activity. Gaming is considered a business and a recreational activity and does not ordinarily promote social welfare. For example, Rev. Rul. 66-150, 1966-1 C.B. 147, holds that an organization operating social facilities (including a bar, restaurant, and game room) as its primary activity is not exempt. However, this activity may be appropriate for such an organization when it furthers its exempt purpose. For example, Rev. Rul. 74-361, 1974-2 C.B. 159, holds that social activities engaged in for the purpose of increasing camaraderie of firemen promote social welfare as they encourage better performance.

Section 501(c)(4) organizations are also subject to an inurement proscription. See the Taxpayer Bill of Rights II, PL 104-168, 110 Stat. 1452 (1996).

Gaming activities do not serve exempt purposes of section 501(c)(5) - Labor, Agricultural, and Horticultural Organizations, and 501(c)(6) - Business Leagues and similar organizations. The conduct of such activities may result in unrelated business taxable income (UBTI) or jeopardize exemption.

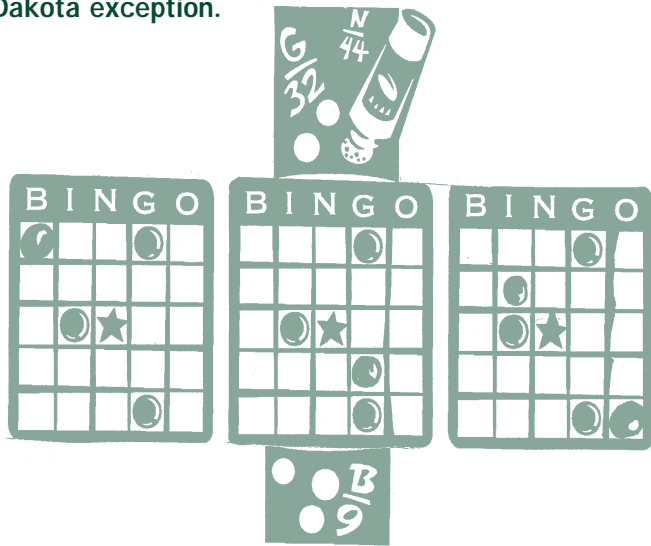
There are several categories of organizations whose exempt function includes providing social or recreational activities for members and their bona fide guests. Such organizations include social clubs described in section 501(c)(7), fraternal beneficiary societies described in section 501(c)(8), domestic fraternal societies described in section 501(c)(10), and veterans’ organizations described in section 501(c)(19). Gaming activities involving only members directly further exempt social/recreational purposes under these sections. Gaming open to the general public may result in UBIT or adversely affect exempt status.

UNRELATED BUSINESS INCOME TAX (UBIT) - IN GENERAL

An exempt organization is subject to tax on unrelated business income (UBI) from revenues derived from the conduct of a regularly carried on trade or business which is not substantially related to its exempt

purposes. See Publication 598, Tax on Unrelated Business Income of Exempt Organizations, for further discussion on the tax on UBI, including filing requirements and computing UBI. An organization may be subject to interest and penalty charges if it files a late return or fails to pay tax when due. Also, see the Instructions for Form 990-T, Exempt Organization Business Income Tax Return, for information for filing Form 990-T if an organization has gross income from an unrelated trade or business of \$1,000 or more. Income from regularly conducted gaming is treated as UBI, unless a specific exclusion applies. See Announcement 89-138, 1989-45 I.R.B. 41 (Nov. 6, 1989) at Exhibit A.

Exclusions to UBTI include: certain **bingo games** (section 513(f)), the **volunteer labor exception** (section 513(a)(1)), qualified **public entertainment activities** under section 513(d)(2), and the **North Dakota exception**.



Exception for certain bingo games

The Code provides an exception from UBTI for any income from bingo games (Code section 513(f)). Note: This exception has limited applicability to organizations described in section 501(c)(7).

Bingo is defined as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the

game. As used in this section, bingo game means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property are distributed in the presence of all persons placing wagers in that game.

The exception applies only if the game is legal under state and local law and not in direct commercial competition with similar games conducted by for-profit organizations. If Bingo is expressly prohibited under state law or local law, it is immaterial whether state or local officials enforce the law.

EXAMPLE 1: *Church Z, a tax-exempt organization, conducts weekly bingo games in State O. State and local laws in State O expressly provide that bingo games may be conducted by tax-exempt organizations. Bingo games are not conducted in State O by any for-profit businesses. Since Z's bingo games are not conducted in violation of state or local law and are not the type of activity ordinarily carried out on a commercial basis in State O, Z's bingo games do not constitute an unrelated trade or business.*

EXAMPLE 2: *Rescue Squad X, a tax-exempt organization, conducts weekly bingo games in State M. State M has a statutory provision that prohibits all forms of gaming including bingo games. However, that law generally is not enforced by state officials against local charitable organizations such as X that conduct bingo games to raise funds. Since gaming is prohibited under state law, the bingo games are illegal, and X's bingo games constitute an unrelated trade or business regardless of the degree to which the state law is enforced.*

This exception does not apply to bingo games conducted in a jurisdiction in which the games are "ordinarily carried out on a commercial basis." This means if for-profit organizations can regularly carry on bingo games in any part of the jurisdiction, the exclusion from UBIT does not apply. The jurisdiction is normally the entire state; however, in certain situations, local jurisdiction will control. If state laws permit local jurisdictions to determine whether bingo

games may be conducted by for-profit organizations, or if state law limits or confines the conduct of bingo games by for-profit organizations to specific local jurisdictions, then the local jurisdiction will constitute the appropriate jurisdiction for determining whether bingo games are ordinarily carried out in a commercial manner.

EXAMPLE 3: *Veterans' organizations Y and X, both tax-exempt organizations, are organized under the laws of State N. State N has a statutory provision that permits bingo games to be conducted by tax-exempt organizations. In addition, State N permits bingo games to be conducted by for-profit organizations in City S, a resort community located in County R. Several for-profit organizations conduct nightly bingo games in City S. Y conducts weekly bingo games in City S. X conducts weekly bingo games in County R. Since state law confines the conduct of bingo games by for-profit organizations to City S, and since bingo games are regularly carried on there by those organizations, Y's bingo games conducted in City S constitute unrelated trade or business. However, X's bingo games conducted in County R outside of City S do not constitute unrelated trade or business.*

In order to qualify for the "Bingo" exclusion, the wagers must be placed, winners determined, and prizes or other property distributed in the presence of all persons placing wagers in that game.

Income from the sale of "Instant Bingo" or "Mini Bingos" does not qualify for the Bingo exception. Instant Bingo or mini bingos are considered pull-tab games, not regular bingo games. See Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner, T.C. Memo 1995-439, aff'd, 98 F.3d 190 5th Cir. (1996). Pull-tabs are games where an individual places a wager by purchasing preprinted cards that are covered with pull-tabs. Winners are determined by the individual's pulling back the sealed tabs on the front of the card, and then comparing the patterns under the sealed tabs with the winning patterns preprinted on the back of the card. Winners normally collect their prizes from the pull-tab seller cashier.

Volunteer Labor Exception

The term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation. Although the term "substantially all" is not defined in the context of unrelated trade or business, an unofficial guideline, borrowed from other areas of exempt organization law, is 85%. Please note, that few cases strictly apply the 85% test. Instead, "substantially all" is to be applied in a general manner. Payment made to bartenders, waitresses, snack bar staff, maintenance workers, security, etc. may be considered in determining "substantially all" for purposes of the "volunteer labor exception."

"Compensation" is given a broad interpretation. Even the provision of free drinks or food to workers may be considered compensation if the facts show that the free items are more than a mere gratuity and are intended to be compensation for the workers' services.

Compensation also includes any tips the workers may receive from patrons at the gaming session. Many local jurisdictions strictly prohibit tipping at gaming functions. If tipping is allowed, the exception for "volunteer" labor does not apply. If tips are prohibited by the local jurisdiction and the organization is conducting Bingo and the workers receive tips, the exception for certain bingo games may be inapplicable.

Tuition Reduction

The waiver or reduction of fees for workers for items or services normally charged to non-workers also constitutes compensation. In the following example, the reduction of tuition is compensation to the parents.

EXAMPLE 4: *ABC Organization operates a private school and sponsors gaming activities to raise revenue for the school. Parents who work at the gaming activity are given a tuition reduction of \$50 for each week they work at the gaming session.*

Payment of compensation in this manner or compensation deferred to a later date may be subject to the organization to UBIT. See Chapter 5 for additional information regarding employment tax reporting requirements.

Public Entertainment Activities

Section 513(d) of the Code also provides that income from qualified public entertainment activities engaged in by qualified organizations will not be treated as unrelated trade or business income. A public entertainment activity is one traditionally conducted at fairs or expositions promoting agricultural or educational purposes. Such activities include, but are not limited to, any activity, one of the purposes of which is to attract the public to fairs or expositions or to promote the breeding of animals or the development of products or equipment.

Public entertainment activities are excluded from unrelated trade or business only when they are conducted by a qualifying organization:

- in conjunction with an international, national, state, regional, or local fair or exposition;
- in accordance with the provisions of state law which permit the activity to be operated or conducted solely by such an organization, or by an agency, instrumentality, or political subdivision of such state; or
- in accordance with the provisions of state law which permit such an organization to be granted a license to conduct not more than 20 days of such activity on payment to the state of a lower percentage of the revenue from such licensed activity than the state requires from organizations not described in IRC 501(c)(3), (4), or (5).

A qualifying organization is defined in section 513(d)(2)(C) of the Code as an organization described in section 501(c)(3), (4) or (5), which regularly conducts, as one of its substantial exempt purposes, an agricultural or educational fair or exposition. Activities such as horse racing with parimutuel betting would not be considered unrelated trade or business under this section provided the above requirements are met.



North Dakota Exception

Section 311 of the Deficit Reduction Act of 1984 (as amended by section 1834 of the Tax Reform Act of 1986) provides that for purposes of section 513 of the Code, the term unrelated trade or business does not include games of chance conducted by nonprofit organizations if the conduct of such games does not violate any state or local law and, as of October 5, 1983, there was a state law (originally enacted on April 22, 1977) in effect which permitted only nonprofit organizations to conduct such games. This provision applies to taxable years ending after June 30, 1981. The amendment contained in the Tax Reform Act of 1986 limits the exception to games of chance conducted in North Dakota. Only North Dakota enjoys the exception for non-bingo gaming conducted after October 22, 1986.

RECORDKEEPING



This chapter explains the recordkeeping responsibilities of a tax-exempt organization with regard to gaming income, payouts, and expenses. Examples and suggested recordkeeping methods are provided.

Organizations conducting gaming generate a substantial amount of income at each session, primarily in the form of cash. The cash passes through many hands, which could result in numerous abuses. Thus, every organization should be actively involved in overseeing and controlling each facet of the gaming activity to insure funds are not diverted to private individuals or for private purposes. Oversight involves not only choosing a location to hold the gaming operation, reviewing and approving leases if applicable, but also involvement in conducting the gaming operation. For instance, there should be two different individuals selling pull-tabs and monitoring the control numbers to insure that unauthorized pull-tabs are not being used by individuals claiming to be winners.

The following is only one example of oversight for a bingo operation. If pull-tabs are sold or other forms of gaming conducted, additional controls should be initiated.

- The manager/operator has control over the execution of the game, including payouts, and records the transactions of the game on the daily sheet.
- The cashier receives funds and records serial numbers of games sold.
- A separate cash controller prepares the inventory/paid out reports and independently counts cash receipts and compares the cash on hand to the reports.
- A separate inventory controller reviews the daily sheets received from the operator to determine inventory usage and profit achieved. The inventory controller may also



- ensure that all deposits stated on the daily sheet actually appear on the bank statement.
- A separate check writer is responsible for making all payments related to the gaming expenses.
- The Board of Trustees of the organization reviews and compares the bingo reports or daily sheets with the previous reports for consistency. The Board should monitor the bingo game to ensure that internal controls are functioning properly.

RECORDKEEPING

Exempt organizations are required to maintain all books and records used to determine tax liabilities and to determine information reporting responsibilities, such as Form W-2. Exempt organizations are required to keep the same types of books and records that would be maintained by any other business, including cash receipt and disbursement journals, accounts payable journals, general ledgers, detailed source documents, and copies of any federal tax returns filed.

Organizations conducting gaming activities must maintain records of gross income, prize payouts, and disbursements to substantiate the information submitted on the informational return, Form 990, and the income tax return, Form 990-T. Gross income from gaming activities is determined before any deduction for prizes, taxes, or any other expenses is taken. Exhibits B, C, and D provide examples for pull-tabs, tip boards, and bingo recordkeeping that will provide you with the information required for filing Forms 990 and 990-T. The information in the examples will also provide you with guidance helpful for monitoring your gaming operation.

EXAMPLE 5: *XYZ, an exempt organization, sells pull-tabs during its bingo session. The box of pull-tabs contains 2,400 tickets that sell for \$1 each. The gross receipts for that box of pull-tabs should be \$2,400.*

EXAMPLE 6: *If John Doe, a player, cashes in a \$1 winning ticket for another ticket, \$1 should be included in gross receipts. The theory behind this is that John Doe actually cashed in his ticket for \$1 in cash, then purchased the second ticket for \$1. For simplicity's sake, the cash payment and purchase of the second ticket was combined. Therefore you include the dollar in gross receipts and in prizes awarded.*

Specific recordkeeping requirements concerning non-member income of social clubs exempt under section 501(c)(7) of the Code are explained in Rev. Proc. 71-17, 1971-1 C. B. 683. Note: Section 501(c)(8), 501(c)(10), and 501(c)(19) organizations should also

**Save Your Records
generally three years from
the filing or due date
of the return**

maintain separate records of member and non-member income. Records would include membership records.

Records must be retained as long as the contents may be material in administration of any Internal Revenue law. This usually means as long as the statute of limitations has not expired on the applicable tax year for income tax (generally three years from the filing or due date of the return). In addition, Employment Tax Regulations specify that records must be preserved for at least four years after the due date of employment tax returns, or, if later, four years from the date when the tax was paid.

State and local laws may contain additional recordkeeping and reporting requirements for organizations conducting gaming. State and local laws may also contain licensing requirements and expense limitations relevant to determining expense deductions under section 162 of the Code. It is recommended that each organization obtain a copy of these rules and regulations from the appropriate state or local agency.

FILING REQUIREMENTS



This Chapter describes the filing requirements for the annual information reporting of income and expenses, information returns required for certain wagering activities, and the withholding and backup withholding returns as the filing requirements relate to gaming activities (Bingo, instant bingo, pull-tabs, door prizes) conducted by tax-exempt organizations.

Organizations Conducting Gaming Activities Generally File:

- Form 990Return of Organization Exempt From Income Tax, or
- Form 990-EZShort Form Return of Organization Exempt From Income Tax
- Form 990-T.....Exempt Organization Business Income Tax Return
- Form W-2GCertain Gambling Winnings
- Form 11-COccupational Tax and Registration Return for Wagering
- Form 730Tax on Wagering
- Form 940.....Employer's Annual Federal Unemployment (FUTA) Tax Return
- Form 941Employer's Quarterly Federal Tax Return
- Form 945.....Annual Return of Withheld Federal Income Tax
- Form 8109Federal Tax Deposit Coupon
- Form 1099-MISC....Miscellaneous Income
- Form 1096Annual Summary and Transmittal of U.S. Informational Returns
- Form 5754Statement by Person(s) Receiving Gambling Winnings. (*Note: This form is not filed with the Service.*)

NOTE:

The use of a promoter or contractor to operate gaming for an exempt organization does not relieve the exempt organization of its responsibility to file the appropriate forms.

ANNUAL FILING REQUIREMENTS

Forms 990 and 990-EZ Exempt organizations conducting gaming normally file Form 990, Return of Organization Exempt From Income Tax, or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax, as annual gross receipts, whether related or unrelated, is generally more than \$25,000. **Note:** gross income is computed before any prizes, payouts, or expenses are deducted. The amount of prizes and expenses paid for gaming should be combined and reported on the Special Events and Activities section of Form 990. The instructions for completing the Form 990 or Form 990-EZ should be consulted when preparing the form.

Form 990-T - Exempt Organizations Business Income Tax Return

When gross UBI from gaming activities is over \$1,000, any domestic or foreign organization exempt under section 501(a) must file Form 990-T. Gross income is gross receipts minus the cost of goods sold. See the Instructions for Form 990-T for additional information for defining gross income and the cost of goods sold.

Failure to file the appropriate forms may subject the organization to penalties.

INFORMATION RETURNS REQUIRED FOR CERTAIN WAGERING

FORM W-2G - Certain Gambling Winnings Certain wagering transactions require the filing of Form W-2G and Form 1096, Annual Summary and Transmittal of U.S. Information Returns. The Form W-2G is filed when an individual(s) wins a prize with a minimum specific dollar amount at a gaming event. The winner must provide the game operator with proper identification including his/her social security number. Form W-9, Request for Taxpayer Identification Number and Certification, may be used to record the information.

The Form W-2G should be completed by the bingo game operator upon payment of the prize to the winner. Copies B, C, and 2 of this form should be given to the prize winner at the time of completion. The other three copies must be given by the bingo game operator to the person responsible for making federal income tax withholding payments; e.g., the treasurer of the exempt organization.

Copy A of Form W-2G and Form 1096 must be submitted to the Internal Revenue Service by February 28 of the year following the year the gaming winnings were paid. Copy 1 of W-2G is submitted to the State and Copy D is retained by the payer.

The following chart describes when a W-2G normally needs to be issued:

TYPE OF GAME	AMOUNT OF PRIZE PAID IS EQUAL TO OR GREATER THAN:	
Bingo	\$1,200	•Not reduced by wager
Instants/Pull-tabs	\$ 600	•Not reduced by wager •At least 300 times the amount of the wager
Slot Machines	\$1,200	•Not reduced by wager
Keno	\$1,500	•Reduced by wager.

Regular Bingo Game Prizes

A single bingo prize of \$1,199.99 or less does not require the completion of a Form W-2G or the withholding of federal income tax. A single bingo

prize of \$1,200 or more requires the completion of a Form W-2G by the bingo game operator. The winner of a single prize of \$1,200 or more must furnish the bingo game operator with proper identification, along with his/her Social Security Number (SSN). Two types of identification (e.g., driver's license, social security card, or voter registration card) should be furnished by the winner to verify his or her name, address, and SSN. If the winner does not provide a taxpayer identification number (SSN), the bingo game operator must withhold tax (backup withholding) at the rate of 31 percent.

EXAMPLE 7: *CDN, an exempt organization, conducts a weekly bingo game. A payout of \$1,300.00 is made for a single game. The winner furnishes identifying information, along with her SSN to the organization; therefore, the organization must complete Form W-2G, but does not have to withhold.*

EXAMPLE 8: *If the winner in the Example above had refused to provide the SSN, the Form W-2G would be completed without the SSN. The income tax withheld is reported on Form 945, Annual Return of Withheld Federal Income Tax. Note: The winner would receive \$897.00 (\$1,300.00 gross winnings minus \$403.00 federal income tax withheld).*

Instant Bingo Game Prizes/Pull-Tabs

A single pull-tab prize of \$599.99 or less does not require completion of Form W-2G or the withholding of federal income tax. A single pull-tab prize of at least \$600.00, but not more than \$5,000.00, requires the completion of a Form W-2G if the prize is 300 times the amount of the wager. The winner must furnish the game operator proper identification along with his/her SSN or the game operator must withhold tax at the rate of 31 percent. Backup withholding applies to the amount of winnings reduced, at the option of the payer, by the amount wagered.

A single pull-tab prize winning, less the wager, exceeding \$5,000.00 requires the completion of Form W-2G, and regular gambling withholding of 28 percent of the net winnings.

EXAMPLE 9: *CDN sells pull-tabs at its weekly bingo session. One type of pull-tab sold pays a progressive jackpot, that is, the winning ticket from each box entitles the ticket holder to select a number from a second punchboard without an additional wager being made. If the ticket holder selects the winning punchboard number he/she wins the jackpot. If the winning ticket holder does not select the winning punchboard number, he/she may be paid a consolation prize. The jackpot is increased and carried over to the next box of pull-tabs sold. If a patron wins \$100 on the winning ticket from the box of pull-tabs, then selects a number from the progressive punchboard that pays \$550, a Form W-2G must be completed. Since the purchase of the initial ticket entitled the patron to both amounts, the amounts are combined and considered as a single prize.*

EXAMPLE 10: *CDN sells instant bingo game tickets. A winner receives \$950.00 from one of the pull-tabs, which cost \$1.00. The winner refuses to provide his identification number; therefore, CDN must complete Form W-2G as well as withhold 31 percent of the winnings. The income tax withheld is reported on Form 945. The winner would receive \$655.50 (\$950.00 gross winnings minus \$294.50 federal income tax withheld).*

EXAMPLE 11: *CDN has another winner of \$5,100.00 from one of the pull-tabs, which cost \$10.00. Because the winnings, less the wager, exceed \$5,000.00, a Form W-2G is completed and federal income tax is withheld. The income tax withheld is reported on Form 945. The winner would receive \$3,674.80 (\$5,100 gross winnings less \$1,425.20 withholding tax). (Computed \$5,100 - \$10 x 28%.)*

Multiple Winners

When paying out a prize from a wagering activity, exempt organizations need to determine whether the prize:

- is being paid to an individual, or
- is being paid to a member of a group of two or more winners on a single ticket, or
- is being paid to a person who is not the actual winner.

If prizes are paid to a member of a group of two or more winners on a single ticket or paid to a person who is not the actual winner, the exempt organization must complete Form 5754, Statement by Person(s) Receiving Gambling Winnings. The completion of Form 5754 enables the exempt organization to prepare Form W-2G. There are two parts to Form 5754, the first lists the identification of the person to whom the winnings are paid, and the second part lists the actual winners and their respective shares of the winnings. The exempt organization should use the information to complete Form W-2G for each winner. Form 5754 is not submitted to the Internal Revenue Service, but should be kept for a period of four years.

The determination of whether a Form W-2G is required is based on the amount of the prize paid on the winning ticket, not each individual's share of the prize.

EXAMPLE 12: *XYZ sells pull-tabs at its weekly bingo session. John Doe and Judy Smith jointly purchased a \$1 pull-tab that was the winning ticket of a \$1,200 jackpot. Form 5754 must be prepared along with two Forms W-2G.*

If John and Judy contributed equal amounts toward the purchase of the ticket and agreed to share equally in any prizes won, Form 5754 would be completed as follows:

- **Part I** - List the name, address and identification number of the individual to whom the prize was actually paid (prize must be paid to one individual). In the box for amount received, include the total \$1,200 prize.
- **Part II** - List John Doe's name, address and identification number. Include in box (d) \$600 as the amount won (his share of the prize). List Judy Smith's name, address and identification number. Include in box (d) under her name \$600 (her share of the \$1200 prize).
- **Signature** - Form 5754 should be signed and dated by the party receiving payment of the prize from the organization.

Note:

In the above example, Form W-2G should be completed for both John Doe and Judy Smith showing the gross winnings of \$600 each.

REGULAR GAMBLING WITHHOLDING & BACKUP WITHHOLDING CHART

GAME	REGULAR GAMBLING WITHHOLDING REQUIRED-PRIZES MORE THAN	BACKUP WITHHOLDING APPLIES ON PRIZES EQUAL TO OR EXCEEDS
BINGO	NO WITHHOLDING REQUIRED	\$1,200
INSTANT BINGO, PULL-TABS, RAFFLES	\$5,000	\$ 600

The above chart explains when withholding and backup withholding is required.

WITHHOLDING AND BACKUP WITHHOLDING

Organizations need to understand the withholding and backup withholding rules for games such as bingo, pull-tabs and raffles. "Instant Bingo" or "Mini Bingos" are considered pull-tab games, not regular bingo games. Raffles are considered lotteries for the purpose of withholding and backup withholding. Withholding on gambling winnings, including backup withholding, is reported on Form 945, Annual Return of Withheld Federal Income Tax.

Withholding

Withholding refers to the regular withholding of income tax from prizes paid. This withholding is required at the rate of 28%.

Backup withholding

Backup withholding refers to the withholding of tax that applies to reportable prizes when the recipient fails to provide a taxpayer identification number obtained by filing Form W-9. A taxpayer identification number is not supplied if the number is obviously incorrect (i.e. the number does not contain nine digits or contains alpha characters). The backup withholding rate is 31%.

EXAMPLE 13: XYZ paid a pull-tab prize of \$750 to a single ticket winner. The winner would only give his name as J. Doe. Since the winner failed to supply a taxpayer identification number, XYZ should collect backup withholding of \$232.50 ($\$750 \times 31\%$) and pay the winner \$517.50 ($\$750 - \232.50). If the winner had supplied his taxpayer identification number, no withholding would be required.

EXAMPLE 14: XYZ pays a single pull-tab prize of \$6,000. The winner provides an SSN. XYZ should withhold \$1,680 ($\$6,000 \times 28\%$) and pay the winner \$4,320 ($\$6,000 - \$1,680$).

Non-cash prizes

If the prize is not cash, the fair market value of the item won is considered the amount of the winnings. The withholding and backup withholding rates, if required, are applied to the fair market value of the item won. The amount to be withheld should be collected from the prize winner.

Nonresident Aliens

If a bingo or pull-tab prize is won by a nonresident alien, the winnings are reported on Form 1042S, Foreign Persons U.S. Source Income Subject To Withholding. The withholding is reported to IRS on Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons. Unlike the requirements for Form W-2G, there is no dollar threshold for withholding or reporting purposes. The withholding rate on nonresident aliens is generally 30%, unless the foreign country has a treaty with the United States for a lower rate. Form W-8, Certificate of Foreign Status, or a substitute form containing a substantially similar statement provides information as to whether an individual is a nonresident alien individual, foreign entity, or exempt foreign person not subject to certain U.S. information return reporting or backup withholding rules.

Reporting the Withholding

The exempt organization reports regular withholding from gaming winnings on Form 945, Annual Return of Withheld Federal Income Tax, line 1. Backup withholding is reported on Form 945, line 2. Form 945 is filed annually by January 31 of the following year. If the due date falls on a Saturday, Sunday, or a legal holiday, the return is due the next business day. For example, a Form 945 for 1997 is due February 2, 1998.

The exempt organization will be responsible for paying regular gambling withholding or backup withholding, whether or not it collects the withholding from the prize recipient.

The best time to collect withholding or backup withholding is before the prize is paid.

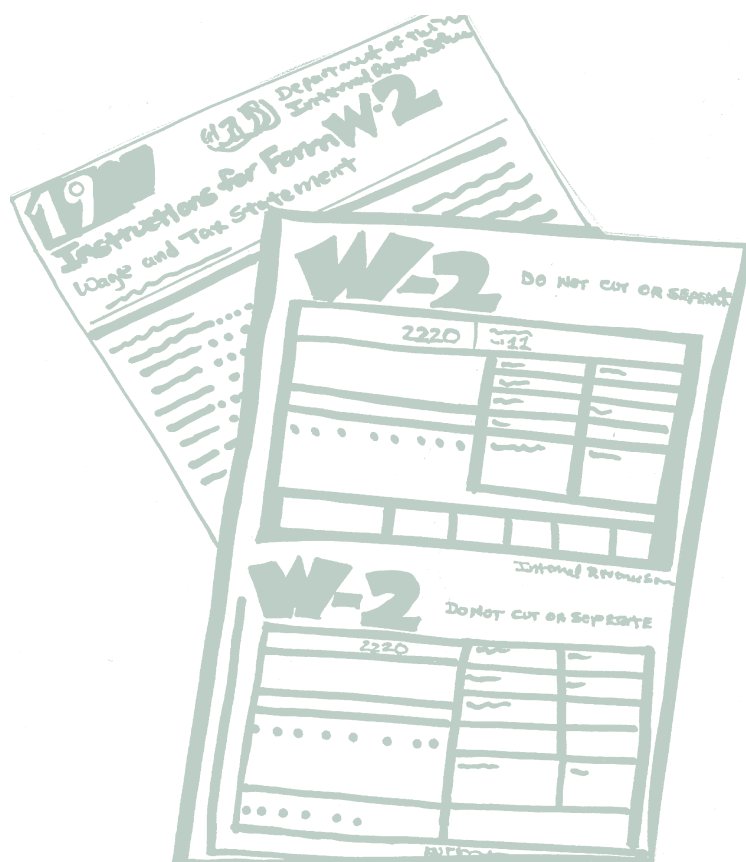
EXAMPLE 15: *M purchased a \$1 ticket for a raffle conducted by X, an organization exempt from income tax under section 501(c). On October 31, the drawing was held and M won \$6,000. Since the proceeds from the wager are greater than \$5,000 (\$6,000 minus the \$1 cost of the ticket), X must withhold \$1,679.72 ($\$5,999 \times 28\%$) from M's winnings.*

If X fails to withhold, it will be liable for the tax. In this example, if X fails to withhold the \$1,679.72 before the prize is distributed, X is liable for that amount.

If the payer, as part of the prize, pays the federal tax required to be withheld without deducting the taxes from the prize, the prize is deemed to include the amount of the federal tax paid by the payer. If the payer pays all of the federal tax required to be withheld, the payer must pay as tax deducted and withheld, an

amount equal to 38.88 percent of the amount actually paid to the winner. On Form W-2G, the amount of tax paid by the payer is shown in the box for federal income tax withheld. See Notice 93-7, 1993-1 C.B. 297, for additional information.

Your organization will be responsible for paying regular gambling withholding or backup withholding, whether or not you collect the withholding from the prize recipient.



In addition, a trust fund recovery penalty may apply when income taxes that should be withheld are not withheld or are not paid to the IRS. Under this penalty, certain officers or employees of your organization become personally liable for payment of the taxes and are penalized an amount equal to the unpaid taxes. This penalty may be applicable when these unpaid taxes cannot be immediately collected from your organization. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for and paying over these taxes, and who acted willfully in not doing so. Willfully in this case means voluntarily, consciously and intentionally failing to pay.

FOR MORE INFORMATION:

See IRS Publication 15, Circular E, Employer's Tax Guide.

EMPLOYMENT TAX REQUIREMENTS



This chapter explains when the tax-exempt organization conducting gaming activities with paid and/or volunteer workers must submit Form W-2, Form 941, and Form 940.

Tax-exempt organizations are not exempt from employment taxes if they have compensated employees. Federal employment taxes are those imposed under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding. Employers are required to pay FUTA tax on wages paid to employees. Employers are also required to pay the employers' share of Social Security and Medicare taxes on the wages paid to the employees and to withhold the employee's share of Social Security and Medicare taxes and federal income tax from the employee's wages.

The Internal Revenue Code provides that, for purposes of Social Security and Medicare taxes, FUTA, and federal income tax withholding, the term "wages" means all payments received for "employment" with certain specified exceptions. Therefore, unless payments to employees are excepted from the term "wages" or the services performed by the employee are excepted from the term "employment," such payments will be subject to Social Security and Medicare taxes, FUTA, and federal income tax withholding.

The following compensated employees are generally involved in gaming operations:

Paid Workers

If the gaming workers are compensated, whether by your organization or by patrons' tips, you are responsible for filing and paying employment taxes. Generally, if your organization has the right to control the worker, he or she is your employee and should be treated as such.

Other workers

In addition to gaming workers, you may have other individuals that should be treated as employees, such as security watchmen, snack bar workers or janitors. If your organization has the right to direct and control the worker, that worker is your employee.

Workers not treated as employees

You may have to file information returns (Form 1099-MISC) to report certain types of payments made during the year to workers who are not treated as employees (independent contractors).

Corporations

If the company you have hired to perform services for your organization is incorporated, you do not have to issue a Form 1099-MISC.

Hiring New Employees or Contractors

You should have the individual performing services complete Form W-9, certifying the correct Taxpayer Identification Number (TIN) and name, and whether the provider is incorporated, before any services are provided. Form W-9 is used to request payees to furnish a Taxpayer Identification Number and to certify that the number is correct (certification).

FILING REQUIREMENTS

Each employer is responsible for:

- Furnishing the employee a copy of Form W-2, Wage and Tax Statement, by January 31 of the year following the year of payment.

EXAMPLE 16: *For employment taxes withheld in 1997, you must provide a 1997 Form W-2 by January 31, 1998.*

- Filing Form W-2 with the Social Security Administration (SSA) by February 28 of the year following the year of payment. Use Form W-3, Transmittal of Income and Tax Statements, to transmit Forms W-2 to SSA.
- Filing Form 941, Employer's Quarterly Federal Tax Return.
- Filing Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. Section 501(c)(3) organizations are excepted.

Form 941

Each employer is responsible for filing Form 941, Employer's Quarterly Federal Tax Return, reporting wages, income tax withholding, and Social Security and Medicare Tax each quarter. The return is due the last day of the month following the end of the calendar quarter. If you deposited all the tax when due, you have 10 additional days to file the return.

EXAMPLE 17: *The Form 941 for the first quarter of 1997 (January - March) would be due April 30, 1997.*

Form 940

Each employer, unless exempt under section 501(c)(3), is responsible for filing Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. This return is due by January 31 of the following year. If you deposited all the tax when due, you have 10 additional days to file the return.

WORKERS NOT TREATED AS EMPLOYEES

Form 1099-MISC must be filed to report payments of \$600 or more to persons not treated as employees for services performed in your trade or business. The \$600 threshold applies to all payments made during the calendar year, not to any one payment.

EXAMPLE 18: *XYZ pays Ted Oaks \$100 per week to clean up the hall where the bingo sessions are held. Mr. Oaks operates his own janitorial service as a sole proprietorship, has the right to hire and fire his own help, and provides his own tools and supplies. XYZ does not have the right to direct and control Mr. Oaks, and he is therefore not an employee of XYZ. XYZ should file Form 1099-MISC for Mr. Oaks.*

EXAMPLE 19: *ABC pays Don Maples \$100 per week to clean up the hall where the bingo sessions are held. Mr. Maples does not have the right to hire and fire assistants. ABC requires that the work be done by Mr. Maples. ABC provides the supplies and tools for Mr. Maples. Based on the above facts, Mr. Maples should be treated as an employee and ABC should withhold income taxes and employment taxes and report Mr. Maples' wages on Form W-2.*

TIPS

All tips received by an employee are taxable income subject to federal income tax. Tips paid in cash (or checks or other cash equivalent, including charged tips) of \$20 or more that an employee receives in a calendar month while working for any one employer are wages subject to Social Security and Medicare taxes, FUTA, and income tax withholding. Tips of less than \$20 received by an employee during a calendar month while working for a particular employer are not wages for Social Security and Medicare taxes, FUTA or federal income tax withholding purposes, even though such tips are taxable income. Once the amount of tips received in a calendar month reaches \$20 from any one employer, the entire amount of tips received is included in wages, not just the amount over \$20.

An employee who receives \$20 or more in tips must report those tips in writing to the employer by the tenth day following the month in which the tips are received.

EXAMPLE 20: Don Maples is a volunteer and sells pull-tabs at the weekly bingo. He received \$30 in tips in March from a winner. He must report them to the organization conducting the gaming (employer) by April 10.

Form 4070, Employee's Report of Tips to Employer, may be used for this reporting. The employer may require more frequent reporting of tips. The employer must withhold Social Security and Medicare taxes and Federal income tax on reported tips. See Publication 531, Reporting Tip Income, for more information.

DEPOSITING TAXES

In general, you must deposit the following taxes, making separate deposits for each type of tax:

- Form 945 taxes, including backup withholding and regular withholding.
- Form 941 taxes, including employer and employee Social Security and Medicare taxes and income taxes withheld from wages.
- Form 940 taxes, Federal unemployment taxes.
- Income tax withheld.

There are two methods of depositing employment taxes, including Form 945 and 941 taxes. Some taxpayers are required to deposit using the Electronic Federal Tax Payment System (EFTPS), and other taxpayers may elect to deposit using this system. See Circular E, Employer's Tax Guide, for information about electronic deposit requirements and EFTPS. If you are not making deposits by EFTPS, use Form 8109, Federal Tax Deposit Coupon, to make deposits at an authorized financial institution (i.e. a commercial bank authorized to accept federal tax deposits) or Federal Reserve Bank.

WHEN USING FORM 8109 FOR DEPOSITS:

- Separate deposits are required for Form 940, 941, and 945 taxes. **Do not** combine deposits for these Forms.
- **Do not** use the deposit coupons to pay delinquent taxes that have been assessed by the IRS. These payments should be sent directly to your Internal Revenue Service Center along with a copy of any related notice the IRS sent you.
- Mail or deliver each deposit coupon and a single payment covering the taxes to be deposited to a financial institution qualified as a depository for federal taxes or to the Federal Reserve Bank/Branch (FRB) serving your geographical area.
- Follow the instructions on the front of the coupon.
- Make the check or money order payable to the depository or FRB where you make your deposit. To help ensure proper crediting of your account, include your employer identification number, the type of tax (e.g. Form 940), and tax period to which the payment applies on your check or money order.
- If your total liability will be less than \$500 for any return period, deposits are not required and the payment may be made with the return. However, if you are unsure if your liability will exceed \$500, make deposits to

avoid failure to deposit penalties.

- If you have not enrolled to deposit using EFTPS, the IRS will send you a coupon book after you apply for an employer identification number. The coupons will be preprinted with your name, address, and employer identification number. They have entry boxes for indicating the type of tax and the tax period against which the deposit is to be applied.

NOTE:

It is very important to clearly mark the correct type of tax and tax period on each deposit coupon. This information is used by the IRS to credit your account.

FOR MORE INFORMATION:

See IRS Publication 15, Circular E, Employer's Tax Guide.

TAXES ON WAGERING



This chapter explains the application of the taxes on wagering (Excise Tax and Occupational Tax) on tax-exempt organizations conducting bingo games, pull-tabs, raffles, and tip boards.

In addition to the application of UBIT, all organizations which conduct gaming activities should be aware that the sponsorship of such activities may lead to the imposition of a wagering excise tax and an occupational tax per sections 4401 and 4411 of the Code. 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 these taxes.

There are two types of wagering taxes:

- An excise tax imposed on the amount of the wager.
- An occupational (or stamp) tax imposed on the persons engaged in receiving wagers.

DEFINITION OF WAGER

The wager is the amount risked by the person placing the bet, not the amount the person stands to win. The term “wager” does not include drawings conducted by exempt organizations so long as **no part of the net proceeds of such drawing inures to the benefit** of any private shareholder or individual.

Application of the Taxes on Wagering

In general, the taxes on wagering apply to:

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

- **Pull-tabs, Raffles and Tip Jars** meet the definition of taxable wagers placed in a lottery.
- **Bingo Games** (not Instant Bingo) are specifically excluded from the application of the wagering tax.

Any one of the above activities 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 the organization constitute inurement to the benefit of members for purposes of determining the application of the wagering tax.

EXAMPLE 21: *The Order of ABC, a fraternal organization, conducts a raffle to raise money. The raffle is open to public participation. 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 Order’s social, recreational or fraternal activities, or to reduce the members’ dues, constitutes inurement.*

WAGERING EXCISE TAX

The first tax is the wagering excise tax imposed by Code section 4401. The tax is imposed on the gross

amount of the wagers received. This means that the tax is based on the total amount received before any payout of prizes or other expenses.

For example, 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.

Amount of the tax.

The amount of the tax depends upon whether the wager is authorized under state law.

- **Authorized Wagers.** If the wager is authorized under state law, the amount of the tax is 0.25 percent of the amount of the wager. Thus, if the gross wagers were \$1,000, the amount of the tax would be \$2.50 ($\$1,000 \times .0025$).

EXAMPLE 22: *ABC, exempt under section 501(a), sells pull-tabs in its bar. State law provides that organizations exempt under section 501(a) may sell pull-tabs through employees. Members of the public may purchase pull-tabs. Proceeds from the pull tab sales 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 23: *The facts are 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, ABC is not subject to the wagering excise tax.*

- **Unauthorized Wagers.** If the wager is not authorized under state law, the amount of the tax is 2 percent of the amount of the wager. Thus, if the gross wagers were \$1,000, the amount of the tax would be \$20 ($\$1,000 \times .02$).

EXAMPLE 24: *ABC Lodge, exempt under Code section 501(c)(10), sells pull-tabs across the bar at its Lodge. The proceeds go to its general account to pay 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 section 4401 because the proceeds of the wagers are used to offset the general, social, recreational or fraternal activities of the membership.*

Under the facts given above, 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 25: *A section 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 was 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 some of the proceeds benefit the members, the organization would be subject to section 4401 on the **full amount wagered** at the 0.25 percent rate.

Form 730

The excise tax under Code section 4401 is paid with the filing of Form 730, Tax on Wagering. Generally, taxable wagers and lotteries include wagers on sporting events, pull-tab operations, wagering pools, lotteries,

numbers games, punchboards, and other similar types of wagering. Form 730 is a **monthly** tax return and is due each month by the last day of the month following the month for which you are reporting wagers. If you do not have any wagers to report for a month, write "NONE" on the return. If you do not expect to file Form 730 in the future, write "FINAL RETURN" on the return. The Instructions to Form 730 provide additional filing information. An organization may be subject to a penalty for failure to file the form and for failure to pay the tax.

OCCUPATIONAL TAX

The second of the two taxes on wagering is the occupational or stamp tax imposed under Code section 4411. 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 due from a "principal." A principal is a person or organization in the business of accepting wagers, or an employee agent of such organization. The latter would include, for example, a paid bartender who sells pull-tabs over a social club's bar. An employer identification number (EIN) must be used, not a Social Security Number. If the person or organization in the business of accepting wagers or the employee agent of such organization does not have an EIN, complete Form SS-4, Application for Employer Identification Number, and attach it to the Form 11-C when the form is filed. A Form 11C, Occupational Tax and Registration Return for Wagering, must be filed before such organizations or persons begin accepting wagers. After the return is filed and the fee paid, the IRS will issue a letter as proof of registration and payment. Once the initial return is filed, the responsible party must file a renewal return by July 1 for each year that the principal accepts wagers. See the instructions for the Form 11-C for additional information. An organization may be subject to a penalty for failure to file the form and for failure to pay the tax.

EXAMPLE 26: XYZ sells pull-tabs and arranges for 10 people to receive wagers from the public on XYZ's behalf. XYZ also employs a secretary and a bookkeeper. XYZ and each of the 10 persons are liable for tax. Each files Form 11-C. The secretary and bookkeeper are not liable for the tax unless they accept wagers for XYZ.

Amount of the Tax

The amount of the occupational tax depends on whether or not the wager is authorized under state law. If the wager is authorized under state law, the amount of the occupational tax is \$50 per year per person receiving wagers. If the wager is unauthorized under state law, the amount of the tax is \$500 per year per person receiving wagers.

EXAMPLE 27: *ABC Lodge, exempt under Code section 501(c)(10), sells pull-tabs across the bar at the Lodge. The proceeds go to the Lodge's general account to pay 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 is liable for the wagering excise tax under Code section 4401 at 2%, because the proceeds are used to sponsor the Lodge's fraternal and social activities and the pull-tabs were not sold by volunteer labor. Because it is liable for the tax under section 4401, ABC is also subject to the occupational tax under section 4411 at \$500 per each person selling pull-tabs.*

ABC is subject to the 2% and \$500 rates because the acceptance of the wager is not operated in accordance with state law. State law only allows the sale of pull-tabs by volunteer labor, and ABC uses paid bartenders to sell the pull-tabs.

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EXHIBITS



The following contains examples of spreadsheets for recording information to show income, payout expenses, and profits from various gaming activities.

- **EXHIBIT A**

ANNOUNCEMENT 89-138:

TAXATION OF GAMBLING ACTIVITIES CONDUCTED BY TAX-EXEMPT ORGANIZATIONS

- **EXHIBIT B**

SPREAD SHEET EXAMPLE:

GAMES PLAYED & RECEIPTS PER GAME

- **EXHIBIT C**

SPREAD SHEET EXAMPLE:

REPORT OF GAMES PLAYED, GAMES LOST, OR GAMES DESTROYED

- **EXHIBIT D**

SPREAD SHEET EXAMPLE:

BINGO INVENTORY & RECEIPTS

EXHIBIT A

TAXATION OF GAMBLING ACTIVITIES CONDUCTED BY TAX-EXEMPT ORGANIZATIONS

ANNOUNCEMENT 89-138

Purpose

The purpose of this Announcement is to remind tax-exempt organizations that income from the public conduct of Bingo and other gambling activities may be subject to the unrelated business income tax imposed by section 511(a) of the Internal Revenue Code. Over the years, changes to the unrelated business income tax provisions applicable to Bingo and other gambling activities have created confusion for tax-exempt organizations. This Announcement will recap the rules applicable in this area.

Background

Frequently, tax-exempt organizations have been involved in conducting Bingo and other games of chance such as pull-tabs, raffles, video games, poker, 21, punch board, and lotteries for the public. Conduct of these games has been a means of raising funds to carry on their exempt activities. The organizations that have historically engaged in these activities include: charities described in section 501(c)(3) of the Code; social welfare organizations described in section 501(c)(4); recreational organizations described in section 501(c)(7); fraternal organizations described in section 501(c)(8) or (10); and, veterans organizations described in section 501(c)(19).

With more and more tax exempt organizations getting involved in this industry, the Service is concerned with the level of the noncompliance of some organizations with the unrelated business income tax provisions and will be reviewing the gambling activities of tax exempt organizations as part of its Special Emphasis Program on Fund-Raising Activities.

Unrelated Business Income Tax Provisions Governing The Public-Conduct of Bingo and Gambling Activities

Prior to 1976, the income of a number of tax exempt organizations from the public conduct of gambling activities (including Bingo) was subject to unrelated business income tax. See Rev. Rul. 68-505, 1968-2 C.B. 248, which holds a county fair association that is exempt under section 501(c)(3) subject to unrelated trade or business tax on income from parimutuel betting conducted in connection with its two-week race meeting. See also Smith-Dodd Businessman's Assn. Inc., 65 TC 620 (1975), holding a businessman's association, exempt under section 501(c)(4), subject to unrelated business income tax on proceeds from public bingo games.

In the Tax Reform Act of 1976, Congress enacted an exception under section 513(d)(1) of the Code for "public entertainment activity" described in section 513(d)(2) conducted in conjunction with public fairs or expositions. This exception, applicable to organizations described in section 501(c)(3), 501(c)(4), or 501(c)(5), covers:

- (1) public entertainment activity conducted in conjunction with an international, national, State, regional, or local fair or exposition,
- (2) activity conducted in accordance with State law which permits the activity to be conducted only by that type of exempt organization or by a governmental entity,
- (3) activity conducted in accordance with State law which allows that activity to be conducted for not more than 20 days in any year and which permits the

organization to pay a lower percentage of the revenue to the State than is required from other organizations.

The legislative history of the Tax Reform Act of 1976 indicates that section 513(d) of the Code was meant to reverse Rev. Rul. 68-505.

In 1978, Congress enacted an exception from unrelated business income tax for income from certain bingo games. This exception was intended to apply to bingo games conducted for the public. The exception is contained in section 513(f) of the Code. The section 513(f) exception refers to bingo games that are not normally conducted on a commercial basis if the conduct of the games is not in violation of state and local law. At the same time, Congress also provided that the bingo income of section 527 political organizations, that met the requirements of section 513(f)(2), would be treated as "exempt function" income for purposes of section 527(e)(1).

In section 311 of the Deficit Reduction Act of 1984, Congress enacted yet another exception that applied to games of chance other than Bingo. This exception involved games of chance conducted after June 30, 1981. It applied in situations where as of October 5, 1983; there was a state law in effect that permitted the conduct of games of chance only by a nonprofit organization.

Two amendments to section 311 followed in the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), that ultimately limited the exception to games of chance conducted by nonprofit organizations in the state of North Dakota.

The net effect of the legislation from 1984-1988 is to exempt from tax income from games of chance (other than Bingo) conducted in North Dakota after June 30, 1981, that do not violate state or local law. From June 30, 1981, through October 22, 1986, games of chance (other than Bingo) conducted outside the state

of North Dakota are not subject to unrelated business income tax as long as state law was in effect on October 5, 1983, that permitted the conduct of games of chance only by a nonprofit organization. These rules are applicable to games of chance conducted for the public. As indicated above, the treatment of proceeds from Bingo under the unrelated business income tax provisions is governed by section 513(f) of the Code.

In summary, therefore, although section 513(f) of the Code exempts the income from certain bingo games legally conducted by exempt organizations from taxation as unrelated trade or business income, income from other gambling activities conducted by exempt organizations outside of North Dakota after October 22, 1986, is generally treated as unrelated business income unless it meets one of the other exceptions of section 513, such as where substantially all the work in carrying on the activity is performed by volunteers under section 513(a)(i).

EXHIBIT B
SPREAD SHEET EXAMPLE:
GAMES PLAYED & RECEIPTS PER GAME

If you are reporting games lost or destroyed, skip column D and Columns I through O.

Circle Game Played		These games have been: (check only one)										Page of Pages							
Full-tabs		Tipboards	Paddlewheels	Other	Destroyed	Lost						Month	Year	L	K	O			
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q			
Mfg. ID	Part Number	Game Serial Number	Date put in Play	Ideal gross receipt	Ideal Prizes	Total Value Unsold Tickets	Gross Receipts (E minus G)	Total Value of Prizes Paid	Net Receipts (H minus I)	Cash in Hand	Cash Over or Short	Date Removed from Play							
1	INS Dev66k	030964	100297	1320	924	20	1320	924	396	393	-3	100498							
2																			
3																			
4																			
5																			
6																			
7																			
8																			
8																			
10																			
11																			
12																			
13. Add the amounts in columns J, K, L, M, and N and fill in the total of each column here.													924	393	-3	100498			
14. If you are attaching other pages, add together the totals of columns J, K, L, and N to all attached pages and fill in total of each column here.																			

EXHIBIT C

SPREAD SHEET EXAMPLE:

REPORT OF GAMES PLAYED, LOST, OR DESTROYED

Circle Game Played • Cull-tabs • Tipboards • Paddlewheels • Other													Month Year			Page of Pages		
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O				
Name of Game & Form #	Registration Stamp #	Game Serial #	Date put in Play	Price Per Ticket	Number of Tickets	Ideal Gross Receipts	Ideal Prizes	Total Value Unsold Tickets	Gross Receipts (G minus I)	Total Value of Prizes Paid	Net Receipts: (J minus K)	Cash in Hand	Cash Over or Short	Date Removed from Play				
1705	57210	03096	10/02	1.00	1320	1320	924	-	6320	924	396	396		10/04				
2410	57219	02285	10/02	1.00	984	984	739	-	984	739	245	245		10/09				
3410	57220	03159	10/03	1.00	984	984	739	-	984	739	245	245		10/05				
4																		
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11																		
12																		
13. Add the amounts in columns J, K, L, M, and N and fill in the total of each column here.									3,288	2,402	886	886						
14. If you are attaching other pages, add together the totals of columns J, K, L, and N to all attached pages and fill in total of each column here.																		

EXHIBIT D
SPREAD SHEET EXAMPLE:
BINGO INVENTORY & RECEIPTS

Date of Bingo Session: *10/04/98*

A	B	C	D	E	F	G	H	I
Name of Game	Mfr. ID	Serial Numbers in Game	Serial Numbers Sold	Cost per sheet	Number of Sheets Sold	Gross Receipts (E times F)	Prizes Paid	Net Receipts (G minus H)
1 Postage Stamp	Bw90			.50	300	150	125	25
2 Crazy I	"			1.00	400	400	200	200
3 Small PKg	"			12.00	510	6,120		
4 Large PKg	"			18.00	222	3,996	3,000	7,116
5								
6								
7								
8								
9. Add the amounts in columns G, H, and I and fill in the total of each column here.						x 10,666	3,325	7,341
10. If you are attaching other pages, add together the totals of columns G, H, and I and fill in here.						x		

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page.

OTHER IRS RELATED PUBLICATIONS

The Internal Revenue Service (IRS) provides other publications and annual reporting instructions that cover specific aspects relating to topics discussed herein.

- Publication 15Employer's Tax Guide (Circular E)
- Publication 15AEmployer's Supplemental Tax Guide
- Publication 510Excise Taxes
- Publication 515Withholding of Tax on Nonresident Aliens
and Foreign Corporations
- Publication 526Charitable Contributions
- Publication 531Reporting Tip Income
- Publication 535Business Expenses
- Publication 557Tax-exempt Status for Your Organization
- Publication 578Tax Information on Private Foundations
and Foundation Managers
- Publication 598Tax on Unrelated Business Income of
Exempt Organizations
- Publication 1391Deductibility of Payments Made to
Charities Conducting Fund-Raising Events
- Publication 1771Charitable Contribution Substantiation &
Disclosure Requirements
- Instructions for Forms 1099, 1098, 5498, and W-
2G,Reporting Requirements



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Internal Revenue Service

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