

**Publication 3079**

# **Tax-Exempt Organizations and Gaming**

Volume 1 of 2



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# Introduction

Saturday night bingo in the church hall, one-armed bandits in the social club, video lottery at the veterans' club, poker night at the fraternal lodge – these are examples of gaming<sup>(1)</sup> – sometimes called gambling – by organizations exempt from federal income tax.

For many years now, exempt organizations have operated these and many other types of games as a part of their activities. Why do organizations “game”? Probably the number one reason is to raise funds – either to help cover the cost of running their organizations or to support worthy causes. For some organizations, gaming also permits its members to socialize with each other and fosters fellowship.

Whatever the reason, an organization conducting any type of gaming should understand the relationship between that activity and its exempt purposes, and how the activity can impact its federal tax-exempt status. An organization engaged in gaming

activities also needs to understand its tax and information reporting responsibilities. This publication provides an exempt organization with the information it needs to engage in gaming activities in a manner that will not jeopardize its exempt status or lead to unexpected tax liabilities, whether the organization is currently running games or is considering whether to start.

Note: Many states and localities regulate gaming by exempt organizations. This publication does not address state or local gaming licensing requirements. For licensing requirements, please consult the appropriate agencies in your locale.

(1) Gaming includes (but is not limited to): bingo, pull-tabs/instant bingo (including satellite and internet bingo), Texas Hold-Em poker and other card games, raffles, scratch-offs, charitable gaming tickets, break-opens, hard cards, banded tickets, jar tickets, pickle cards, Lucky Seven cards, Nevada Club tickets, casino nights, Las Vegas nights and coin-operated gambling devices. Coin-operated gambling devices include slot

machines, electronic video slot or line games, video poker, video blackjack, video keno, video bingo, video pull-tab games and so on.

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## **Chapter 1**

# **Gaming's Impact on Tax-Exempt Status**

This chapter explores the impact of gaming on an organization's tax-exempt status according to the section of the Internal Revenue Code (IRC) under which it is exempt. Chapter 2 explores when an organization's gaming might give rise to income tax liability. You should refer to your organization's exemption letter from the IRS to determine the subsection under which you are recognized as exempt. If you do not have a copy of your organization's letter, you can call IRS Tax Exempt and Government Entities Customer Account Services at 877-829-5500 (toll-free) to request a copy or to determine your organization's subsection.



Gaming, itself, does not further the exempt purpose of most organizations. In general, when gaming does not further the organization's exempt purpose, gaming is no different than the conduct of any other trade or business carried on for profit. In most instances, gaming's contribution to the operations of an exempt organization is generation of funds to pay expenses associated with the conduct of the organization's exempt activities.

The exceptions to the general rule (that gaming does not usually further an exempt purpose) include organizations whose exempt purposes include social or recreational activities. For these organizations, gaming itself may further an exempt purpose.

For more information on specific subsections, see the following summaries and **Publication 557, Tax-Exempt Status for Your Organization.**

## **Section 501(c)(3) – Charities, Schools, Churches and Religious Organizations**

An organization may qualify for exemption under IRC Section 501(c)(3) if it is organized and operated exclusively for religious, charitable, scientific, literary or educational purposes or for the purposes of testing for public safety, fostering national or international amateur sports competition or preventing cruelty to children or animals. To be exempt under Section 501(c)(3), an organization must engage in activities that accomplish one or more of these purposes. Examples of Section 501(c)(3) organizations include schools, churches and non-profit hospitals.

A common misconception is that gaming is a “charitable” activity. There is nothing inherently charitable about gaming. It is a recreational activity and a business. Although a charity may use the proceeds from gaming to pay expenses associated with its charitable programs, gaming itself does not further any charitable purpose. Thus, gaming cannot be a

more than an insubstantial purpose of a 501(c)(3) organization.

In addition, a Section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals or persons controlled directly or indirectly by such private interests. No part of the net earnings of a Section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. (2) A private shareholder or individual is a person having a personal and private interest in the activities of the organization. An organization puts its exempt status in jeopardy when gaming results in inurement or prohibited private benefit to individuals, or where funds from the activity are diverted for private purposes.

A charity conducting gaming as an insubstantial part of its activities will not ordinarily jeopardize its tax-exempt status but may be subject to the tax on unrelated business income. See Chapter 2.

The IRS determines whether an organization is conducting a “substantial” unrelated activity by examining all the facts and circumstances. There is no “bright-line” or numerical test prescribed by the IRC. The IRS will consider the dollars raised by and spent on an unrelated activity as well as the time and other resources devoted to it in making the determination of substantiality.

Every 501(c)(3) organization has a second important tax classification: It is either a **private foundation** or a **public charity**.

Certain types of organizations – schools, hospitals and churches, among others – are specifically listed in the IRC as public charities. Many organizations, however, must show and maintain a broad base of financial support from the public to be classified as public charities. If these organizations receive too much of their financial support from a limited number of sources or from an unrelated trade or business, such as gaming, they may fail the “public support” test and be classified as private foundations.

If an organization is classified as a private foundation because its sole source of support is from an unrelated trade or business, it will have excess business holdings in a business enterprise within the meaning of IRC Section 4943(a)(1), and the organization must divest itself of them. Generally, the organization must cease to operate its gaming activities (or at least substantially restructure its operations and sources of support).

For more information about foundation classification, the public support tests for certain public charities and the special tax rules that apply to private foundations, see **Publication 557, Tax-Exempt Status for Your Organization**.

(2) A private shareholder or individual is a person having a personal and private interest in the activities of the organization.

## **Section 501(c)(4) – Social Welfare Organizations**

Section 501(c)(4) organizations promote social welfare. These types of organizations are sometimes called civic leagues. They

operate primarily to further the common good and general welfare of the people of a community through civic betterment and social improvements. No part of a Section 501(c)(4)'s net earnings may be used to benefit any private shareholder or individual. An organization puts its exempt status in jeopardy when gaming revenue is diverted for private purposes. Examples of social welfare organizations include civic leagues, volunteer fire companies and homeowners' associations.

Gaming is considered both a business and a recreational activity; it does not ordinarily promote social welfare. For example, Revenue Ruling 66-150 holds that a 501(c)(4) organization whose primary activity was to operate a social facility (including a bar, restaurant and game room) is not exempt under Section 501(c)(4). Therefore, a Section 501(c)(4) organization whose primary activity is gaming may jeopardize its exempt status.

In very limited situations, however, a social activity such as gaming may be considered a social welfare activity. The volunteer fire company described in Rev. Rul. 74-361,

provided a club room for both on and off duty members of the department when they were not otherwise engaged in fire calls. The facility was not open to the public. Access to the social club served to increase camaraderie of the firefighters and encouraged better performance of the department, thus promoting social welfare.

Provided that the organization's primary purpose is the promotion of social welfare, the conduct of gaming will not ordinarily jeopardize its tax-exempt status, but its gaming income may be subject to the tax on unrelated business income.

## **Section 501(c)(5) and 501(c)(6) – Labor and Agricultural Organizations and Business Leagues**

Section 501(c)(5) describes labor, agricultural and horticultural organizations. Their exempt purposes include bettering the conditions of workers, improving the grade of products and/or developing a higher degree of efficiency in a particular occupation. Section

501(c)(6) organizations are devoted to the improvement of conditions of one or more lines of business. Like Section 501(c)(3) and Section 501(c)(4) organizations, inurement of any part of the net earnings of a Section 501(c)(5) or Section 501(c)(6) organization to the benefit of any private shareholder or individual jeopardizes its exemption.

Gaming does not further the exempt purposes of any of these types of organizations. Thus, an organization exempt under Section 501(c)(5) or 501(c)(6) may jeopardize its exemption if gaming becomes the organization's primary activity. Even if the activity does not jeopardize the organization's exempt status, and the gaming income may be subject to the tax on unrelated business income.

## **Section 501(c)(7), 501(c)(8) and 501(c)(10) – Social Clubs and Fraternal Organizations**

The exempt function of organizations classified under these sections includes providing social and recreational activities for



members and their bona fide guests.<sup>(3)</sup> Thus, social clubs and fraternal organizations may engage in gaming involving only members without jeopardizing their exempt status.

Gaming open to the public does not further the exempt purposes of social clubs or fraternal organizations. Section 501(c)(7), 501(c)(8) and 501(c)(10) organizations whose primary activity is public gaming jeopardize their exempt status and the gaming income may also be subject to the tax on unrelated business income.

Section 501(c)(7) social clubs endanger their exempt status when receipts from nonmembers – including those from gaming activities – exceed certain thresholds. A social club may receive no more than 35 percent of its gross annual receipts (including investment income) from sources outside of its membership. Within that 35 percent, no more than 15 percent of gross receipts can come from the public's use of club facilities or services. If those limits are exceeded, the club's exempt status may be in jeopardy.

## **Section 501(c)(19) – Veterans' Organizations**

This subsection describes posts or organizations of past or present members of the U.S. Armed Forces. To qualify for exemption under Section 501(c)(19), at least 75 percent of the members must be past or present members of the U.S. Armed Forces and at least 97.5 percent of all members must be past or present members of the U.S. Armed Forces, cadets (including only students in college or university ROTC programs or at armed services academies) or spouses, widows, widowers, ancestors or lineal descendants of past or present members of the U.S. Armed Forces or of cadets. In addition to these membership requirements, a veterans' organization must be operated for one or more of the following purposes:

- To promote the social welfare of the community.
- To assist disabled and needy war veterans and members of the U.S. Armed Forces

and their dependents and the widows and orphans of deceased veterans.

(3) For Section 501(c)(7), 501(c)(8), 501(c)(10) and 501(c)(19) organizations, the term “bona fide guests” is generally defined as individuals whom the member invites and for whom the member pays. If, for example, a nonmember pays for his or her own wagers in gaming activities, he or she is considered to be a member of the public and not a guest, even though he or she may have entered the organization’s premises with a member. Also, if an organization requires only a nominal payment to join as a “member,” individuals making this payment to gain admission to the organization’s facilities or activities may not be considered members or bona fide guests.

- To provide entertainment, care and assistance to hospitalized veterans or members of the U.S. Armed Forces.
- To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors.

- To conduct programs for religious, charitable, scientific, literary or educational purposes.
- To sponsor or participate in activities of a patriotic nature.
- To provide insurance benefits for its members or dependents of its members or both.
- To provide social and recreational activities for its members.

(Note: Some older veterans' organizations hold exemption as 501(c)(4) social welfare organizations. A veterans' organization that is unsure of the IRC section it is classified under in IRS records should contact Customer Account Services at 877-829-5500.)

Gaming that is limited to members and bona fide guests furthers a 501(c)(19) veterans' organization's social and recreational purposes. However, if a 501(c)(19) organization permits the public to participate in its social and recreational activities – including gaming – the activity does not further an exempt function.

Veterans' organizations may endanger their exempt status if a social or recreational activity open to the public becomes a primary activity of the organization. If a social or recreational activity (such as gaming) that is open to the public is not the primary purpose of a veterans' organization, exemption will not be jeopardized, but the gaming income may be subject to the tax on unrelated business income.

In addition, inurement of any part of the net earnings of a Section 501(c)(19) organization to the benefit of any private shareholder or individual jeopardizes its exemption.

For more information about veterans' organizations, see **Publication 3386, Tax Guide – for Veterans' Organizations.**

## **Section 527 – Political Organizations**

A political organization exempt under IRC Section 527 is organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures to influence or attempt to

influence the selection, nomination, election or appointment of an individual to a federal, state or local public office.

Generally, political organization income (including contributions and proceeds from political fundraising or entertainment events) is not subject to federal income tax, as long as the income results from events that are political in nature and not carried on in the ordinary course of a trade or business. One factor that indicates an event is “political” is the extent to which it is related to a political activity aside from the need of the organization for income or funds.

Political organizations might conduct raffles to raise funds. In general, the proceeds from a raffle are taxable unless the raffle is conducted during a political fundraising or entertainment event. Where there is no evidence that the sale of raffle tickets is closely related to a political event, the IRS will generally conclude that revenue is taxable income.

Income from bingo may be exempt function income for political organizations, provided it

is segregated for use for an exempt (political) function. To be exempt, the game from which the income is derived must meet the requirements for the statutory bingo exclusion described in Chapter 2.

## **Chapter 2**

### **Gaming and Unrelated Business Income**

An exempt organization is not taxed on income from an activity that is substantially related to its exempt purposes even if that activity is a trade or business. However, if an exempt organization regularly carries on a trade or business that is not substantially related to its exempt purpose, except that the trade or business provides funds to carry out that purpose, income from the unrelated trade or business may be subject to tax. As explained in Chapter 1, gaming is considered related to an organization's exempt purpose only in specific circumstances. As a general rule, gaming is considered unrelated to exempt purposes.

This chapter provides an overview of the unrelated business income (UBI) tax and the exclusions from that tax. See **Publication 598, Tax on Unrelated Business Income of Exempt Organizations**, for a more in-depth discussion of the unrelated business income tax and additional information about filing requirements and computing unrelated business income.

The following three conditions must be met before an activity may be classified as an unrelated trade or business: (4)

1. The activity must be considered a trade or business;
2. The activity must be regularly carried on; and
3. The activity must not be substantially related to the organization's exempt purpose. (The fact that the activity generates income for the organization to spend on its charitable programs does **not** make the activity related to the organization's exempt purpose.)



When will gaming generate UBI? Let's look at each of the three parts of the definition in relation to gaming.

First, gaming is generally considered a "trade or business" if it generates revenue.

Second, gaming is considered "regularly carried on" if it is conducted with a frequency and continuity similar to comparable activities of a non-exempt organization and if pursued in a manner similar to commercial gaming activities. Gaming activities will not ordinarily be treated as regularly carried on if they occur only occasionally or sporadically. For example, gaming conducted only at an annual fundraising event is not regularly carried on. On the other hand, gaming that occurs weekly is considered to be regularly carried on.

Third, gaming is generally not an exempt activity. As discussed in Chapter 1, whether gaming is substantially related to an organization's exempt purposes will depend on the classification of the exempt organization, and the circumstances under which the activity is conducted.

Even if a gaming activity meets the three conditions above, some UBI exceptions may apply. These include:

- Certain bingo games;
- Activities conducted with substantially all volunteer labor;
- Qualified public entertainment activities; and
- Games of chance conducted in North Dakota.

These exceptions are explained below in more detail. In addition to these exceptions, gaming does not generate taxable income when it actually furthers the exempt purposes for which an organization exists. This can be the case for membership organizations (generally, Section 501(c)(7), 501(c)(8), 501(c)(10) and 501(c)(19) organizations), as explained in Chapter 1.

## **Bingo**

Certain bingo games are not included in the term “unrelated trade or business.” To qualify

for this statutory bingo exclusion, a game must:

- Meet the definition of bingo under the IRC and Regulations;
- Not violate state or local law where it is played; and
- Be played in a jurisdiction where bingo games are not regularly carried on by for-profit organizations.

Bingo is defined in the IRC and Regulations 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 pre-selected pattern such as a horizontal, vertical or diagonal line or all four corners. The first participant to form the pre-selected pattern wins the game. In addition, for a game to meet the legal definition of bingo, wagers must be placed, winners must be determined and prizes or other property must be distributed in the presence of all persons placing wagers in that game.

(4) Social clubs exempt under Section 501(c)(7) are treated differently under the UBI tax rules. See the separate discussion on Unrelated Business Income Tax and Section 501(c)(7) Social Clubs on page 8.

A wagering game that does not meet the definition of bingo under the IRC and Regulations does not qualify for the exclusion regardless of its name. For example:

- Satellite and internet bingo do not qualify because these games are conducted in many different places simultaneously and those placing wagers are not all present when the wagers are placed, the winners are determined and the prizes are distributed.
- "Instant Bingo," "Mini Bingo" and similar pull-tab or scratch-off games do not qualify. In these games, a player places a wager by purchasing a card containing pre-printed numbers or a pattern covered by tabs or film. By uncovering the numbers or pattern, the player discovers whether the card is a winner. Unlike bingo

meeting the exclusion, the winners of these games are pre-determined.

The bingo exclusion applies only if the game is legal under the laws of the jurisdiction where it is conducted. Even if a jurisdiction rarely enforces or generally disregards a law prohibiting bingo, the conduct of bingo is not legal for this purpose.

The bingo exclusion applies only if for-profit organizations cannot regularly carry on bingo games in any part of the same jurisdiction. Jurisdiction is normally the entire state; however, in certain situations, local law may control.

**Example:** 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. Because 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 qualify for the

exception from an un-related trade or business.

Because of the statutory bingo exclusion, an exempt organization may conduct games meeting the exclusion to raise funds, and the activity will not generate unrelated business income subject to taxation. (The exception does not apply to 501(c)(7) social clubs. See below.)

## **Volunteer Labor**

Does your organization use volunteers to conduct its gaming? Even if gaming is not limited to bingo games that meet the bingo exclusion, the gaming will **not** be considered an unrelated trade or business – and the income earned from it will not be taxed – if **substantially all** the work is performed by volunteers. Although “substantially all” is not defined in this context, an unofficial guideline borrowed from other areas of exempt organization law is 85 percent. Absent other factors, if at least 85 percent of the work (as measured by the number of hours worked) is carried on by people who work without pay

and no more than 15 percent of the work is carried on by people who are compensated, as a general rule, "substantially all" work will have been performed by volunteers.

**Tip: If you rely on the volunteer labor exclusion to exclude gaming from unrelated trade or business, you should maintain accurate records reflecting the number of hours worked by compensated and volunteer workers.**

**Example:** A volunteer fire company regularly holds a slot machine night that is open to the public. Regularly holding public slot machine nights may, given the facts and circumstances, be considered unrelated trade or business. However, because unpaid volunteers performed the work at the slot machine night, the income from the wagering is not taxable as unrelated business income.

"Compensation" is interpreted broadly and may include payments to bartenders, waitresses, snack bar staff, maintenance workers, security and other workers, as well as the tips these workers receive from patrons at the gaming session. Workers who

obtains good or services at a reduced price in return for their services may be considered to be compensated.

**Example:** ABC Organization operates a private school and sponsors gaming to raise revenue for the school. Parents who work at the gaming session are given a tuition reduction of \$50 for each week they work. This reduction of tuition is compensation to the parents; they are not working as “volunteers.”

Compensation may also include non-monetary benefits, such as free drinks or food, if the items are more than a mere gratuity and are intended to be compensation for the workers' services. On the other hand, a worker who receives insignificant monetary or non-monetary benefits is considered a volunteer, not a compensated worker. Determining whether a benefit is insignificant requires consideration of the value of the benefit and:

- The quantity and quality of the work performed;



- The cost to the organization of providing the benefit; and
- The connection between the benefit received and the performance of services.

Note that the volunteer labor exclusion is separate from the bingo exclusion. Thus, if gaming satisfies the bingo exclusion, the bingo income is not taxed even if workers are paid, as long as state or local law does not prohibit payment. Many jurisdictions, however, **require** as a condition of receiving a gaming license that exempt organizations conduct their gaming activities with **all** volunteer labor. If an exempt organization violates the requirement by compensating its bingo game workers, then the bingo exception would not apply if the payment made the game illegal under state law.

Compensation includes tips. If tipping is allowed, the exception for volunteer labor may not apply. Many jurisdictions prohibit tipping at gaming venues. When the organization conducts bingo, the bingo exclusion may not apply if tipping occurs in violation of the jurisdiction's prohibition.

## **Qualified Public Entertainment**

Income from qualified public entertainment activities is also excluded from the definition of unrelated business income. A “public entertainment activity” is one traditionally conducted at a fair or exposition promoting agriculture and education, including any activity whose purpose is designed to attract the public to fairs or expositions or to promote the breeding of animals or the development of products or equipment. A “qualifying organization” is an organization exempt under Section 501(c)(3), 501(c)(4) or 501(c)(5) that regularly conducts an agricultural and educational fair or exposition as one of its substantial exempt purposes.

To be excluded from the term “unrelated trade or business,” a public entertainment activity must be conducted by a qualifying organization:

- In conjunction with an international, national, state, regional or local fair or exposition;

- In accordance with provisions of state law that permit only qualifying organizations (or an agency, instrumentality or political subdivision of the state) to conduct the activity; or
- In accordance with provisions of state law that permit a qualifying organization to be granted a license to conduct the activity for 20 days or less on payment to the state of a lower percentage of the revenue from the licensed activity than is required from non-qualifying organizations.

**Example:** Organization X, a 501(c)(5) agricultural organization, conducts harness racing at an agricultural fair in State L pursuant to a state law that permits the organization to conduct parimutuel betting in connection with the races. Income from wagers placed is excluded from the tax on unrelated business income.

## **Games of Chance Conducted in North Dakota**

Most games of chance conducted by exempt organizations in North Dakota are not

unrelated trades or businesses if conducting the games does not violate any state or local law. See Section 311 of the Deficit Reduction Act of 1984, as amended by Section 1834 of the Tax Reform Act of 1986.

## **Unrelated Business Income Tax and Section 501(c)(7) Social Clubs**

Most types of exempt organizations pay tax on their unrelated business taxable income. A Section 501(c)(7) social club, on the other hand, must pay tax on its gross income except that portion that is considered *exempt function income*.

The exempt function income of a social club is, generally, its gross income from dues, fees and charges received from members in return for providing recreational and social facilities or services to those members, their dependents or guests. Because gaming is recreational and social, the income a social club receives from gaming activities limited to its members is considered exempt function income and is not subject to tax. On the other

hand, income received from gaming activities open to nonmembers is part of the social club's gross income that is subject to the unrelated business income tax.

Social clubs do not qualify for any of the exclusions explained above. Even if a social club conducts a bingo game that would fall within the bingo exclusion or uses only volunteers to conduct all its gaming, if the public participates, the income will be taxable. In addition, the nonmember income, if a large enough percentage of the social club's overall income, may jeopardize its exempt status.

## **Determining Whether Gaming Generates UBI – Flow Chart**

At the end of this chapter is a flow chart to help you assess whether your gaming – or other – activity creates UBI for your organization. Exhibit A is for all organizations except 501(c)(7) social clubs. The flow chart is a summary of the unrelated business income rules and exclusions. See Publication 598, Tax on Unrelated Business Income of

Exempt Organizations, for a complete explanation.

## **Reporting UBI and Paying Tax**

When gross UBI (gross receipts) equals or exceeds \$1,000, an organization must file **Form 990-T, Exempt Organization Business Income Tax Return**. If an organization's total anticipated tax for the year equals or exceeds \$500, it must pay quarterly estimated tax. **Form 990-W, Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations**, may be helpful in computing the tax. However, do not send this form to the IRS. Failure to pay estimated taxes as required or to file the appropriate forms may subject the organization to penalties.

If you find that you are unable to file Form 990-T by the original due date, you can request an extension of time by filing **Form 8868, Application for Automatic Extension of Time To File an Exempt Organization Return**, by that original due date. If you are a corporation or a trust, you

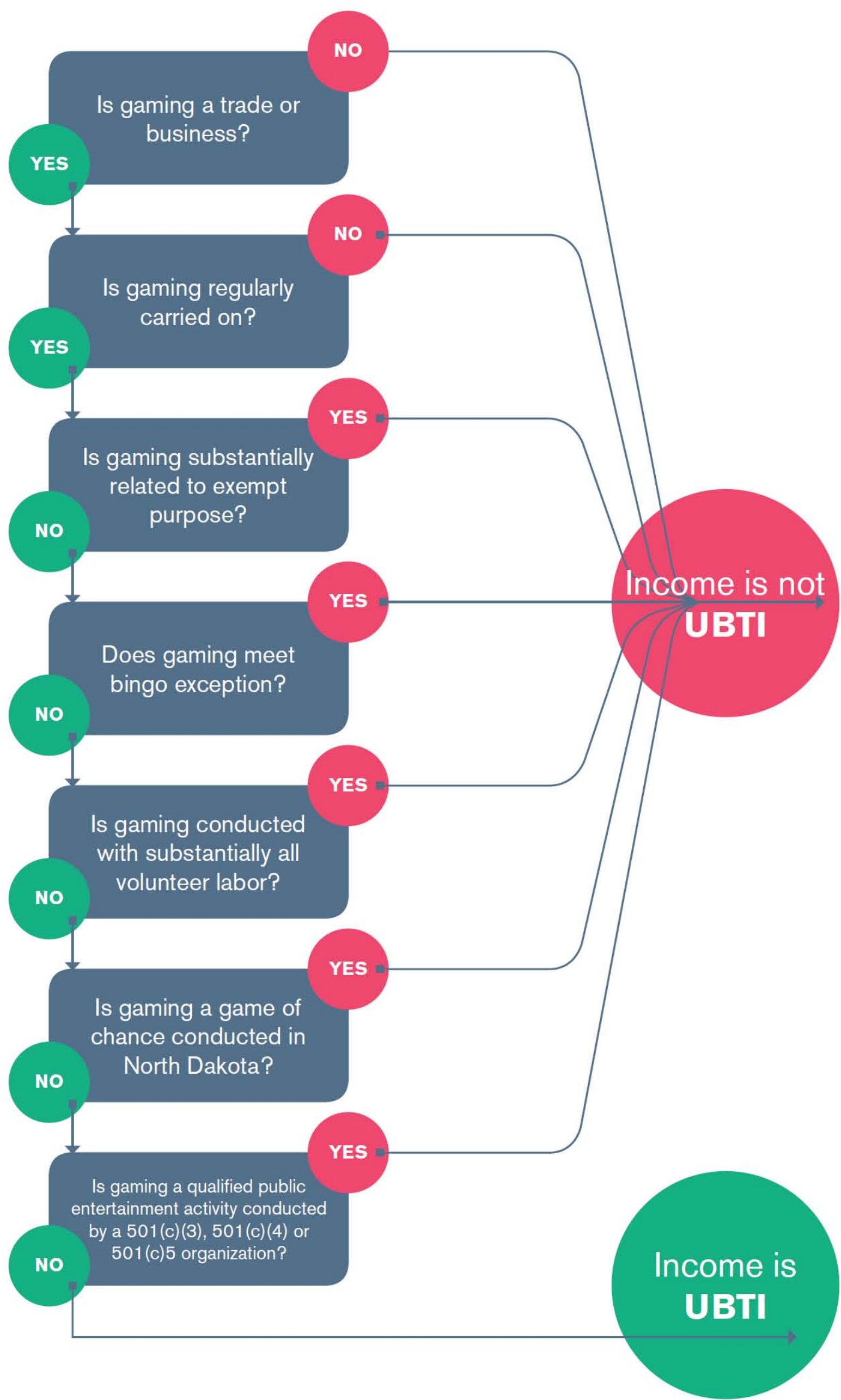
may request an automatic 6-month extension.

You must pay any unrelated business income tax due by the original due date for filing Form 990-T. No extension for paying the tax will be given. Do not send the payment with Form 990-T. You must deposit the tax by the Electronic Federal Tax Payment System (EFTPS).

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Is It Unrelated Business Taxable Income (UBTI)? (Does Not Apply to 501(c)(7) Organizations)



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# Chapter 3

## Maintaining Records

### Recordkeeping

An exempt organization must maintain complete books and records so it can meet its reporting responsibilities and determine any tax liabilities it may have. Exempt organizations must keep the same types of books and records that other businesses maintain. These include cash receipt and disbursement journals, accounts payable journals, general ledgers, detailed source documents and copies of any federal tax returns filed. See **Publication 583, Starting a Business and Keeping Records**, for general information about tax recordkeeping requirements.

**Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities**, or **Publication 4221-NC, Compliance Guide for Tax Exempt Organizations (other than 501(c)(3) Public Charities and Private Foundations)**, contain information

on recordkeeping requirements that apply specifically to exempt organizations.

**Revenue Procedure 71—17**, explains the recordkeeping required of 501(c)(7) social clubs to document member vs. nonmember income. Fraternal organizations (Section 501(c)(8) and 501(c)(10)) and veterans' organizations (Section 501(c)(19)) should also maintain complete records of member and nonmember income.

Organizations that conduct gaming must maintain records of gross receipts from gaming, prize payouts and other related disbursements to substantiate information submitted on the exempt organization information return (Form 990 or 990-EZ) and the income tax return (Form 990-T), if one is required.

An organization must maintain records until the statute of limitations expires; generally three years from the later of the filing or due date of a return. Employment tax returns should be kept for four years after the due date of the return, or four years from the date when the organization paid the tax, if

the payment date was later than the due date.

## **Effective Gaming Controls**

Gaming can generate substantial amounts of income. Much of it is cash that passes through many hands at each gaming session. Exempt organizations should carefully oversee and control gaming to ensure that funds are not diverted to private individuals or for private purposes.

Effective oversight is more than simply choosing a location to hold the gaming and approving the lease or other arrangements with the gaming operator. The exempt organization should maintain active involvement in the conduct of the games themselves.

Here is an example of appropriate oversight for a bingo operation that conducts multiple sessions per week:

- A gaming manager controls the execution of the games, including payouts, and records transactions on a “daily sheet.”

- A cashier – a different person from the gaming manager – receives funds and records serial numbers of games sold.
- A third person serves as cash controller and prepares inventory/paid out reports, independently counts cash receipts and matches the cash to the reports prepared by the gaming manager. He or she also prepares and makes the bank deposit.
- A fourth person serves as inventory controller and reviews the daily sheets received from the gaming manager to determine inventory usage and profit achieved. The inventory controller may also receive the bank statement directly and ensure that all deposits stated on the daily sheet appear on it.
- A fifth person writes the checks to pay gaming expenses.
- The organization's board of directors reviews and compares bingo reports or daily sheets with previous reports for consistency. The board monitors the

games to ensure that internal controls are functioning properly.

If an organization also sells pull-tabs at its bingo sessions or conducts other forms of gaming, it will want to implement additional controls, such as verifying that the gaming manager reports all receipts.

State and local laws may require additional recordkeeping and reporting and impose specific internal controls over gaming.

Contact the appropriate agencies to determine the state and local rules that may apply.

## **Chapter 4**

# **Exempt Organizations Reporting Requirements**

The IRC requires most exempt organizations to file an annual information return showing gross receipts and disbursements and other information the IRS needs to administer the tax laws. **Form 990, Return of Organization Exempt From Income Tax,**

or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax, are the standard forms used to make this re-port. (See the IRS website for the **filing thresholds** for each of these forms.) Filing a 990-T to report UBI will not satisfy an organization's obligation to file an annual return or notice.

Most small tax-exempt organizations whose annual gross receipts are normally \$50,000 or less may meet their filing requirements by submitting **online Form 990-N**, also known as the e-Postcard, unless they choose to file a complete Form 990 or Form 990-EZ instead.

For a gaming organization, gross receipts include **all** amounts wagered in games, not just the net proceeds after winning wagers have been paid out. Therefore, most organizations conducting gaming will have gross receipts well above the Form 990-N filing threshold.

**Note:** If an organization eligible to file an e-Postcard chooses to file a Form 990 or 990-EZ instead, it must file a **complete** return, including all required sections and schedules.



Churches and certain other religious organizations are excepted from filing either an annual return or an e-Postcard. See the Instructions for Form 990 or Form 990-EZ for a description of the religious organizations that are excepted from the requirement to file an annual return or e-Postcard.

If you are required to file an annual return or e-Postcard, you must file it by the 15th day of the 5th month after your accounting period ends. If your accounting period coincides with the calendar year, file your return or e-Postcard by May 15th following the close of the tax year.

You can get an automatic 6-month extension of time for filing a Form 990 return by filing **Form 8868, Application for Automatic Extension of Time To File an Exempt Organization Return**, by the original due date of the return. You cannot get an extension of the due date for filing an e-Postcard.

If you are required to file an information return or e-Postcard, and you fail to do so for

three consecutive years, your exempt status is automatically revoked by law.

You must make a copy of your Form 990 or 990-EZ annual information returns available for public inspection during normal business hours at your principal office and at regional or district offices. A return must be made available for a period of three years from the date it was required to be filed. Most organizations are not required to disclose the names and addresses of any contributors reported on Schedule B of the return.

## **Schedule G, Form 990 or Form 990-EZ**

If your organization's revenue from gaming exceeds a threshold amount, you will be required to complete and attach **Schedule G, Supplemental Information Regarding Fundraising or Gaming Activities**, to your Form 990 or Form 990-EZ. (For details on the threshold amounts triggering filing of Schedule G, see the instructions for **Form 990 or Form 990-EZ**.)

Use Part III of Schedule G to report specific information about your organization's gaming activities. To be able to complete this part, for each tax year you will need to know:

- Gross revenues from bingo, pull-tabs/instant bingo and other types of gaming;
- Cash and non-cash prizes paid for each type of gaming;
- Rent or costs of facilities and other direct gaming expenses;
- Percentage of your organization's games operated in your own facilities and in outside facilities;
- Percentage of volunteer labor for each type of gaming;
- States in which you operated gaming activities and the states in which your organization holds gaming licenses;
- Revocation, suspension or termination of any of your organization's gaming licenses;

- Amount of mandatory charitable distributions from gaming proceeds required under state law, or the amount of proceeds spent on your organization's own exempt activities;
- Names and addresses of the gaming manager and the person who prepares your gaming/special events books and records; and
- Information about third parties with which your organization has contracts to receive gaming revenue.

For detailed information about filing requirements for Forms 990, 990-EZ or 990-N, see their instructions, which include an explanation of the public inspection rules for these forms.

## **Chapter 5**

# **Workers Conducting Gaming Activities**

It's Saturday night and your lodge is hosting its weekly bingo game for members and their

guests. During the game, Mr. P tends the bar and Ms. J calls the numbers. The lodge pays Ms. J \$10 an hour for calling numbers. Mr. P, though not paid for tending bar, does receive tips from bingo patrons. You probably know that you should withhold income, Social Security and Medicare taxes from Ms. J's wages and send these taxes and the employer share of Social Security and Medicare taxes to the IRS, as well as report the wages and tax to both Ms. J and the Social Security Administration on Form W-2, Wage and Tax Statement. But did you also know that you may have reporting and withholding requirements for Mr. P's tip income?

This chapter will help your organization determine whether its gaming employees should be classified as employees, independent contractors or volunteers. (Different compliance requirements apply to each type of worker.) This chapter also examines compensation: Is your organization compensating its gaming workers and if so, how, and how much? (Just a "tip" here: Mr. P's tips count as compensation!) Then, the

information in this chapter will help you make sure that your organization does not inadvertently turn its gaming “volunteers” into compensated employees.

This chapter ends with a quick survey of your organization’s reporting and withholding responsibilities for any compensated employees and independent contractors. (These requirements apply to **any** workers your organization pays – not just those employed in its gaming activities.) The chapter also discusses the recordkeeping and reporting that employees must do for tip income.

## **Employee, Independent Contractor or Volunteer?**

A worker at your organization’s gaming activity is:

- An employee – someone whose work your organization has the right to control and direct;
- An independent contractor – someone your organization contracts with to

provide a specific service or product. Your organization contracts with the person for the end product or service and does not have the right to supervise or direct how the independent contractor does the work; or

- A volunteer – someone who works for your organization for no compensation, either monetary or non-monetary. Note that volunteers can be either employees or independent contractors under the common law test.

Generally, if a worker is compensated in any manner, he or she will be either an employee or an independent contractor. As noted above, someone is your employee when you have the right to control and direct that person's work, not only as to the result to be accomplished but also as to the details and means by which that result is accomplished. In other words, an employee is someone who is subject to your will and control not only as to what will be done but how it will be done. You need not actually direct or control how the person works; simply your right to do so

is sufficient to make the person your employee.

For more information on how to determine whether a worker is an employee or independent contractor, see **Publication 15-A, Employer's Supplemental Tax Guide**, and **Publication 1779, Independent Contractor or Employee**. Then, if you are still unsure whether the person you are paying is an employee or independent contractor, you can ask the IRS for a ruling by filing **Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding**.

## **Types of Compensation**

All pay you give to an employee for services performed is considered wages and is subject to federal employment taxes unless an exception applies. The pay may be in cash or in other forms. It includes salaries, bonuses, commissions and fringe benefits. How you measure or make the payments does not matter.



If your organization uses a method other than cash or a check to pay its workers, you are paying them “in kind.” Payments in kind may be in the form of goods, lodging, food, clothing or services. Generally, the fair market value of the payments at the time they are provided is subject to employment taxes.

Tips gaming activity workers receive from players, whether cash or non-cash, are taxable income. Tips paid to a worker in cash, checks or other cash equivalent (including charged tips) of more than \$20 in a calendar month while working for any one employer are also wages subject to employment taxes.

## **Volunteers and Gaming Activities**

Exempt organizations often rely on uncompensated workers when conducting gaming. In fact, many states and localities require that exempt organizations use all (or substantially all) volunteer labor to conduct their games to qualify for a license.

If a “volunteer” worker at a gaming activity is permitted to receive tips from players and the

volunteer is subject to the direction and control of the organization, he or she becomes a compensated employee. The organization would have the same reporting and withholding requirements for this person as for any other employee. In addition, by permitting the otherwise-volunteer worker to receive tips, the organization may be violating state or local rules that require all volunteer labor for licensed gaming organizations.

Exempt organizations often want to recognize and thank their volunteers, and often do so with awards or gifts. In general, if these are non-cash items of nominal value, such as turkeys or hams around the holidays, they would not constitute taxable wages. However, cash items, including gift certificates as well as any other taxable fringe benefit, would be a payment of taxable compensation, and if the volunteer is subject to the organization's right to direct and control, the amounts are wages. This is true even if the organization receives donated gift certificates, which it then passes on to its volunteers.

Organizations should be aware that their methods of thanking or recognizing

volunteers may create employment tax and reporting responsibilities.

What if an organization permits an individual to help out at a gaming activity and thereby “work off” a program payment or fee that he or she would otherwise have? These arrangements – whether “voluntary” or required – can also result in a worker having wages subject to employment taxes.

**Example:** Private school X, a 501(c)(3) organization, conducts a weekly bingo game to raise funds for the school. Parents who work at the bingo games are given a tuition reduction of \$100 for each week they work.

The fair market value of the parent’s or guardian’s work at the weekly bingo game is \$100 – the amount of the tuition reduction. Generally, the parent would be subject to the organization’s right to direct and control (unless the parent is in the business of running bingo games); thus, a parent who works at the weekly bingo game has compensation of \$100.

# **Your Organization's Reporting and Withholding Responsibilities for Employees**

If your organization's gaming workers are employees, you are responsible for withholding and paying employment taxes and filing and furnishing the required employment tax forms and information returns. This section provides a general discussion about withholding and reporting employment taxes. If your organization has employees, see **Publication 15, (Circular E), Employer's Tax Guide**, and the **Instructions for Forms W-2 and W-3** for the specific rules you will need to follow.

**Soliciting a Social Security Number** – An employer has a requirement to solicit an employee's Social Security number (SSN) at the time the employment begins. Because the employee is required to furnish **Form W-4, Employee's Withholding Allowance Certificate**, to the employer on commencement of employment, Form W-4 may be used for the initial solicitation of the employee's SSN. See **Publication 1586**,

**Reasonable Cause Regulations and Requirements for Missing and Incorrect Name/TINs**, for more information about solicitation requirements when employees do not furnish their SSNs.

**Withholding Income Tax** – As an employer, you must withhold federal income tax from your employees' wages. To know how much tax to withhold, you should have a Form W-4 on file for each employee. Ask all new employees to give you a signed Form W-4 when they start work. You can provide **Formulario W-4(SP), Certificado de Exención de Retenciones del Empleado** in place of Form W-4, to your Spanish-speaking employees. Generally, a Form W-4 remains in effect until the employee gives you a new one.

In some cases, where a serious under-withholding problem is found to exist for a particular employee, the IRS may issue a notice (commonly referred to as a "lock-in letter") to the employer specifying the withholding rate (marital status) and maximum number of withholding allowances

permitted for a specific employee for purposes of calculating the required withholding. The IRS will provide the employee with an opportunity to dispute the determination before the employer adjusts withholding based on the lock-in letter.

After the lock-in letter takes effect, the employer must disregard any Form W-4 that results in less tax withheld, until the IRS notifies the employer otherwise. However, the employer must honor any Form W-4 that claims a withholding rate (marital status), withholding allowances and any additional amount that results in more income tax withheld than at the withholding rate and withholding allowances specified in the lock-in letter. Employers who use electronic Form W-4 systems must make sure the employee cannot override the lock-in letter to decrease withholding through the electronic Form W-4 system.

**Withholding and Paying FICA Taxes** – The Federal Insurance Contributions Act (FICA) imposes taxes on both the employee and the employer. FICA taxes are composed of two

elements: old-age, survivor and disability insurance (OASDI, commonly known as Social Security) and hospital insurance (Medicare).

The Social Security tax rate is 12.4 percent, split equally between employee and employer. The tax applies to wages up to a “wage base” limit. The wage base limit is the maximum wage that is subject to the tax for the year. The wage base limit is adjusted annually.

The employee and employer each pay the Medicare tax rate of 1.45 percent on wages, for a total of 2.9 percent. There is no wage base limit for Medicare tax; all covered wages are subject to Medicare tax.

The employer collects the employee portion of the Social Security and Medicare taxes by deducting the tax from the employee’s wages at the time of each payment. For tipped employees, an employee’s regular pay may not be enough to withhold all the taxes owed on the regular pay plus reported tips. If this happens, an employee can give the employer money until the close of the calendar year to pay the rest of the taxes.

If the employer cannot collect all the Social Security and Medicare taxes on the tips reported by an employee, the uncollected taxes must be reported on Form W-2. See **Employee's Responsibility for Tip Income**, below, for more information. As an exempt organization, you need not withhold or pay FICA taxes for an employee that you pay less than \$100 for the calendar year.

If income, Social Security or Medicare taxes that are required to be withheld are not withheld or are not paid, the organization is liable for the taxes and certain individuals may be personally liable for the amount of the employee taxes as a trust fund recovery penalty.

**Paying FUTA Taxes** – Employers are subject to a federal unemployment (FUTA) tax on the total employment wages during the calendar year. Only the employer pays FUTA tax. FUTA tax is not collected from the employee's wages.

Services performed in the employ of a Section 501(c)(3) organization are excluded from the definition of "employment" for FUTA tax



purposes. Consequently, 501(c)(3) organizations do not pay FUTA tax on their employees' wages.

Services performed in the employ of other types of exempt organizations are excepted from the definition of FUTA employment in any calendar quarter in which the remuneration earned for those services is less than \$50.

Application of these FUTA exceptions is based on the status of the common law employer.

**Filing Form 941, Employer's Quarterly Federal Tax Return** – Every employer liable for withheld income and FICA taxes must report its liability. The report is ordinarily made quarterly on Form 941, which must be filed by the last day of the month following the close of the calendar quarter. If, by that date, you made timely deposits (see below) in full payment of your taxes for the quarter, you can take an additional 10 days to file Form 941. If you discover an underpayment or overpayment error on a previously filed Form 941, use **Form 941-X, Adjusted Employer's Quarterly Federal Tax Return**

**or Claim for Refund**, to make the correction. **Publication 15, (Circular E), Employer's Tax Guide**, and the **instructions for Form 941-X** provide more information.

**Filing Form 944, Employer's Annual Federal Tax Return** – If, based on your Form 941 reporting history, the IRS estimated that your liability for FICA tax and withheld income tax for the year will be \$1,000 or less, or you inform the IRS that you expect your annual tax liability to be \$1,000 or less, you may be notified to file an annual return on Form 944 instead of the quarterly Form 941. You must get IRS approval to start (or to stop) filing Form 944. Form 944 is due by January 31 following the end of the calendar year of the return. If, by that date, you made timely deposits in full payment of your taxes for the calendar year, you can take an additional 10 days to file Form 944. If you discover an underpayment or overpayment error on a previously filed Form 944, use **Form 944-X, Adjusted Employer's Annual Federal Tax Return or Claim for Refund**, to make the correction.