

# Audit Technique Guide – Organizations Conducting Gaming Activities

## Introduction

These guidelines are for employees of the Exempt Organizations Examinations division who are assigned audits of organizations conducting gaming activities.

These guidelines are not intended to be a technical resource. For an overview of information on the topic of gaming, read the Continuing Professional Education articles. Note that these articles may contain outdated materials:

- [1986-G: Update on Fundraising](#)
- [1990-M: Gambling Activities of Exempt Organizations](#)
- [1996-D: Update on Gaming Activities](#)
- [1997-D: Detecting Fraud in Charity Gaming](#)
- [1997-E: Excise Tax and Occupational Tax on Wagering](#)
- [1999-E: Update on Excise Tax and Occupational Tax on Wagering](#)
- [1999-N: UBIT: Current Developments](#)
- [2002-F: UBIT: Current Developments](#)

## Preaudit Procedures

Review [Publication 3079, Tax-Exempt Organizations and Gaming](#), for guidance on:

- Exemption issues
- Employment tax issues
- Occupational and wagering excise taxes
- Record keeping requirements
- Reporting requirements
- Unrelated business income issues
- Withholding requirements

See [IRM 4.75.10.6, Initial Analysis](#) for discussion on:

- Statute of limitations
- Determination file (not applicable for organizations under a group ruling)
- IDRS information
- classification sheet and referral package.
- Organizational requirements
- Review of the return

## State/Local Agency Information

Identify the state/local agency in charge of gaming enforcement. When possible, make connections within the agency. Many of the agency employees also pursue gaming issues and can provide explanation for the particular rules/regulations of the agency.

Each jurisdiction requires specific reports from licensed gaming operators. Reports may vary depending on the type of gaming activity. Most reports will be monthly or quarterly in nature.

The gaming reports may provide consolidated information useful during your pre-audit analysis or in preparing audit reports.

**Example:** An Oregon Department of Justice Annual Raffle License Report provides dates of raffle sales, total sales, expenses, cash prizes, and cost of non-cash prizes. Use such information in preparing for the initial interview or an unrelated business income adjustment.

When needed, contact the agency for guidance on how an organization should properly conduct gaming activities. Compare the guidance received to the procedures actually used by the organization. Discrepancies may highlight avenues for improper enrichment by those operating the games.

Review the information reported periodically on the application for a gaming license filed with the gaming regulators. Compare the amounts reported from the game under audit with games similar in size within its respective county. If the game under audit reports significantly less revenue and a smaller profit margin when compared to similar operations in its locality, that could indicate “skimming” or private purposes being served.

## **Tax Form Review**

All organizations conducting gaming, regardless of the legality of the activity within the gaming jurisdiction, are subject to a plethora of filing requirements. You may need to secure delinquent returns.

Common issues encountered involve reporting of net income versus gross receipts, worker classification, and liability for income and excise taxes.

Not all returns discussed below require in depth pre-audit analysis. Certain forms, such as the Forms 11-C and 730 are either filed or not, and either are correctly reported or not. Other returns, such as the Form 990/990-EZ Schedule G, Supplemental Information Regarding Fundraising or Gaming Activities, provide a wealth of information during a large, unusual and questionable item analysis.

The subsections below discuss specific guidance for the following forms:

- [Form 990-EZ, Short Form Return of Organization Exempt From Income Tax](#)
- [Form 990, Return of Organization Exempt From Income Tax](#)
- [Form 990/990-EZ Schedule G, Supplemental Information Regarding Fundraising or Gaming Activities](#)
- [Form 990-PF, Return of Private Foundation or Section 4947\(a\)\(1\) Nonexempt Charitable Trust Treated as a Private Foundation](#)
- [Form 990-T, Exempt Organization Business Income Tax Return](#)
- [Form 940, Employer’s Annual Federal Unemployment \(FUTA\) Tax Return](#)
- [Form 941, Employer’s QUARTERLY Federal Tax Return](#)
- [Form 944, Employer’s ANNUAL Federal Tax Return](#)
- [Form 945, Annual Return of Withheld Federal Income Tax](#)
- [Form 730, Monthly Tax Return for Wagers](#)
- [Form 11-C, Occupational Tax and Registration Return for Wagering](#)
- [Form W-2 G, Certain Gambling Winnings](#)

- [Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons](#)
- [Form 1099-MISC, Miscellaneous Income](#)

### Form 990-EZ

The Form 990-EZ line 6a captures the gross revenues from gaming. Line 6c lists the direct expenses from gaming and fund-raising activities.

Organizations may include payroll expenses, employment taxes and costs for renting a facility in the expenses on line 6c, in lieu of lines 12 and 14. The instructions to the form do not clarify whether the organization should segregate such expenses out of line 6c.

Be aware that the list of officers, directors, trustees, and key employees in part IV may not include the gaming manager, who might be listed in part VI, lines 50 or 51.

Caution: In order to avoid reporting requirements for part VI, some workers may request or “suggest” that their compensation be split into wages and non-employee compensation. Others may receive taxable fringe benefits without having such benefits included in their compensation.

### Form 990

The table below highlights entries for possible concern in the course of the large, unusual, or questionable item analysis:

Form 990		
Part Number	Line Number	Issue
IV	19	Triggers Schedule G. Threshold of \$15,000 gross receipts.
IV	28	Triggers Schedule L. Business transactions with related parties (gaming manager, hall operator, and others.)
V	1	Captures Form W-2 G, backup withholding information.
V	2	Captures payroll information. Lack of employees may signal possible classification issue (compensated volunteers.)
V	3	Triggers Form 990-T. Threshold of \$1,000 gross income (gaming gross receipts less prize payouts.)
VI	3	If answered yes, review the contracts with the management company (gaming hall operator, landlord, and others.)
VI	12	Review for conflicts of interest between officers and organization.

VII	All	May include the gaming manager as a key employee.
VIII	6b	Common place for stashing gaming payroll expenses.
VIII	9	If present, look for Schedule G and Form 990-T. Be wary for netted receipts on Line 9a in lieu of gross.
VIII	10	Look for reporting of sales of bingo daubers and snack food.
IX	All	Gaming expenses may have been reported on any line.

Note: Gross income as referenced for Form 990, Part VIII line 9a is gross receipts, as contrasted to gross income for Form 990-T which is gross receipts less cost of goods sold (prize payouts.). Treas. Reg. 1.61-3

Not all organizations properly recognize gaming activities as gaming income.

**Example:** An organization conducts a drawing as a fund-raiser. Each member pays \$3 for a ticket. The organization treats the drawing as a fund-raiser, when in fact it is a raffle.

Some organizations may conduct the gaming operations through third party negotiators. The operator collects the gross receipts, makes the prize payouts, pays the payroll expenses, pays or collects the rent and remits the remainder to the organization. In such situations, the organization may split the expenses among various lines, such as rental expenses, to hide the extent of the cost of operating the gaming activities. Consider the possibility of substantial private benefit or inurement in such situations.

**Example:** An organization enters into a contract with an individual who acts as landlord, gaming manager, and payroll supervisor. While the state limits the amount the individual may charge the organization for various classes of expenses, the lucrative gaming activity generates little revenue for the organization after the subtraction of the expenses.

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

If an organization's revenue from gaming exceeds \$15,000, the organization must complete and attach Schedule G to its Form 990 or Form 990-EZ.

Note: Form 990-N filers do not file Schedule G. If an organization improperly files Form 990-N in lieu of a Form 990 or 990-EZ, secure Schedule G if obtaining delinquent return.

Part III of Schedule G requires specific information about the organization's gaming activities, which provides a dearth of information for the risk analysis. The section requires the organization to report:

- Gross revenue from bingo, pull-tabs/instant bingo/progressive 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 the organization's games operated in its own facilities and in outside facilities.
- Percentage of volunteer labor for each type of gaming.
- States in which the organization operated gaming activities and the states in which it holds gaming licenses.
- Revocation, suspension or termination of any of the organization's gaming licenses.
- Amount of mandatory charitable distributions from gaming proceeds required under state law or the amount of proceeds spent on the organization's own exempt activities.
- Names and addresses of the gaming manager and the person who prepares the organization's gaming/special events books and records.
- Information about third parties with which the organization has contracts to receive gaming revenue.

Schedule G also requires membership organizations to indicate whether non-members participated in gaming activities. If the organization checks yes, check for whether the organization is required to file Form 990-T, Form 730, and Form 11-C.

Note: Even though a non-member participates in a gaming activity, the participation may not necessarily trigger liability for taxes. For organizations other than those described in Section 501(c)(3), at issue is whether the member pays for the non-member's participation (possible Unrelated Business Income - UBI), and whether an organization that sells to non-members uses the funds to subsidize regular operations (possible wagering, occupational taxes).

### **Form 990-PF**

There is no specific line on the Form 990-PF for reporting gaming income. Private foundations conducting gaming activities can be subject to unrelated business income taxes, excess business holdings excise taxes (IRC Section 4943), and a potential change in foundation status, if the organization pursues termination of private foundation status under IRC Section 507(b)(1)(B).

While a private foundation may exclude bingo income from UBI treatment, the active conduct of a business enterprise may trigger IRC Section 4943 excise tax. If the foundation operates the activity solely by itself, treat the foundation as a sole proprietor and liable for the tax. If the foundation conducts the activity through a partnership, corporation or other entity in which the foundation holds an equity interest, the foundation would need to limit its ownership in such interest under IRC Section 4943 attribution rules.

### **Form 990-T**

Organizations conducting taxable gaming do not always file [Form 990-T](#). For those that do, see if the organization:

- Claims various expenses that may not be directly related to the activity.
- Reports income from concessions (daubers, food, drink, etc.).
- Reports pull-tab prizes as cost of goods sold.

- Report wages in multiple locations (rental expenses, cost of goods sold, etc.).

Check for whether the return claims “lawful purpose expenditures” that generate net operating losses. When claiming the expenditures, the organization should limit the amount claimed to no more than the net income from the gaming activity. Concessions and other non-gaming activities are not normally covered by lawful purpose expenditure rules.

### **Forms 940 / 941 / 944 / 945 / W-2G / 1099 / 1042 / 1042-S**

For guidance on employment tax issues, see [IRM 4.23.3, Classification, Selection and Assignment of Employment Tax Cases](#).

Using command code IRPTRR with designation code R, retrieve the Forms W-2, W-2 G, 1042-S, and 1099 electronically. Send a request to the designated Exam Program and Planning specialist to receive the files.

Use the Information Report Analysis System (IRAS) to analyze the data. Generate all reports. Look them over, noting those that need further development during the field phase of the audit.

### **Forms 730 / 11-C**

For guidance on when an organization must file Forms 730 and 11-C, see [Publication 3079, Tax-Exempt Organizations and Gaming](#).

For membership organizations, other than those described in Section 501(c)(3), note whether the organization files the forms. If the organization does not, note to check on whether games are restricted to members only.

If filed, note the totals from the Forms 730 for later comparison with the state/local agency reports. Subsequent discrepancies may give rise to audit assessments.

If you obtain the list of licensed gaming workers from the state/local agency’s website, check for Form 11-C filings.

Note: If you find a filed Form 11-C, but the organization has not filed Forms 730, note the issue for further development. Either the employee may have filed in error or the organization has delinquent Form 730.

### **Initial Information Document Request**

See [IRM 4.75.10, Exempt Organization Pre-Audit Procedures](#), for procedures relating to Form 4564, Information Document Request (IDR).

Request source documents such as retained games, sales register slips, bank deposit slips and time sheets. Request only a sampling. Pick random dates or weeks to sample, specifying a start and end date or a specific date. Ask for the documents to be available at the audit site (or the representative’s office). At a minimum, request the monthly gaming reports required by the state/local agency.

Note: If you determine information from the source documents is not being recorded in the books, submit a follow up request expanding the number of documents requested.

## **Initial Interview**

See IRM 4.75.10.11, Planning the Initial Interview, for guidance on general questions to ask in the initial interview.

During the initial interview, determine the:

- gaming manager and gaming employees
- gaming supplier and concessions vendors
- bar or concession staff
- procedures for handling inventory and cash
- procedures for accounts receivable and accounts payable
- procedures for prize payouts
- procedures for introducing and retiring games (pull-tabs and punch boards)
- classes of and caps on the gaming licenses
- maximum sizes of the prizes
- number and types of reports filed with the gaming jurisdiction and the IRS
- number of gaming locations and jurisdictions
- extent of usage of volunteers
- restrictions (if any) on who may purchase and participate

Determine whether the organization uses another entity to conduct gaming activities. Obtain a copy of any partnership, joint venture, or operating agreements.

Discuss whether and, if so, how the board monitors the game to ensure that the organization collects all funds from the operator and workers.

Determine if the gaming operation has a system of internal controls to safeguard adequately the revenue generated from the game. The internal control structure should ensure that the different members of the charity handle various parts of the gaming activity, each of whom serves as a check on the others.

## **Field Audit Procedures**

The procedures below supplement those presented in [IRM 4.75.11, On Site Audit Guidelines](#).

As organizations conducting gaming activities process large volumes of cash, be prepared to issue requests to third party contacts for verifying information. For restrictions and guidelines on such contacts, see [IRM 25.27, Third Party Contacts](#).

Note: Consider asking the organization to sign Form 12180, Third Party Contact Authorization Form. Provide a copy of the form to the third party when making the third party contact.

Potential third party contact includes:

- Gaming supplies vendors
- Concessions supplies vendors
- Temporary staffing or employee leasing companies
- Landlords

If the organization fails to provide records, issue summons when needed. See [IRM 25.5, Summons](#), for procedures. Consult Area Counsel for assistance in crafting the summons and discussing methods of delivery. Visit the SB/SE intranet site for:

- Common summons addresses
- Enforcement traps
- Frequently asked questions
- Preparation charts
- Sample summons attachments

### **Facility Tour(s)**

At the conclusion of the initial interview, request a tour of the gaming facility. Suggested items to take with you on the tour:

- Clipboard with paper
- Pen or pencil
- Highlighter
- Copy of a floor plan
- Measuring tape (minimum of 10 feet)
- Digital camera

During the tour, note responses to the following questions with respect to the gaming facility:

- How big is the facility (length X height X width)?
- What is the lot size of the property (length X width)?
- What portion of the parking lot (if any) is used for players (length X width)?
- What are the confines of the gaming area (length X height X width)?
- Are rest rooms open to players, and if so, when are they open?
- What are the dimensions of the rest rooms (length X height X width)?
- How much space is devoted to game management (length X height X width)?
- What are the hours of operation?
- How many days a year does the gaming facility operate?
- Are special hours set aside for special or other events, and if yes, what are they?
- What games does the organization conduct in the area?
- How do players gain access to the facility?
- Does the organization advertise on signs outside the facility, and if so, where?

If the gaming facility contains concessions, note responses to the following questions:

- What is the size of the space set aside for concessions operations (length X height X width)?
- Where is the concession activity conducted?
- Where are concession supplies stored?
- What is the size of the storage area for concessions (length X height X width)?
- Who may purchase the concessions?

- What are the hours of operation for the concessions?
- Who works in the concessions (name, title, years of employment)?
- How does the organization report the pay to the concessions workers?

With respect to game storage, note responses to the following questions:

- Where are the games for sale kept?
- Where are the used games kept?
- How long are the games held onto?
- What do you do with the winning game cards/tabs/etc.?
- If the organization gives merchandise as prizes, where does the organization store the merchandise?
- What records does the organization keep with regards to the prizes?

With respect to internal controls, note responses to the following questions:

- Where does the organization store the money from the games?
- Are gaming funds kept separate from other organization funds?
- Who sells the game supplies (cards, pull-tabs, tickets, daubers, etc.)?
- Who handles the gaming receipts?
- Who pays out the gaming prizes?
- Who handles the inventory?
- Who makes the payments for the supplies?
- Who handles the invoices?
- Who has authorization to make payments?
- Who performs the accounting functions (payroll, accounts payable, accounts receivable)?
- How do you pay workers?

Have the tour guide explain the procedures for:

- Selling gaming supplies (cards, pull-tabs, tickets, daubers, etc.)
- Handling inventory
- Conducting gaming activities

Take measurements and photographs of the gaming and concessions areas. On the floor plan, highlight the gaming and concession areas.

For membership organizations, ask participants to display their membership cards. For any guests, ask if they purchased any gaming supplies or concessions. Record the responses.

### **Source Document Inspection**

To ensure that the organization's reporting is accurate and honest, always sample source documents. Depending on the size of the organization you may sample only a few items, or you might review all of the documents available.

Primary source documents provide details to support amounts recorded in the books. Source documents also provide information about transactions that are not captured in most accounting systems.

Prior to reviewing the records of an organization become familiar with SB/SE audit technique guide for cash intensive businesses. See [Cash Intensive Businesses Audit Techniques Guide - Table of Contents](#). In addition, see Training Publication 1125-002, Gaming Compliance Training for Indian Tribal Enterprises for general guidance available on issues common to gaming activities.

If equipped with a portable scanner, scan the documents in lieu of making copies when directed to secure a copy of a document.

### **Cancelled Checks**

Perform a bank statement reconciliation. Select employees for payment verification. Match checks to the payroll account to determine whether all employee payments were included in the Form W-2.

Track the check number sequences. Identify any missing checks. Verify the existence of voided checks. Confirm that voided checks were not processed.

View the back of the check to see who deposited the payment. Kickback schemes often involve a check writer depositing a check written to another party.

Trace the cancelled checks to the ledger. Identify all payments to individuals and businesses that perform services. Exclude those that sell inventory (grocery stores, gaming vendors). Match you list against the Forms 1099. Pursue collection of any delinquent Forms 1099-MISC.

Secure copies of cancelled checks (or check images) as supporting documentation for any issues that arise (employment tax, discrepancy adjustment, withholding).

### **Contracts/Agreements**

Review all contracts/agreements with the organization. Identify both parties to the contract. Note who signs the contract for each party.

Determine whether the contracts provide for excessive benefits for the person(s) performing the services.

Example: A contract with the landlord of the gaming hall sets rent at \$250 a bingo session. As the gaming hall holds three sessions a day, seven days a week, the rent comes out to \$22,812.50 per month ( $\$250 \times 3 \text{ sessions per day} \times 365 \text{ days} / 12 \text{ months}$ ). The hall is 3,700 square feet, which translates to \$73.96 a square foot per year in rent ( $\$250 \times 3 \text{ sessions per day} \times 365 \text{ days} / 3,700 \text{ square feet}$ ). A neighboring facility of the same size normally rents for \$10.20 a square foot per year. In this situation, the rental payments are excessive, generating private benefit to the landlord.

For those contracts conferring excessive benefits, determine whether the other party to the contract is an insider of the organization. Develop a case for excess benefit transactions for those organizations where IRC Section 4958 can apply. For all other organizations, determine whether the organization operates for the benefit of the other party. If yes, pursue revocation, if applicable.

## Daily Record

An organization must keep a daily record showing the gross amount of all wagers on which wagering tax is due.

The record for each day's operations must show:

- The gross amount of wagers accepted.
- The gross amount of each class or type of wager accepted on each separate event, contest, or other wagering medium.
- The gross amount, separately, of wagers:
- Accepted directly by the organization or at its registered place of business.
- Accepted for the organization by its agents at any place other than its registered place of business.
- The gross amount of tax collected from or charged to bettors as a separate item.

The organization must maintain a separate record of each agent or employee receiving wagers on its behalf. Such record must include the employee's or agent's name, address, periods of employment, and TIN, (Employees may obtain a TIN by visiting [www.irs.gov](http://www.irs.gov).)

Every agent or employee of the organization that receives wagers on its behalf at any place other than its registered place of business must keep daily record of:

- The gross amount of wagers received.
- The amount, if any, retained as a commission or as compensation for receiving the wagers.
- The amount turned over to the organization.

All records are subject to the standard three year retention rule.

Reconcile the gaming operations' gross receipts reported on the Form 990 to the gross receipts reported on the summary of the daily gaming sheets. Trace the gross income from the gaming occasions to the bank deposit slip for each occasion. Closely scrutinize the gaming operation if currency deposits do not happen soon after each gaming occasion.

## Grants

For charitable organizations whose primary purpose is to raise funds from the operation of gaming and pay the proceeds to other charities, review any large grants or contributions to other charities. The grantee may be required to make kickbacks to the for-profit fund-raising companies owned and operated by persons related to officers of the grantor. Contributions may also link to the grantee's participation in supply or service agreements with the grantor officer's for-profit companies.

Review minutes of meetings of the governing board, committees and other groups to determine whether the officers of the charity approved the grant. Closely scrutinize grants if officers of the charity do not approve large contributions and the grants do not appear to further the charity's mission statement.

Compare the date the grantor makes the grants and the date of any management and supply agreements signed by the grantee. This may provide evidence that the contributions may link the grantee's participation in supply or service agreements with the grantor officer's related companies.

### **Forms W-4/W-9**

Review the [Forms W-9](#) and [W-4](#). Match the forms to the [Forms W-2 G](#), 1099 and [W-2](#). Identify any inconsistencies.

Secure copies of modified Forms W-4. See [IRM 4.75.12.16, Form W-4 Compliance Program](#).

Pursue backup withholding if the organization failed to obtain identifying numbers when required.

### **Inventory**

Organizations conducting gaming maintain an inventory of unsold games. Document the inventory storage procedures. Determine who has access to the unsold inventory.

Note: Proper internal controls would have those in charge of inventory be separate from those purchasing and selling the inventory.

Identify the vendors supplying games. Consider third party contacts to the vendors to verify amounts of inventory sold to the organization.

Ask how the organization tracks its inventory. Compare any separate inventory records to the invoices and gaming jurisdiction records.

Compare boxes of pull-tabs in the inventory to the supplier invoices described in the books and records. For those pull-tab deals not reflected in the organization's supplier invoices, contact the manufacturer to identify the supplier of pull-tabs purchased for cash by describing the serial number and form number of the applicable boxes. Once identified, interview the supplier's salesperson to determine the frequency of currency purchases by the organization.

Some gaming activities have relatively easy cost of goods sold calculations. Others may not be so easy to compute. The same applies for food and beverage sold in connection with the gaming activities (adjacent bar, cafeteria, snack shop or other food service.)

To compute the Cost of Goods Sold (CGS) excluding prizes paid for pull-tabs:

- Identify the particular game.
- Determine the number of pull-tabs sold.
- Divide that number by the total number in an unopened box of pull-tabs.
- Multiply that result by the invoiced cost of the box.
- Note: Unsold pull-tabs are inventory and a capital asset.

For a punch board involving merchandise:

- Identify all of the items awarded as prizes.
- Tally the itemized invoice amounts.

- Add in the cost of the punch board.
- Subtract any prizes awarded.

Reviewing inventory amounts may also result in identifying unreported income amounts. For items that are purchased in bulk, such as liquor or food items:

- Determine the number of servings per bottle, package, or other measure.
- Identify the number of bottles, packages or other items purchased and used during the year.
- Multiply the number of items sold by the servings per item.
- Compare the result to the amount recorded in the books.

## **Ledgers and Journals**

Vouch selected transactions to the source documents to ensure existence of the transaction.

Test the internal controls to determine whether the records may be accurate.

Question the individuals of the organization about Large, Unusual or Questionable (LUQ) entries.

Review in detail the transactions within the general fund of the charity for expenditures that indicate inurement or private benefit.

## **Point of Sale Systems (POS)/Register Tapes**

Due to modernization enabling the usage of tablets, phones, and laptops as POS devices, such systems are susceptible to fraud. Electronic sales suppression programs permit those using the programs to alter the sales data. Use of such programs is illegal. If you suspect records have been altered, contact the Fraud Technical Specialist for assistance.

If an organization uses POS system, see if the system already separately tracks items that are subject to tax. Compare the totals generated to amounts reported on the applicable tax return. If no return is filed, pursue collection of the delinquent returns or propose assessment of the delinquent taxes.

Many gaming jurisdiction reports use Z tape information to determine the amount of income per month. You can likewise use Z tapes to generate such information for purposes of the Forms 730 and 990-T.

Also use the Z tapes to verify sales on a specific day, when either tracing from the tapes to the journals, or vouching from the journals to the tapes.

## **Purchase Invoices**

Compile a list of the vendors. Compare the list to that maintained by the organization. Send third party letters to the vendors to request copies of the vendor's invoices to the organization as needed.

Compare the invoiced items to the amounts recorded in the inventory ledger. Identify and ask about any discrepancies.

## **Retained Games**

If expanding the audit to subsequent years, you may be able to sample a retained game from a subsequent period.

Sampling a game would provide verification of the payout amounts and the number of unsold games. Use such numbers to determine the cost of goods sold for UBI purposes.

## **Time Cards**

Sample the time sheets for those individuals whose wages fall into the LUQ analysis. Use block, dollar limitation, or statistical sampling as needed to identify the samples.

Compare the sampled time sheets to the ledger and journal entries. Verify the amounts reported. Identify any discrepancies. Propose adjustments for any discrepancies that are material in size.

## **Related Entities**

Identify related entities early in the audit. The gaming operation may have related management, real estate, supply, equipment, or concession companies.

Determine the relationship between the exempt organization and the professional operator and/or supplier.

Determine whether any management, real estate, supply, equipment or concession companies receive only reasonable compensation as would ordinarily be paid for like services by like enterprises. See Treas. Reg. 1.162-7(b)(3).

Review any management, supply, rental, or concession agreements. Closely scrutinize agreements where payments for services or supplies are based on gross receipts, gross income, or net income from the gaming operation.

The following factors in a management or operating agreement may indicate private benefit or inurement:

- The contract is lengthy in duration.
- The contract provides penalties if the exempt organization terminates the agreement.
- The gaming operator was not selected through an open bidding.
- The organization lacks documentation of the gaming operator being selected through open bidding.

Commercial operators sometimes use subleases to divert money from an exempt organization. In such arrangements:

- A commercial operator leases property from the owner.
- The operator becomes the landlord to the exempt organization.
- The operator charges rent exceeding the amount paid to the primary lessor.

Charging rents in excess of fair market value siphons off profits. This allows the operator-landlord to retain the bulk of the profits of the games. This may give the operator-landlord a direct pecuniary interest in the profitability of the games.

Compare the rent paid by:

- The commercial operator under the primary lease.
- The exempt organization under the sub-lease.

If the sublease rent appears disproportionately high compared to the primary lease, there could be private benefit/inurement issues.

## **Relationships**

To determine whether the relationship is an agency relationship, joint venture, sale/license agreement or a more complex arrangement.

The agency relationship exists if both:

- The agreement/relationship between the parties manifests intent for the contractor to act on the exempt organization's behalf in conducting the business activity.
- The exempt organization can control the contractor's activities performed on its behalf.

If an agency relationship exists, the activities of the agent (operator/supplier) are attributable to the principal (the exempt organization). See *National Collegiate Athletic Association v. Commissioner*, 92, T.C. 456 (1989), rev'd on other grounds, 914 F.2d 1417 (Ct. Cl. 1990).

Where the contractual relationship is not one of agency, a joint venture (taxable as a partnership pursuant to IRC Section 761(a) and IRC Section 7701(a)(2)) may exist. Determine the income taxable to each party under the partnership taxation principles in Subchapter K. See IRC Section 512(c) for the exempt organization's treatment of income for unrelated business income tax purposes.

Whether an activity is regularly carried on, depends on the activities of the venture, and not solely the exempt organization's activities. As a rule, the Service will not find a partnership where the parties did not intend to create one.

If the factors indicating agency are not present, the relationship between the parties may involve the sale of the right to conduct the gaming. Key factors of a sale or licensing of the use of an organization's tax exemption to obtain a state permit to conduct gaming are:

- The intent of the parties.
- The right to control the activity.
- The fee arrangement.

A particular arrangement may employ both elements of agency and licensing. Examine each arrangement carefully to determine how it should be characterized.

Example: An exempt organization may license its right to conduct gaming but hire a manager for concessions.

## Issue Development

During the audit, you may identify issues of:

- Exempt status qualification
- Excise taxes (gaming)
- Excise taxes (intermediate sanctions)
- Employment taxes
- Foundation status
- Payment/prize reporting
- Unrelated business income
- Withholding/backup withholding

If you encounter one of the above issues, obtain approval to expand the audit to the current year. Monitor the gaming operation. Determine types of packages and/or specials purchased by the players at the beginning of a gaming occasion. Compare the cash received at the door from the players to the door receipts reported previously by the gaming operation. While the onsite observation does not establish or disprove the accuracy of reported receipts, use your observations to refine the scope of the audit.

Bingo and pull-tab operations may consist of more than one established legal entity. Identify related entities as early as possible in the audit. Ascertain that any management real estate supply, or equipment companies are receiving reasonable and true compensation as would ordinarily be paid for like services by like enterprises under like circumstances, as described in Treas. Reg. 1.162-7(b)(3).

Talk to current and former workers. If the organization will not divulge the names of former workers, consider issuing a summons for such information.

## Illegal Gaming

Under common law, the term “charity” encompasses all the major categories identified separately under IRC Section 501(c)(3). IRC Section 501(c)(3) organizations organized and operated exclusively for exempt purposes are common law charities.

As a matter of trust law, no trust can be created for an illegal purpose. The purpose is illegal if:

- The trust property is to be used for an objective, which violates criminal law.
- The trust tends to induce the commission of crime.
- The accomplishment of the purpose is otherwise against public policy.

Scott on Trusts, section 377 (3d ed. 1967).

All charitable trusts (and by implication all charitable organizations, regardless of form) are subject to the requirement their purposes not be illegal or contrary to public policy. See [Rev. Rul. 71-447, 1971-2 C.B. 230](#).

The Service cannot make determinations about the illegality of activities under laws other than the Internal Revenue Code. If a state or locality has not taken action with respect to a purported illegal act, the Service cannot declare the act illegal and revoke exemption.

If uncertain an activity violates state law, and the state gaming authority is willing to do so, request an opinion from the state gaming authority as to whether the activity is in violation of the law. Be aware of the disclosure problems involved.

If the organization is engaged in an illegal activity, there may be a concomitant private benefit, inurement, or substantial non-exempt purpose. Address all issues fairly presented by the facts of the particular case in any proposed revocation. The illegal activity may be used as one basis for proposing revocation of exempt status, but it should not be the sole basis.

The illegality/public policy doctrine applies under IRC Section 501(c)(4) in a manner similar to its applicability under IRC Section 501(c)(3). See [Rev. Rul. 75-384, 1975-2 C.B. 204](#).

For IRC Section 501(c)(7) organizations, the illegality of gaming activities involving only members and guests generally will not jeopardize exemption if the activities further the exempt purposes of the social club. See Rev. Rul. 69-68, 1969-1, C.B. 153.

IRC Section 513(f) generally provides that the term “unrelated trade or business” does not include any trade or business which consists of conducting bingo games. However, under IRC Section 513(f)(2)(C), this exception does not apply to any game of bingo that violates state or local law. Use a standard analysis under IRC Sections 511, 512 and 513 to determine whether to impose unrelated business income tax if conducting the game of bingo violates any state or local law.

## **Exemption**

When analyzing the gaming activities with respect to exemption, take note, of the following:

- The amount of money, time and other resources spent on the activity.
- The manner in which the activity is conducted.
- The purposes for which the net proceeds are expended.

Calculate the ratios of the money, time, and resources spent on the gaming activities as compared to all other activities.

If the ratios all point to the gaming activity being the primary function of the organization consider revocation if social and recreational activities are not exempt purposes.

Factors to consider for proposing revocation include:

- Charitable programs are not commensurate in scope with financial resources.
- Failure to use funds for exempt purposes.
- Inurement of net income to insiders.
- Lack of other activities.

Note: Consult Area Counsel when appropriate to determine whether to propose revocation.

When preparing audit report proposing revocation, reference with the following citations when applicable:

### Revocation Citations

Citation	Holding
<a href="#">Rev. Rul. 66-225, 1966-2 C.B. 227</a>	A nonprofit organization which provides entertainment for its members doesn't qualify for exemption under IRC Section 501(c)(7) where it's controlled by a taxable corporation and operated as an integral part of its business.
<a href="#">Rev. Rul. 67-5, 1967-1 C.B. 123</a>	A foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation.
Rev. Rul. 70-244, 1970-1 C.B. 132	An organization providing luncheon and bar facilities for its members but having no specific program directed to the improvement of business conditions, doesn't qualify for exemption under IRC Section 501(c)(6).
Better Business Bureau of Washington D.C. v. U.S. 326 U.S. 279	A single nonexempt purpose, if substantial in nature, disqualifies an organization from qualifying under IRC Section 501(c)(3).
B.S.W. Group, Inc., 70 T.C. 352	Under the Section 501(c)(3) operational test, the organization's purpose, rather than the nature of its activities, determines whether the organization is entitled to tax-exempt status.
Church of Gospel Ministry, Inc. v. U.S., 640 F.Supp. 96 (D.D.C. 1986)	The organization failed to keep records adequate to determine the full nature of its operations and failed to show that its operations don't inure in part to the private benefit of its officers.
Help the Children, Inc., 28 T.C. 1128	An organization whose activities consisted of bingo games for members and their guests was engaged in a business or commercial activity for profit.
KJ'S Fundraisers, Inc., T.C. Memo. 1997-424, affirmed 166 F.3d 1200 (C.A. 2, 1998)	The organization failed the operational test because it conferred an excessive private benefit on the operators of a bar. Its primary purpose was to attract customers who would otherwise have gone elsewhere to gamble.
Make a Joyful Noise, Inc., T.C. Memo 1989-4	Operating regularly scheduled motto games on behalf of other exempt organizations is a trade or business unrelated to the organization's exempt purposes.
Piety, Inc. , 82 T.C. 193	An organization whose sole activity is the operation of bingo games that intends to contribute its profits to exempt organizations may not qualify for exemption on the ground that it will donate its profits to exempt organization.
P.L.L. Scholarship Fund, 82 T.C. 196	The organization has the burden of proof to establish that it is organized and operated for exempt purposes.
Pius XII Academy, Inc., T.C. Memo. 1982-97, affirmed 711 F.2d 1058 (C.A.6 1983), certiorari denied 464 U.S. 982,	While an organization need not be in actual operation before it can seek exemption from tax, it must describe proposed operations in sufficient detail to show that it will meet the requirements for exemption.

rehearing denied 464 U.S. 1064	
Schoger Foundation, 76 T.C. 380	Operation of a religious lodge. If an activity serves a substantial nonexempt purpose, the organization may not qualify for exemption even if the activity also furthers an exempt purpose. The organization has the burden of proof to establish an activity is operated primarily for an exempt purpose and that the nonexempt activities are only incidental to that exempt purpose and less than substantial.
South Community Association, T.C. Memo. 2005-285	The gaming operation was the organization's principal activity and was conducted by petitioner as a business for profit.
Variety Club Tent No. 6 Charities, Inc., T.C. Memo. 1997-575	The organization conducted bingo in which inurement was present. The organization "operated in a manner materially different from that originally represented." The organization was revoked retroactively.

## Employment Taxes

Determine whether worker classification issues are present. If yes, give the organization's officers [Publication 1976, Do you Qualify for Relief under Section 530?](#) Open an employment tax audit for all quarters on AIMS via RCCMS. Notify the organization that you have opened an employment tax audit.

For worker classification cases, perform a Section 530 analysis before considering proposing any assessments. Consult TEGE Area Counsel and CSCI Employment Tax Coordinator for assistance in completing the analysis.

The table below outlines situations triggering a worker classification determination:

## Worker Classification Issues

If:	Then:
Non-accountable plan payments (employee)	Non-worker classification issue
Non-accountable plan payments (non-employee)	Worker classification issue*
Tips (employee)	Non-worker classification issue
Tips (non-employee)	Worker classification issue
Unreported compensation (employee)	Non-worker classification issue
Unreported compensation (non-employee)	Worker classification issue*

Unreported fringe benefits (employee)	Non-worker classification issue
Unreported fringe benefits (non-employee)	Worker classification issue
*Payments to independent contractors for services rendered don't necessarily trigger a worker classification issue. Such situations may require completion of Forms 1099 to report the payments, if there is no question about the independent contractor status	

Use the most current version of the Employment Tax Examiner's Report when generating your employment tax reports. For guidance on employment tax issues, see [IRM 4.23, Employment Tax](#). See [IRM 4.75.15.8.5, Employment Taxes](#), for the list of letters to use.

### **Excise Taxes (Gaming)**

See [Publication 3079](#) for the discussion of occupational and wagering taxes. Review the following code sections and regulations:

- IRC Section 4401
- IRC Section 4402
- IRC Section 4403
- IRC Section 4411
- IRC Section 4412
- IRC Section 4421
- IRC Section 4422
- Treas. Reg. Section 44.4401-1 to -3
- Treas. Reg. Section 44.4402-1
- Treas. Reg. Section 44.4411-1
- Treas. Reg. Section 44.4412-1
- Treas. Reg. Section 44.4421-1

Ascertain whether the organization:

- Retains the required daily records.
- Files the applicable returns.
- Applies the specific exemptions.

Determine whether the activity:

- Falls within the purview of the occupational and wagering taxes.
- Meets one of the exemptions from tax.
- Is legal under state law.

Pursue assessment of tax when the activity is subject to the tax and does not meet an exemption. Non-Private Foundation Excise Taxes. If the taxpayer is liable for delinquent Forms 11-C and 730, do not secure the delinquent returns. Perform the following actions:

- Prepare a substitute for return package. See [IRM 4.75.22.7, Substitute for Return Procedures](#).
- Prepare and audit report using Form 5384, Excise Tax Examination Changes and Consent to Assessment & Collection and Form 886-A, Explanation of Items. See Instructions for Completing 5384 and 5385.
- Issue the 30-day letter. See [IRM 4.75.15.10, Formal Reports of Examination](#).
- Secure the taxpayer’s agreement or protest.
- Obtain payment or installment agreement, if agreed.
- Issue a rebuttal to the protest, if unagreed. See [IRM 4.75.15.12, Rebuttals to Formal Protests](#).
- Note: [Forms 11-C](#) have a fiscal year month of 07, regardless of which month the taxpayer first starts accepting wagers.

When preparing an audit report proposing gaming excise taxes, reference the following citations when applicable.

### Excise Tax Gaming Citations

Citation	Holding
Rev. Rul. 55-754, 1955-2 CB 471	Amount subject to tax: The tax on wagers applies to the total amount actually risked by the bettor.
Rev. Rul. 57-241, 1957-1 C.B. 419	Non-coin-operated gaming devices: The operation of a certain non-coin-operated gaming device is a taxable lottery.
Rev. Rul. 57-258, 1957-1 C.B. 418	Pull tabs: Pull tabs are lotteries that are subject to wagering and occupational taxes.
Rev. Rul. 57-521, 1957-2 C.B. 779	Puzzle contests: A puzzle contest in which the element of skill rather than that of chance determines the winners isn't a wagering pool or lottery within the meaning of IRC Section 4421.
Rev. Rul. 72-481, 1972-2 CB 581 (Rev. Rul. 55-754, 1955-2 CB 471, distinguished.)	Use of “free plays” won in a “bingo spindle game”: Constitutes taxable wagers only to the extent the player assumes an additional risk in the use of such plays.
Rev. Rul. 74-425, 1974-2 C.B. 373, and Rev. Rul. 79-145, 1979-1 C.B. 360	Calcutta pool: Whether wagering and occupational taxes apply to a Calcutta pool operated in connection with a golf tournament.
Rev. Rul. 79-146, 1979-1 C.B. 361	Keno games: Basic Nevada Keno, Five Race Keno, and Four way Express Keno meet the requirements for exclusion from the term “lottery” within the meaning of IRC Section 4421(2)

<p>Pittsburgh Press Club v. United States , 579 F.2d 751</p>	<p>Member only activity: When limiting participation in a revenue-raising activity to members of a tax- exempt organization the financial resources generated by the activity and used to support the organization “are merely shifted between members of such a group, and no tax consequences attach to that shifting.”</p>
<p>Rochester Liederkranz, Inc. v. United States, 456 F.2d 152</p>	<p>Revenue from members only: Where participation in the revenue raising activity is limited to members of a social or fraternal organization, inurement is not established since the financial resources merely shift between members of the group.</p>

### **Excise Taxes (IRC Section 4958)**

For a complete technical discussion and directions concerning intermediate sanctions and excess benefit transactions, see [IRM 7.27.30, Taxes on Excess Benefit Transactions](#).

If Section 4958 could apply, identify all key employees, officers, directors, and trustees of the organization. Determine which individuals participated in excess benefit transactions.

Compile a list of all excess benefit transactions. Make copies or scan the cancelled checks (or bank statement images of cancelled checks.) Place copies of the cancelled checks in case file of the person receiving those specific payments.

If pursuing the organization manager tax, establish the elements of knowledge, participation, willfulness and lack of reasonable cause before issuing an audit report.

For cases of excess compensation, obtain assistance of an LB&I engineer via the Specialist Referral System and consult Counsel when drafting the report.

Review TAM 200243057. Adapt the issue, law, and government positions and format as applicable in your audit report. Follow the procedures in [IRM 4.75.22.7, Substitute For Return Procedures](#), in connection with the procedures in [IRM 4.75.15.8.7, Non-Private Foundation Excise Taxes](#).

### **Foundation Status**

Receipt of substantial gaming income may affect the foundation status of an IRC Section 501(c)(3) organization and may, in turn, have other consequences.

When performing a foundation status analysis, use the gross non-UBI gaming receipts and the net UBI gaming income. See the table below for where the amounts fall when completing the numerator and denominator portions of the fraction.

## Foundation Status Test Rules

Code Section	509(a)(1) & 170(b)(1)(A)(vi)		509(a)(2)	
	Top (numerator)	Bottom (denominator)	Top (numerator)	Bottom (denominator)
Non-UBI gaming (bingo)	Exclude	Exclude	Include	Include
UBI gaming (pull-tabs, etc.)	Exclude	Include (net)	Exclude	Include (net)

If an organization's sole source of income comes from gaming activities, several adverse consequences may occur:

If the organization's income is <b>solely</b> from:	Then the organization is:
Non-UBI gaming	A public charity under IRC Section 509(a)(2)
Less than 1/3 non-UBI gaming, More than 2/3 from UBI gaming	A private foundation
UBI gaming	A private foundation

If the organization's sole source of income comes from UBI gaming activities this may be an indication that the organization fails to operate for exempt purposes.

When preparing the audit report for a change in foundation status, reference the following citations when applicable:

### Foundation Status Citations

Citation	Holding
Treas. Reg. 1.170A-9(f)(2)	An organization must normally receive more than one-third of its support from any combination of gifts, grants, contributions and membership fees from permitted sources.
IRC Section 509(a)(2)	An organization must normally receive more than one-third of its support from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources, and no more than one-third of its support from gross investment income and the excess of the amount of unrelated business taxable income over the amount of taxes imposed by IRC Section 511.
Treas. Reg. 1.170A-9(f)(3)(i)	To qualify under IRC Sections 509(a)(1) and 170(b)(1)(A)(vi), the organization must receive at least 10 percent of its support from governmental and public sources.
Treas. Reg. 1.170A-9(f)(4)(vii)	<p>For new IRC Section 170(b)(1)(A)(vi) organizations, if the organizations fail the support tests for its fifth and sixth years, the organizations are private foundations for purposes of IRC Sections 507, IRC 4940, and IRC Section 6033 as of the start of the sixth year. In year seven, the organization is a private foundation for all purposes.</p> <p>For other IRC Section 170(b)(1)(A)(vi) organization, failure to meet the support tests for two consecutive years causes the same treatment as of the start of the second consecutive year, and treatment as a private foundation for all purposes as of the following year.</p>
Treas. Reg. 1.170A-9(f)(7)(iii)	Organizations primarily dependent on gross receipts from related activities don't satisfy the support tests for IRC Section 170(b)(1)(A)(vi) organizations.
Treas. Reg. 1.509(a)-3(d)(1)	For new IRC Section 509(a)(2) organizations, if the organization fails the support tests for its fifth and sixth years, the organization is a private foundation for purposes of IRC Sections 507, IRC 4940, and IRC Section 6033 as of the start of the sixth year. In year seven, the organization is a private foundation for all purposes.
Treas. Reg. 1.509(a)-3(c)(1)(i)	An IRC Section 509(a)(2) organization that fails to meet either support test for two consecutive years is a private foundation as of the start of the second consecutive year for purposes of IRC Sections 507, IRC 4940, and IRC Section 6033. As of the third year, the organization is a private foundation for all purposes.

Citation	Holding
Education Athletic Association, Inc., T.C. Memo. 1999-75	Since all of the organization's gross receipts derived from pickle card sales and the sale of pickle cards constitute UBTI, the organization is a private foundation.
St. John's Orphanage, Inc. v. U.S., 16 Cl.Ct. 299 (1989)	Organization failed to meet 10% public support requirement for IRC Section 509(a)(1) classification and is a private foundation.

### Prize Payment Reporting

Compile a list of all persons to whom the organization issued a check from the gaming account. Determine which individuals were recipients of prizes. Identify those individuals who did not receive Forms W-2G. Ask the organization to explain why the individuals did not receive Forms W-2G. Verify the organization's responses. Pursue collection of delinquent Forms W-2G.

Note: If in possession of the electronic copy of the ledger, generate the list of the payees from the copy. Review the cancelled checks to verify that the names stated in the ledger match the names on the checks.

Using IRAS, identify the Forms W-2G that contains errors. Propose penalties for the incorrect returns. See [IRM 20.1.7, Information Return Penalties](#), for directions and [IRM 4.75.22.12, Forms W-2, 1099-MISC and Other Information Returns](#), for EO Examination specific procedures.

Using the list compiled above, identify any payees who meet the Form 1099-MISC requirements. Compare your list to the list generated by IRAS. Review the invoices if any from the payees. Determine whether the payments are for materials or for services, rent, or other items subject to Form 1099-MISC. If for materials, exclude the payee. Pursue collection of delinquent Forms 1099-MISC.

Review the other accounts of the organization. Compile similar lists of payees. Compare your lists to the list generated by IRAS. Review invoices to determine what the payments are for. Identify those individuals or businesses that did not receive Forms 1099-MISC. Pursue collection of the delinquent forms.

Note: If in possession of the electronic copy of the ledger, access the vendor list. Compare the vendor list to the transaction journal to identify payees not included in the vendor list.

See [IRM 4.75.15.8.11, Miscellaneous Civil Penalties](#), for RCCMS procedures and other directions when imposing information return penalties.

## **Unrelated Business Income**

In general, income from regularly conducted gaming activities is treated as unrelated business taxable income, unless a specific exception applies.

### **Definition of “unrelated business taxable income” under section 512(a)(1) is for 501(c) organizations other than those described under sections 501(c)(7), (c)(9) and (c)(17)**

The definition of “unrelated business taxable income” under Section 512(a)(1) incorporates the definition of “trade or business” under section 513. The definition under section 513 includes several exceptions relevant to gaming activities.

### **Volunteer Labor Exception Under IRC Section 513(a)(1) and Reg. Section 1.513-1(e)(1)**

IRC Section 513(a)(1) and Treas. Reg. Section 1.513-1(e)(1) except from the definition of unrelated trade or business "any trade or business in which substantially all the work is performed for the organization without compensation." The regulations do not specify a particular percentage as satisfying the "substantially all" requirement for this exception; however, the term "substantially all" is found elsewhere in the Internal Revenue Code and has been interpreted to be 85% or more in those situations. See Treas. Reg. Section 53.4942(b)-1(c) and Treas. Reg. Section 1.514(b)-1(b)(1)(ii).

The term "compensation" has broad application. In *Waco Lodge No. 166, Benevolent & Protective Order of Elks v. Commissioner*, 42 CCH Tax Ct. Mem. 1202 (1981), aff'd in part and rev'd in part, 696 F.2d 372 (Ct. Cl. 1983) aff'd in part and rev'd in part, 696 F.2d 372 (Ct. Cl. 1983), the Tax Court stated even free drinks or food provided to workers may be considered compensation for purposes of IRC Section 513(a). On appeal, however, the Fifth Circuit reversed the Tax Court's determination that any monetary or non-monetary payment, no matter how small, is "compensation" under the Code. Instead, the Fifth Circuit held whether non-monetary "payment" is "compensation" must be decided based on the facts and circumstances of each case. Using this as a guide, the Court of Appeals concluded the drinks and food given to workers in the Waco Lodge case was not "compensation" within the meaning of IRC Section 513(a)(1) since the average worker received the equivalent of only \$0.63 an hour. The court stated it did not believe the Code's definition of compensation was meant to include such a "trifling" inducement.

If the organization conducting the gaming activities makes a contribution to another exempt organization in return for the grantee providing volunteer labor, the amount paid is considered compensation in applying the volunteer labor exception in IRC Section 513(a). Because the organization is paying another organization for workers, the activity is not being performed for the payer organization without compensation. It is irrelevant that the workers are not compensated directly by the organization sponsoring the gaming activities.

Tips received by workers from patrons constitute compensation within the meaning of IRC Section 513(a)(1). See *Executive Network Club, Inc. v. Commissioner*, 69 CCH Tax Ct. Mem. 1680 (1995). Thus, if workers receive tips, their labor is not performed without compensation for purposes of this exception.

Secure a description of the duties of employees, contractors, and volunteers associated with the gaming occasions for the year under examination. All workers involved in the operation of the gaming activities must be taken into account. This includes, but is not limited to, workers involved in advertising the activity, the set-up and the clean up of the facilities, the actual operation of the gaming activity, concessions, accounting and legal services, and security.

In determining if substantially all of the work is performed without compensation, the percentage of hours performed by compensated workers compared to volunteers is a relevant factor, but not the sole determinative factor.

Note: Payments to bartenders, waitresses, snack bar staff, maintenance workers, security, and other workers may be considered compensation for this purpose.

If an exempt organization sponsors pull-tab games at a for-profit establishment, where employees of the establishment sell tickets, the organization may not use the exception in IRC Section 513(a)(1). The employees of the establishment are being compensated, albeit by a third party, and, therefore, the exception does not apply.

### **Bingo Games Exception Under IRC Section 513(f)**

IRC Section 513(f) provides that the term "unrelated trade or business" does not include any trade or business, which consists of conducting bingo games. For purposes of IRC Section 513(f), the term "bingo game" means any game of bingo:

Of a type in which usually, the wagers are placed, the winners are determined, and the distribution of prizes or other property is made in the presence of all persons placing wagers in such game;

The conducting of which is not an activity ordinarily carried out on a commercial basis; and

The conducting of which does not violate any State or local law.

Treas. Reg. Section 1.513-5(d) provides that a bingo game is 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, the term *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 is distributed in the presence of all persons placing wagers in that game. The term *bingo game* does not refer to any game of chance (including, but not limited to, keno games,

dice games, card games, and lotteries) other than the type of game described in this paragraph.

The U.S. Tax Court held in *Julius M. Israel Lodge of B'Nai B'rith No. 2113 v. Commissioner*, 70 CCH Tax Ct. Mem. 673 (1995) that "instant bingo" does not satisfy the requirements of IRC Section 513(f) and the proceeds from "instant bingo" activities are subject to the unrelated business income tax under IRC Section 511(a).

Treas. Reg. Section 1.513-5(c)(2) provides bingo games are "ordinarily carried out on a commercial basis" within a jurisdiction, for purposes of IRC Section 513(f)(2)(B), if they are regularly carried on, within the meaning of Treas. Reg. Section 1.513-1(c), by for-profit organizations in any part of the jurisdiction.

Normally the entire state will be the appropriate jurisdiction for determining whether bingo games are ordinarily carried out on a commercial basis. However, if state law permits local jurisdictions to determine if 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 be the appropriate jurisdiction for determining if bingo games are ordinarily carried out on a commercial basis.

In determining if the conduct of the bingo games violates any State or local law, for purposes of IRC Section 513(f)(2)(C), review in detail the state or local law which permits the operation of bingo. Consider securing a legal opinion from the state or local law enforcement agency if the bingo operation appears to violate State or local law. In any factual account provided to a state or local law enforcement agency, be certain to delete all identifying references to the organization under audit to protect against possible disclosure violations.

If the state or local government has made a judicial or an administrative adjudication of illegality with respect to the bingo game, income from the game is not within the exception provided in IRC Section 513(f). If the state is not willing to provide an opinion, and no adjudication has been made, consider contacting Area Counsel or Rulings and Agreements for assistance.

### **Gaming in North Dakota Exception**

Section 311 of the Deficit Reduction Act (DEFRA), (as amended by IRC Section 1834 of the Tax Reform Act of 1986) provides that for purposes of IRC Section 513, 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.

### **Definition of “unrelated business taxable income” under IRC Section 512 (a)(3), including section 501(c)(7) organizations**

IRC Section 512(a)(3) provides special rules used in determining unrelated business taxable income for certain organizations, including those exempt under IRC Section 501(c)(7). For covered organizations, the term “unrelated business taxable income” means gross income (excluding “exempt function income” as defined in IRC Section 512(a)(3)(B)) less allowable deductions which are directly connected with the production of the gross income (excluding exempt function income) and with certain modifications under IRC Section 512. In general, exempt function income means income from payments by members as consideration for the organization providing members, their dependents, or guests, goods, facilities, or services furthering exempt purposes. Exempt function income also includes all income (except income from unrelated trade or business computed under IRC Section 512(a)(1)) which is set aside for a purpose specified in IRC Section 170(c)(4).

Income from gaming (including bingo) is not exempt function income unless:

- It is received from members under circumstances indicating the gaming furthers exempt purposes; or
- It is set aside for a purpose specified in IRC Section 170(c)(4).

### **Deduction of “Lawful Purpose Expenditures” and Similar Amounts**

In *South End Italian Independent Club, Inc. v. Commissioner*, 87 T.C. 168 (1986), acq. in result, 1987-2 C.B. 1, the Tax Court held a tax-exempt social club in Massachusetts could deduct “lawful purpose expenditures” under IRC Section 162. These expenditures are amounts required under state law to be committed to so-called “lawful” purposes in order for the organization to retain its state gaming license. According to the court, these payments were not charitable contributions subject to the “10 percent of-income limitation” under IRC Section 512(b) (10), because they were involuntary expenditures made to obtain a quid pro quo. Instead, they were deductible under IRC Section 162 as being in the nature of a license retention expense. Following the opinion, the Service acquiesced in the result of the case.

The issue of deductibility of lawful purpose expenditures and similar amounts under IRC Section 162 should be resolved consistent with the Service's acquiescence in the South End case. For this purpose, no distinction should be made based on whether the organization is described in IRC Section 501(c)(7) or some other provision, or on whether the gaming proceeds were donated to other charitable organizations or spent in the organization's own charitable activities.

*Women of the Motion Picture Industry, et al. v. Commissioner*. 74 CCH Tax Ct. Mem. 1217 (1997) holds that tax-exempt organizations, that conduct “instant bingo” (not

defined under section 513(f)) games are not entitled to business deductions for amounts transferred from their “instant bingo” accounts to their general accounts until the amounts are actually spent for charitable purposes. The court concluded the “transfer of ‘instant bingo’ proceeds to an organization’s general fund is no more deductible than would be a contribution to a reserve for future liabilities.”

The court did rule in favor of one of the organizations, Waldorf School Association of Texas Inc. (WSA), which paid \$1.2 million to its bookkeeper during 1989, and was entitled to deduct a percentage of the amount paid based on the ratio which WSA’s “instant bingo” proceeds bear to its total gross proceeds. Finally, the court held WSA was entitled to deduct as an ordinary and necessary business expense under IRC Section 162(a) the entire amount of its charitable payments in excess of the minimum amount required by state law (35 percent of instant bingo proceeds). The court rejected the Service’s attempt to distinguish *South End Italian Independent Club Inc. v. Commissioner*, 87 T.C. 168 (1986) and found WSA “risked losing its bingo license if it used any part of its net bingo proceeds for other than charitable purposes.” By making the excess contributions, WSA was assured its license would not be revoked.

### **Allocation of Expenses**

Where facilities or personnel are used to carry on exempt functions and to conduct an unrelated trade or business, determine whether expenses, depreciation, and similar items are allocated between the two uses on a reasonable basis.

Where an exempt organization conducts income-producing gaming activities, expense allocation issues may arise in a number of contexts. If the income from any such activity is subject to tax under IRC Section 511, care should be taken to ensure expenses relating to related activities are not improperly allocated to unrelated activities in determining unrelated business taxable income. For example, pull-tab sales frequently account for the bulk of receipts at a bingo occasion; where this is true, and income from the bingo activity is excepted from tax pursuant to IRC Section 513(f), deductible expenses include only those attributable to the taxable pull-tab activity.

Consider whether to disregard the activity as an unrelated trade or business for lack of a profit motive.

For states where the taxpayer may claim lawful purposes expenditures to reduce the taxable income from gaming (not concessions or other non-gaming activities) to nothing, disregard the activity for lack of a profit motive. Determine the liability on the non-gaming activities.

Use the Report Generation System (RGS) to record the adjustments, perform the tax computations, and prepare the audit report.

Caution: RGS computes the tax at the corporate rate. RGS does not work for trust rates, however, the system can generate a report that you can modify. If needed,

modify the charitable contributions (limit of 50 percent in lieu of 10 percent) and manually compute the tax.

When preparing the audit report proposing taxes on UBI, reference the following citations when applicable:

### Unrelated Business Income Citations

Citation	Holding
<a href="#">Rev. Rul. 59-330, 1959-2 C.B. 153</a>	The holding of semiweekly gaming by an IRC Section 501(c)(5) labor organization is a non-exempt purpose profit-making enterprise that constitutes an unrelated trade or business subject to tax. (Note- This revenue ruling involved bingo, which is now exempt from the definition of “unrelated trade or business” under IRC Section 513(f), therefore, application of the ruling would currently only apply to non-bingo gaming),
<i>Clarence LaBelle Post No. 217, Veterans of Foreign Wars of U.S. v. U.S.</i> , 580 F.2d 270 (C.A.Minn., 1978)	The tax on unrelated business income isn't limited to income earned by a trade or business that operates in competition with taxpaying entities.
<i>Education Athletic Association, Inc.</i> , T.C. Memo. 1999-75	The sale of pickle cards does not contribute importantly to taxpayer's exempt purpose and, therefore is an unrelated trade or business.
<i>Julius M. Israel Lodge of B'Nai B'rith No. 2113</i> , T.C. Memo. 1995-439, affirmed 98 F.3d 190 C.A.5, 1996)	“Instant bingo” doesn't satisfy the requirements of IRC Section 513(f). The proceeds from instant bingo activities are subject to the unrelated trade or business income tax under IRC Section 511(a).
<i>Portland Golf Club v. Commissioner</i> , 497 U.S. 154	An IRC Section 501(c)(7) exempt social club may offset investment income by losses incurred in sales to nonmembers only if those sales were motivated by an intent to profit, determined by using the same method to allocate fixed costs to nonmember sales as that used to compute the club's actual profit or loss.
<i>Rensselaer Polytechnic Institute v. Commissioner</i> , 732 F.2d 1058 (C.A.2, 1984), non-acquiesced AOD 1987-14	Apportioning indirect expenses such as depreciation on the basis of actual hours used is a reasonable method of allocation under Treas. Reg. Section 1.512(a)-1(c).
<i>South End Italian Dependent Club, Inc.</i> , 87 T.C. 168	Expenditures may be deducted against gaming income by a Section 501(c)(7) organization under IRC Section 162 as a business expense rather than a deduction under Section

Citation	Holding
	170 if those expenditures are made in accordance with state laws to retain the organization's gaming license. (Beano)
<i>U.S. v American Bar Endowment</i> , 477 U.S. 105	An IRC Section 501(c)(6) business league selling insurance to members. The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. It's unnecessary to prove or disprove the existence of actual competition between companies whose earnings are taxed and whose are not.
<i>Waco Lodge No. 166, Benevolent &amp; Protective Order of Elks v. Commissioner</i> , T.C.M. 1981-546	The furnishing of free beverages provided to volunteers operating gaming activities for an exempt organization constitutes the payment of compensation for purposes of IRC Section 513(a)(1). (Note- This case involved bingo, which is now exempt from the definition of "unrelated trade or business" under IRC Section 513(f), therefore, application of the case would currently only apply to non-bingo gaming),
Women of the Motion Picture Industry, T.C. Memo. 1997-518	Payments made for lawful purposes by an organization exempt under Section 501(a), when required under state law to retain a gaming license are ordinary and necessary business expenses deductible under IRC Section 162. Proceeds must be expended rather than merely transferred to the organization's general fund. (Bingo, pull-tabs)

### Gaming Effect on Organizations Other Than IRC Section 501(c)(3)

Recreational gaming activities may directly further exempt purposes, and therefore be "substantially related" income and not subject to unrelated business income tax, where the basis for exemption under the particular sub-section includes providing social/recreational activities for members. Gaming activities involving the general public, however, are generally not "substantially related."

IRC Section 501(c) describes several categories of organizations whose exempt function includes providing social or recreational activities for members and their guests. These include social clubs under IRC Section 501(c)(7), fraternal organizations under IRC Section 501(c)(8) or 501(c)(10), and veterans' organizations under IRC Section 501(c)(19). Such organizations may, consistent with exempt status, conduct recreational gaming activities in which members and guests participate. Gaming activities involving the general public, however, do not directly further exempt social/recreational purposes.

Where social/recreational purposes are included under a particular exemption provision, it is important to analyze the meaning of "membership". Membership status that permits the "member" to participate in a particular social/recreational activity may be insufficient to distinguish a member from the general public. For example, Rev. Rul. 58-588, 1958-2

C.B. 265, held an organization formed to operate a health, recreational, and social club did not qualify for exemption under IRC Section 501(c)(7) where its predominant activity was selling services to an unlimited number of so-called "members" who had no right in the management of the club and whose only rights were to use the facilities upon the payment of specified fees. See Rev. Rul. 66-225, 1966-2 C.B. 227, where the organization sold "temporary" memberships to guests at an adjoining motel. For additional information see IRM 7.25.7, Social and Recreational Clubs. See Rev. Rul. 64-194, 1964-2 C.B. 149, for "social" memberships of IRC Section 501(c)(8) organizations.

Gaming activities involving guests of members may also further recreational/social purposes. The mere presence of non-members at a gaming activity does not in itself further exempt purposes. Rather, entertainment activities (such as gaming) provided to bona fide guests of members may further social/recreational purposes. A bona fide guest is one where the member pays the cost of the non-member's participation.

Gaming conducted off the premises of an exempt organization is rarely, if ever, "substantially related" to exempt social/recreational purposes, even if the organization can establish some portion of the income is derived from members.

The extent to which an exempt organization may conduct non-exempt business activities, consistent with exempt status, differs depending on the type of organization.

IRC Section 501(c)(4). In general, the conduct of gaming as a recreational activity does not bring about civic betterment and social improvement; thus it does not promote social welfare within the meaning of IRC Section 501(c)(4). For additional information, see IRM 7.25.4 and Chapter 2 of Publication 3386, Tax Guide Veterans' Organization.

IRC Section 501(c)(5). Gaming activities are not related to the exempt purposes of a labor organization exempt under IRC Section 501(c)(5). See Rev. Rul. 59-330, 1959-2 C.B. 153. For additional information, IRM 7.25.5.

IRC Section 501(c)(6). Gaming activities do not directly further business league purposes and therefore would generally not, standing alone, support exemption under IRC Section 501(c)(6). Moreover, such activities may violate the prohibition in Treas. Reg. Section 1.501(c)(6)-1 which holds the purpose of a business league may not be to engage in a regular business of a kind ordinarily carried on for profit. For additional information see IRM 7.25.6.

IRC Section 501(c)(7). Recreational gaming activities involving members and their guests furthers the exempt purposes of a social club exempt under IRC Section 501(c)(7). For additional information see Chapter 3 of Publication 3386, Tax Guide Veterans' Organizations and IRM 7.25.7.

**IRC Section 501(c)(8) or 501(c)(10). Recreational gaming activities of fraternal associations exempt under IRC Section 501(c)(8) or 501(c)(10) are related to the exempt social and recreational ("fraternal") purposes of such organizations to the extent of members' participation in such activities. To**

**the extent nonmembers participate in such activities, however, the activities are generally not related to the exempt purposes of fraternal organizations. The effect of gaming on exempt status of IRC Section 501(c)(8) organizations is discussed in Chapter 4 of Publication 3386, Tax Guide For Veterans' Organizations. Withholding/Backup Withholding**

Check BMFOLI to see if the organization filed Form 945 (MFT 06) and Forms 1042 (MFT 12). If filed, use TRDBV to obtain the return information. Compare that information to the list of Forms W-2 G and Forms 1099-MISC generated by IRAS.

Obtain a list of game winners from the organization. Use the Exhibit at the end of this section to identify those individuals who were above the thresholds.

Verify whether the organization obtained the names, addresses, and taxpayer identification numbers of those individuals above the thresholds.

Note: The winner can provide the information via Form W-9, Request for Taxpayer Identification Number and Certification, Form 5754, Statement by Person(s) Receiving Gambling Winnings, or other means.

Pursue collection of delinquent Forms W-2G. Propose information return penalties for unfiled or erroneous Forms W-2 G.

Prepare and audit report proposing backup withholding for winners who did not have amounts withheld as required. See [IRM 4.23.8.13, IRC 3406 – Backup Withholding](#), for procedures. When directed to issue a letter, see [IRM 4.75.15.8.5, Employment Taxes](#), for any replacement letters.

To generate the actual audit report, use the Employment Tax Examiner’s Report from the Small Business/Self-Employed Division’s website.

When preparing the audit report proposing backup withholding taxes, reference the following citations when applicable:

**Withholding/Backup Withholding Citations**

Citation	Holding
IRC Section 871(a)	30% tax on gaming winnings for non-resident aliens.
IRC Section 1441(a)	Requirement to withhold taxes on gaming winnings of non-resident aliens at 30%.
IRC Section 3402(q)	Requirement to withhold taxes (at the third lowest rate applicable under section 1(c)) on gaming winnings. General minimum proceeds for this section to apply is \$5,000 (subject to further limitation depending on the type of winnings). This section does not apply to winnings from Bingo, Keno, or Slot Machines.
IRC Section 3406	Backup withholding at fourth lowest rate applicable under section 1(c) (currently 28%) when the payee fails to furnish a TIN to the payor in the manner required, we notify the

	payor that the TIN furnished by the payee is incorrect, there has been a notified payee under-reporting described in IRC 3406(c), or there has been a payee certification failure described in IRC Section 3406(d).
<i>Abeid v. Commissioner</i> , 122 T.C. 404	Non-resident alien's state lottery winnings are taxable.
<i>Barba v. U.S.</i> , 2 Cl.Ct. 674 (1983)	Non-resident alien's gambling winnings are subject to 30% tax.

## Case Closing Procedures

Refer to [IRM 4.75.15, Closing Letters and Reports of Examination](#), for the appropriate letters to issue. Follow the procedures for issuing an initial report and formal report, unless working under a short statute. In such situations, see [IRM 4.75.16.4.2.4, Imminent Statute](#).

If you receive a formal protest, prepare and issue a rebuttal. See [IRM 4.75.15.12, Rebuttals to Formal Protests](#). Verify that the protest is valid before closing the case to the EO Closing Unit. See [IRM 4.75.15.11, Valid Formal Protest](#). Ensure that you have sufficient time remaining on the statute when closing the case to the EO Closing Unit. Request a statute extension if under the minimum required time frames (400 days for cases going to Appeals Division for the first time, 210 days for cases returned from Appeals for further development).

Note: For formal protests to Appeals Division, if the taxpayer does not grant a statute extension for at least the minimum amount of time required, discuss the next course of action with your group manager.

If the taxpayer does not agree but also does not protest the report, treat the case as unagreed. See IRM 4.75.16.6, Cases Subject to Mandatory Review to determine whether to close the case to Mandatory Review or to the EO Closing Unit.

For cases where the taxpayer agrees close the case to the EO Closing Unit. For cases involving correction, such as IRC Section 4958 Taxes on excess benefit transactions, ensure that correction is made before closing the case as agreed. If correction is not made, treat the case as unagreed.

For all case closures, verify that you have completed all required actions. See [IRM 4.75.16, Case Closing Procedures](#).

## Facility Tour Checklist

### Activity Dimensions List

Activity	Yes	No	Dimensions
Gaming room			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Concessions stand			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Public rest rooms			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Game management			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Game storage			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Total facility size			Length ___ ft. x Width ___ ft. x Height ___ ft. = _____
Public parking			Length ___ ft. x Width ___ ft. = _____
Total lot size	N/A	N/A	Length ___ ft. x Width ___ ft. = _____

### Hours of Operation List

Activity	Start	End	Sun	Mon	Tue	Wed	Thu	Fri	Sat
Gaming									
Concessions									
Rest of facility									

### Gaming Concession Worker List

Name	Title	Years	W-2	1099
(Insert rows as needed)				

## Facility Tour Checklist Instructions

For the Activity Dimensions List, check the yes/no boxes in response to your questions concerning whether the organization has the specified activity. In the dimensions column, record your measurements as to the length, width, and height (when applicable) with respect to the space in which the activity occurs.

Note: You will use the information collected for fixed overhead expense allocations for identified unrelated business income issues.

For the Hours of Operation List, record the regular start time and end time for the specified activity. Check the days of the week that the facility is open. If the organization has varying hours for each day of the week, obtain a copy of the organization's published hours of operation.

Note: You will use the information collected for fixed overhead expense allocations and variable direct expense allocations (such as payroll) for identified unrelated business income issues.

For the Gaming/Concession Worker List, record the name of the employee, their title, and their total years of employment. Check the applicable box for either [Form W-2](#) or Form 1099 for each worker. If a person is a volunteer, write "N/A" in the Form W-2

Note: You will use the information collected for both worker classification issues (if present) and for variable direct expense allocations for identified unrelated business income issues.

### Reporting and Withholding Thresholds

See the table below for information on the amounts to be reported to winners.

#### Summary of Reportable Winnings

Type of Gaming	Winnings Amount at Least:	Reduced by Amount of Wager?
Bingo	\$1,200	No
Slot machines	\$1,200	No
Keno	\$1,500	Yes (for same Keno game)
Other wagering transactions (e.g., instant bingo, pull-tabs, raffles, etc.)	\$600 and at least 300 times the wager	At option of payer
Poker tournaments	N/A if winnings are reported on Form W-2 G	Yes

See the table below for information on when to withhold from winnings.

Type of Gaming	Regular Withholding At 25% If Winnings Are:	Backup Withholding At 28% If Winner Does Not Provide TIN and Winnings are:
Bingo	N/A	≥ \$1,200
Slot machines	N/A	≥ \$1,200
Keno	N/A	≥ \$1,500

Sweepstakes, wagering pools, lotteries, and raffles	> \$5000	\$600 to \$5,000
Wagering transactions when winnings are at least 300 times the amount wagered	> \$5000	\$600 to \$5,000
Poker tournaments	N/A if winnings are reported on Form W-2 G	> \$5000

### Unrelated Business Allocation Ratios

Note that there is an item on the 2016-2017 Priority Guidance Plan regarding guidance under Section 512 regarding methods of allocating expenses relating to dual use facilities.

Consider applying the following suggested ratios to each individual expense. Multiple ratios may apply, however you should only apply at the most one ratio per category (time, space, transaction).

### Allocation Ratios

Method	Ratio
Direct Time Days	Number of days with nonmember income divided by the number of days the facility is open in the year.
Indirect Time Days	Number of days with nonmember income divided by the number of days the facility is available for use in the year.
Direct Time Hours	Number of hours the facility is open to nonmembers in the year divided by the number of hours the facility is open in the year.
Indirect Time Hours	Number of hours the facility is open to nonmembers in the year divided by the number of hours the facility is available for use in the year.
Space Indoors (Activity)	Square (or cubic) footage of space used for an unrelated business activity divided by the square (or cubic) footage of the building (or buildings)
Total Space Indoors	Square (or cubic) footage of space used for all unrelated business activities divided by the square (or cubic) footage of the organization's buildings
Space Outdoors (Parking)	Square footage of the parking area open to nonmembers divided by the square footage of the property

Method	Ratio
Total Space Outdoors	Square footage of all space used for unrelated business activities (including buildings and parking) divided by the square footage of the property
Food Transaction Count	Number on nonmember/unrelated business income food sales transactions divided by the total number of food sales transactions
Drink Transaction Count	Number on nonmember/unrelated business income drink sales transactions divided by the total number of drink sales transactions
Gaming Transaction Count	Number on nonmember/unrelated business income gaming sales transactions divided by the total number of gaming sales transactions
Other Merchandise Transaction Count	Number on nonmember/unrelated business income other merchandise sales transactions divided by the total number of other merchandise sales transactions
Total Transaction Count	Number of unrelated business income transactions divided by the total number of all transactions (sales register tapes)
Total Receipts	Total nonmember sales receipts divided by the total sales receipts <b>Note:</b> While taxpayers commonly use this method, this ratio should be used as a last resort.

### Unrelated Business Income Allocation Methodology

Use the following table to assist in allocating expenses towards an unrelated business income generating activity.

## Expense Allocation Worksheet

Entry Description	Amount/Percentage
Expense amount per the Form 990 (or as reconciled)	\$
Organization's estimated percentage applicable to activity	X %
Initial allocated expense amount	= \$
Applicable time ratio (if not applicable, enter 100)	X %
Time allocated expense amount	= \$
Applicable space ratio (if not applicable, enter 100)	X %
Space allocated expense amount	= \$
Applicable transaction ratio (if not applicable, enter 100)	X %
Transaction allocated expense amount	= \$
Other applicable ratio (if any) (if not applicable, enter 100)	X %
Final allocated expense amount	= \$