



NONPROFIT ADVISOR

For DAV Departments and Chapters

Volume 3, No. 4

CHARITABLE GAMBLING – PART TWO

Fall 2011

The federal Internal Revenue Service is interested in almost everything pertaining to charitable organizations, and gambling is no exception. The IRS regulates, or gets involved in, charitable gambling in a number of different ways.

EXEMPT STATUS

In most cases, if a tax-exempt organization devotes a substantial part of its resources (time and/or money) to gambling activities, even those designed to raise funds for programs, the organization risks the loss of its tax-exempt status. Thus, for example, a chapter that ran a bingo operation every single night of the week would have to show, at a minimum, that it devoted more time and effort to activities related to its exempt purpose than to bingo.

UNRELATED BUSINESS INCOME TAX

For DAV departments and chapters, gambling income will be subject to federal taxation (a tax known as “unrelated business income tax” or “UBIT” and equal to regular corporate tax rates) **if** the activity is carried on in a manner and with a frequency comparable to commercial gambling enterprises. Put another way, if the gambling activities of a tax-exempt organization look like a business, the net proceeds will almost always be taxable.

UBIT EXCEPTIONS

There are some limited exceptions that may permit a department or chapter to avoid UBIT on gambling

income. The two most important exceptions are the “bingo exception” and the “volunteer exception.”

The Bingo Exception.

Bingo profits are not subject to UBIT if (1) the game does not violate local laws and (2) is played in a jurisdiction where bingo games are not regularly carried on by for-profit operations. It is important to note that IRS has a very narrow definition of “bingo.” Bingo is defined as a game of chance played with cards printed with five rows of five squares each over which participants, all of whom are in the same place, place markers in response to randomly called numbers. What does that mean? It means that Internet and Satellite Bingo are not considered to be bingo (all players not in the same place). It means that “instant” or “pull-tab” bingo is not bingo (no cards, markers or called numbers). It means that bingo is just . . . bingo.

The Volunteer Exception

Gambling profits may also be exempt from UBIT if the gambling is conducted by volunteer labor. To qualify for this exception, 85% or more of the labor force must be volunteers. IRS has a narrow definition of “volunteer.” Workers who receive tips, or even free drinks, may not qualify as volunteers.

EXEMPT PURPOSE STILL PRIMARY

It is important to realize that even if gambling profits are exempt from UBIT, a chapter or department must still be careful to ensure that gambling does not



become a substantial part of its activity. If that happens, the organization is still subject to the loss of its tax exemption, even though the gambling proceeds themselves may seem to fall within an exception to UBIT. Moreover, it is possible, even likely, that if the IRS revokes an exemption, it will seek some form of retroactive taxation of gambling proceeds generated during the period when the organization was neglecting its exempt purpose.

RECORD-KEEPING AND REPORTING REQUIREMENTS

Charitable gambling involves extensive record-keeping by the exempt organization. Some of these may be imposed under the applicable state nonprofit law. Many are required to satisfy reporting obligations to the IRS.

Most exempt organizations are required to file an annual information return (Form 990, 990-EZ or 990-N depending upon the gross receipts of the organization) with the IRS. For an organization that runs a gambling operation, its gross receipts include all amounts wagered in games, not just the net proceeds. Therefore, most organizations involved in gambling will be well above the limit for filing the simple 990-N, which is essentially an electronic postcard.

Organizations required to file the 990 or 990-EZ must report all gambling activities on Schedule G, *Supplemental Information Regarding Fundraising or Gaming Activities*. This schedule requires disclosure of specific information about the gaming activities including (but by no means limited to) the following:

- Gross revenues from bingo on other types of gambling (on a game-by-game basis);
- Cash and non-cash prizes for each type of gambling
- Direct gambling expenses
- Percentage of volunteer labor for each kind of gambling
- State gambling licenses held
- Identification of those who manage and account for gambling activities

DON'T FORGET THE WINNERS

In many cases, money paid by exempt organizations to gambling winners must be reported to the IRS. In some of those cases, the organization must withhold tax from the winnings and remit that amount to IRS. The rules on this vary widely depending on the type of game involved. An organization can be subject to severe penalties for failing to administer these complicated laws in the correct way.

Nonprofit Advisor is prepared by the Office of the DAV's General Counsel and is published quarterly for the informational use of DAV Departments and Chapters. This newsletter is not intended to replace legal advice that may be required to address individual situations.