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IRS Explains the Ground Rules for Charity Gaming

Games of chance like bingo and raffles are often synonymous with tax-exempt organizations. However, the income from such "gaming" activities operated by charities is not automatically tax-free. The IRS has provided more insight into the key rules in this area in its Publication 3079, *Tax-Exempt Organizations and Gaming*.

Background: A tax-exempt organization doesn't have to pay tax on income from activities that are "substantially related" to its tax-exempt purpose, even if the activity constitutes a trade or business. However, if an exempt organization regularly carries on trade or business activities that aren't substantially related to its tax-exempt purpose, it may be subject to the unrelated business income tax (UBIT).

The fact that an activity generates income that an organization spends on its charitable programs does not necessarily make the activity substantially related to its tax-exempt purpose.

Even if a gaming activity meets the basic requirements for generating unrelated business income, there are several exceptions to the rules, including exceptions for:

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

Here are the details on these four exceptions.

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

For a game to meet the strict tax law definition of "bingo," wagers must be placed, winners must be determined and prizes or other property must be distributed in the presence of all individuals placing wagers in that game. As a result, satellite and Internet bingo games don't qualify for the exception.

Reasons: These games are conducted in many different places simultaneously. In addition, the participants are not all present when the wagers are placed, the winners are determined and the prizes are distributed.

Also "Instant Bingo," "Mini Bingos," and similar pull-tab or scratch-off games don't qualify because the winners are pre-determined.



"A common misconception is that gaming is a "charitable" activity. There is nothing inherently charitable about gaming. It is a recreational activity and a business. Although a charity may use the proceeds from gaming to pay expenses associated with its charitable programs, gaming itself does not further exempt purposes. Thus, the sole purpose of a 501(c)(3) organization cannot be to conduct gaming. "

-- The IRS

2. Volunteer labor - If an organization uses volunteers to conduct substantially all of the work involved in its gaming activities, the gaming won't be considered an unrelated trade or business -- and thus, the income is not subject to tax. An unofficial guideline for "substantially all" of the work is 85 percent.

3. Qualified public entertainment - For this purpose, a public entertainment activity is one that is traditionally conducted at a fair or exposition promoting agriculture and education. This includes any activity with a purpose to attract the public to fairs or expositions, or to promote the breeding of animals or the development of products or equipment.

4. Games of chance in North Dakota - Most games of chance conducted by tax-exempt organizations in North Dakota do not trigger UBIT as long as conducting the games does not violate state or local laws.

IRS Publication 3079 goes on to spell out the critical reporting requirements for gaming activities. If gross unrelated business income (gross receipts minus cost of goods sold) equals or exceeds \$1,000, the organization must file Form 990-T, *Exempt Organization Business Income Tax Return*. If an organization's total anticipated tax for the year equals or exceeds \$500, it must make quarterly estimated tax installments, using Form 990-W, *Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations*. Failing to file the appropriate forms could result in penalties.

If Form 990-T isn't filed by the original due date, an extension may be requested by filing Form 8868, *Application for Extension of Time To File an Exempt Organization Return*, by the original due date.

Any UBIT is due by the original due date for filing Form 990-T. No extension for paying the tax is allowed. The tax must be deposited electronically or paid with a tax coupon.

Finally, the IRS encourages tax-exempt organizations to maintain complete books and records so they can meet their reporting responsibilities and determine any tax liabilities. Keep the same types of books and records that would be maintained for any other business. This includes cash receipt and disbursement journals, accounts payable journals, general ledgers, detailed source documents and copies of federal tax returns.

There may be other responsibilities, such as reporting tip income from workers who receive them at gaming events. Contact your tax adviser for more information.

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