



irs addresses tax-exempt organizations and gaming

MSK Client Alert

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practice areas

nonprofit organizations

On August 11, 2010, the IRS released "Tax-Exempt Organizations and Gaming," a new publication addressing the impact of gaming (a.k.a. gambling) on tax-exempt status and other issues, including unrelated business taxable income (UBTI), recordkeeping, reporting requirements and withholding and excise taxes. The Publication covers raffles, "Saturday night bingo in the church hall, one-armed bandits in the social club, video lottery at the veterans' club, poker night at the fraternal lodge," and other types of gaming activities sponsored by tax-exempt organizations.

Tax-Exempt Status. For most types of tax-exempt organizations, gaming does not further an exempt purpose regardless of the use of proceeds. As a result, a nonprofit conducting gaming as more than an insubstantial part of its activities may jeopardize its tax-exempt status. Further, public charities relying on the "public support" test to avoid private-foundation status cannot receive too much financial support from an unrelated trade or business, such as gaming.

UBTI. Unless an exception applies, a tax-exempt organization is taxed on gaming proceeds if the activity is a trade or business (*the IRS will think so*), regularly carried on (*be careful if it occurs more than annually*), and not substantially related to its exempt purposes (*for certain membership organizations, gaming may be related, but not for a 501(c)(3)*). Exceptions include certain bingo games, activities conducted with substantially all (*85% or more is the unofficial guideline*) volunteer labor (*no tips, please*), and "qualified public entertainment activities."

Recordkeeping. Records must be kept of gross receipts from gaming, prize payouts, and other expenses to substantiate information submitted on returns. Careful oversight of gaming activities is essential to avoid a diversion of funds, and the board of directors should ensure that appropriate internal controls are functioning properly.



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Reporting and Withholding Requirements. Form 990 includes Schedule G for reporting gambling activity information when revenue exceeds certain amounts. One query is the amount of mandatory charitable distributions from gaming proceeds required by state law. The exception in the California Penal Code for certain raffles conducted by charities, for example, requires that at least 90% of the gross receipts be used for charitable purposes.

Workers conducting gaming activities may give rise to numerous compensation reporting and withholding requirements, which also may be applicable to "volunteers" who accept goods, other benefits, or tips. The Publication further warns that, by permitting tips, "the organization may be violating state or local rules that require all volunteer labor for licensed gaming organizations." The California Penal Code exception described above requires that any person receiving compensation for operating a raffle be an employee of the organization.

If a winner receives more than certain threshold amounts (as low as \$600), the organization must report the amount and other information to the IRS, generally using Form W-2G (Certain Gambling Winnings). Withholding requirements apply to certain winnings, and the organization may ultimately be responsible for amounts due but not so withheld.

For example, if Mr. G buys a \$100 raffle ticket and wins a new car valued at \$40,000, the organization would be required to report Mr. G's winnings to the IRS. Further, because the proceeds from the wager exceed the applicable \$5,000 threshold, the organization must withhold \$9,975 (the \$39,900 proceeds from the wager x 25%). Because the new car is a non-cash prize, either Mr. G. must pay the withholding tax to the organization or the organization must pay the withholding tax on his behalf. If the organization pays, the withholding amount is higher because Mr. G also won the value of having the taxes paid.

Excise Taxes. Private foundations conducting gaming may face an excise tax on unrelated business enterprises. Also, unless an exception applies, organizations in the business of accepting wagers may be required to pay both a wagering tax and an occupational tax.

Conclusion. The Publication, available at <http://www.irs.gov/pub/irs-pdf/p3079.pdf>, may serve as a useful guide for tax-exempt organizations conducting or considering gaming activities. Of course, gambling is prohibited or highly regulated by states and local municipalities, and tax-exempt organizations should ensure compliance with those rules as well before engaging in any gaming activities. For example, recent California legislation permits nonprofits to hold "charity poker night" fundraisers subject to strict regulations.

Members of the MSK Charitable Sector Practice Group are available to answer any questions you may have regarding gaming activities conducted by tax-exempt organizations.