

Audit Technique Guide – Veterans’ Organizations

Introduction

This discussion contains detailed technical information and specific audit guidelines to help identify and develop issues for auditing veterans’ organizations.

Note: Because veterans’ organizations can be exempt under IRC Sections 501(c)(4), IRC Section 501(c)(7), IRC Section 501(c)(8), IRC Section 501(c)(10), and IRC Section 501(c)(19), we’re listing guidance for each section. We can use these procedures to examine the two organizations exempt under IRC Section 501(c)(23), however, these organizations’ activities are unique to those entities.

These guidelines aren’t all-inclusive. The intent isn’t to restrict agents from identifying issues or using audit techniques not included here.

Requirements to Qualify as a Veterans’ Organization Under IRC Section 501(c)(19)

To be exempt under IRC Section 501(c)(19), an organization must be:

- A post or organization of past or present members of the United States Armed Forces (USAF)
- An auxiliary unit or society of this post or organization
- A trust or foundation for this post or organization

A veterans’ post or organization must meet these requirements to be exempt under IRC Section 501(c)(19):

- It must be organized in the United States or any of its possessions.
- At least 75 percent of the organization’s members are present or former members of the USAF (veterans).
- Of the remaining 25 percent, substantially all (90%) must be cadets who are students in a college or university Reserved Officers Training Corps (ROTC) program or at an Armed Services academy, or spouses, widows, widowers, ancestors, or lineal descendants of veterans or cadets.
- No more than 2.5 percent of membership may include individuals who aren’t veterans, cadets, spouses, widows, widowers, ancestors, or lineal descendants of veterans or cadets.
- No part of its net earnings may inure to the benefit of any private shareholder or individual.

The organization must be operated exclusively for one or more of these purposes that are to:

- Promote the social welfare of the community (In other words, promote the common good and general welfare of the people of the community).
- Help disabled and needy war veterans and members of the USAF and their dependents, and the widows and orphans of deceased veterans.
- Offer entertainment, care, and help to hospitalized veterans or USAF members.
- Carry on programs to perpetuate the memory of deceased veterans and members of the USAF and to comfort their survivors.
- Conduct programs for religious, charitable, scientific, literary, or educational purposes.
- Sponsor or participate in patriotic activities.
- Offer insurance benefits for members or their dependents.
- Offer social and recreational activities for members.

Members and Non-members of an IRC Section 501(c)(19) Veterans' Organization

A "member" per IRC Section 501(c)(19) is an individual who's eligible for membership under the constitution and bylaws of the veterans' organization.

The veterans' organizing document usually limits membership to past or present USAF members when a central organization in a group exemption controls the post. A veterans' organization member may attend and vote at membership meetings and hold office or participate in national and state conventions. The post also remits a per capita tax to the central organization for their membership dues.

A "nonmember" under IRC Section 501(c)(19) is an individual who isn't a member of the organization. But, the "nonmember" participates in the organization's recreational activities, receives organization's goods or services or pays for the services or goods received. This is a term that describes the social nonmember of the post.

A veterans' organization nonmember can't attend and vote at membership meetings, hold office or participate in national and state conventions. The post doesn't remit a per capita tax to the central organization for their social nonmember dues.

A social nonmember is a member of the general public and a nonmember under IRC Section 501(c)(19), unless the membership category is in the constitution of the central organization or post's creating document.

Definition of "Veterans" for an IRC Section 501(c)(19) Organization

Veterans are present or former members of the USAF. IRC Section 7701(a)(15) defines the "military or naval forces of the United States" and the term "Armed Forces of the United States" as including all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense Secretary of the Army, Secretary of the Navy, or the Secretary of the Air Force. Each term also includes the Coast Guard and the National Guard.

Veterans are members on active duty or honorably separated from the National Guard and the Reserve Forces.

Not veterans: Persons who have been dishonorably discharged from the USAF aren't considered "veterans" or "war veterans" to determine a veterans' organization under IRC Section 501(c)(19) membership composition.

Auxiliary Units of an IRC Section 501(c)(19) Organization

Auxiliary units or societies are corporations or associations that support the purposes and activities of a post made up of veteran members. An auxiliary may be separately organized from the post after receiving a charter from their national parent organization.

An organization may be exempt under IRC Section 501(c)(19) as an auxiliary unit or society of a veterans' post or organization if it meets these requirements:

- It is affiliated with, and organized according to the bylaws and regulations of, a veterans' post or organization described above.
- At least 75 percent of its members are veterans, spouses of veterans, or related to a veteran within two degrees (such as a grandparent, brother, sister or grandchild) represent the most distant allowable relationships.
- All are members of a veterans' post or organization described above, or spouses of a member of such post or organization, or are related to a member of such post or organization within

two degrees.

- No part of its net earnings inures to benefit any private shareholder or individual.

An auxiliary must be separately organized and have a separate Employer Identification Number (EIN) or its members are considered members of the post. These units support a post already recognized as tax-exempt under IRC Section 501(c)(19). If the post isn't exempt under IRC Section 501(c)(19), the auxiliary can't be tax-exempt under IRC Section 501(c)(19).

Provision of Certain Benefits by an IRC Section 501(c)(19) Organization

All IRC Section 501(c)(19) organizations may offer life, sick, accident, or health insurance benefits for their members and their dependents. Most veterans' organizations don't offer these benefits directly; they contract with public insurance companies. The insurance programs are often administered through single purpose trusts or foundations. You may use a trust or foundation to offer the insurance benefits directly. These organizations may also qualify for exemption under IRC Section 501(c)(19).

An organization may be exempt under IRC Section 501(c)(19) as a trust or foundation for a veterans' post or organization if it meets these requirements:

- It's valid under local law and, if organized for charitable purposes, has a dissolution provision under Treas. Reg. 1.501(c)(3)-1(b)(4).
- The corpus or income can't be diverted or used other than to fund a veterans' post or organization for charitable purposes or as an insurance set-aside.
- The trust income isn't unreasonably accumulated, and a substantial portion of the income is distributed to that veteran post or organization, or for exclusively religious, charitable, scientific, literary, educational, or prevention of cruelty to children or animal purposes.
- It's organized exclusively for one or more of the above purposes for which a veterans' post or organization itself may be organized.

Insurance Set-Asides by an IRC Section 501(c)(19) Organization

A veterans' organization may create an insurance set-aside to offer direct insurance benefits through a separately organized trust or foundation. You may also create an insurance set-aside without creating a separate organization. You can create a restricted fund within the IRC Section 501(c)(19) organization if you keep adequate records describing the amounts and designated purposes of the funds.

Member paid amounts for insurance benefits and properly set aside aren't subject to tax as unrelated business income (Treas. Reg. 1.512(a)-4(b)). To be considered properly set aside, you must keep the funds separate from the organization's general funds and accounts.

You must limit these amounts to those reasonably necessary to provide offered insurance benefits and must use them solely for paying those benefits to the members or administer the insurance program. However, you can use excess funds from an experience gain for IRC Section 170(c)(4) or for the reasonable costs of distributing funds for these purposes.

You may not commingle funds for any other purpose with the insurance set-aside. Any other uses of the set-aside funds, such as using them as security for a loan, are considered to be withdrawals from the set-aside. And these amounts are included in unrelated business taxable income in the taxable year they're withdrawn, without any modification under IRC Section 512(b).

The income generated from the set-aside funds may be similarly set aside. It must be set aside in

the taxable year in which it would be included in gross income but for IRC Section 512(a)(4). You may invest this income, pending the action contemplated by the set-aside, without it being considered used for other purposes.

The special rules on income that IRC Section 501(c)(19) organizations receive from offering insurance benefits and funds' expenditures derived from insurance activities don't apply to expenditures made for lobbying purposes. See Senate Report No. 92-1082, 92d Cong. 2d Sess. (reproduced in 1972-2 C.B. 713, at 716).

Exempt Activities of an IRC Section 501(c)(19) Organization Veterans' Organization

Congress permits IRC Section 501(c)(19) veterans' organizations' broad purposes. The broad purposes promote Americanism, sponsor youth activities, provide color guards, conduct patriotic ceremonies functions and community activities. Many also conduct social activities among their members. These activities are consistent with exemption requirements:

- Reviewing proposed legislation that may affect veterans at the federal and state levels
- Testifying before a governmental body under this legislation
- Informing members about the proposed legislation

These are examples of some of the activities conducted by veterans' organizations that promote social welfare:

- Sponsor youth activities whether or not the activity is limited to the members' children. Buying equipment and uniforms for a youth athletic team is a proper post activity.
- Allow other community organizations to use the post facility without charge. Organizations include the social welfare organizations (IRC Section 501(c)(4)), a public school organization or a community group.
- Sponsor the Boy Scouts, Girl Scouts or other youth units of the post, and offer scholarships for students.
- Donate to charities under IRC Section 501(c)(3).
- Visit sick or hospitalized members, veterans and their families.

Social and recreational activities are exempt if post members conduct them. These activities may include:

- Operating a bar or restaurant or both
- Gambling
- Dinner dances

The auxiliary units and societies recognized as tax-exempt under IRC Section 501(c)(19) support the post's purposes and activities. Including their members in the post's social and recreational activities also furthers the post's purposes.

Requirements to Qualify as a Veterans' Organization Under IRC Section 501(c)(4)

An IRC Section 501(c)(4) veterans' organization must be organized as a not-for-profit organization and operated for social welfare purposes. Its primary activities must promote the common good and general welfare of the people of the community. Social welfare activities don't include social, political or business activities. The net earnings of an IRC Section 501(c)(4) organization may not be for private purposes or to benefit private individuals.

There are no membership requirements under IRC Section 501(c)(4). Exemption is based on the type of activities conducted. The post or its central organization can set membership requirements

and include any members' category that its charter allows.

Auxiliary units supporting an IRC Section 501(c)(4) post may qualify for exemption by engaging primarily in activities that directly promote the social welfare of the people of the community.

A central veterans' organization exempt under IRC Section 501(c)(19) may have subordinate posts exempt under IRC Section 501(c)(4) and vice versa. All subordinates under a group ruling, however, must be exempt under the same section of the code. For example, the parent may be exempt under IRC Section 501(c)(4) and list all of its IRC Section 501(c)(19) subordinate posts on its group ruling. The group ruling may not include subordinate organizations exempt under any other code section. These organizations may apply for tax exemption on their own.

Note: A central veterans' organization may also have subordinates that are not tax-exempt.

Social welfare activities include promoting, sponsoring and participating in patriotic activities such as Fourth of July parades, school Flag Day ceremonies and Junior ROTC groups. Other activities include helping needy and disabled veterans, widows, or orphans of deceased veterans; and conducting hospital visits, driving the sick and disabled to the hospital or to medical facilities, recycling, adopting a road for clean-up purposes, and sponsoring a youth baseball team, or other youth groups. These activities listed above aren't exclusive.

A social welfare activity would be using the facility without charge or for actual cost to other community organizations. Charging commercial rents or offering commercial services, such as food and beverage, might result in the income being subject to the unrelated business income tax.

A social welfare purpose isn't operating a bar, restaurant or game room. These activities are social and recreational and may be considered business activities but don't benefit the whole community.

Requirements to Qualify as a Veterans' Organization Under IRC Section 501(c)(7)

IRC Section 501(c)(7) exempts from tax social clubs organized and operated primarily for pleasure, recreation, and similar non-profitable purposes. In keeping with this purpose, nonmember income from all sources is limited and taxed as unrelated business income. Veterans' organizations whose activities are social and recreational, such as operating a bar, restaurant, canteen or casino for members, may be recognized as tax-exempt under IRC Section 501(c)(7).

Social clubs may have different members' categories and aren't required to have a specific percentage of veteran members.

To satisfy the organizational requirements for exemption, a club's charter, bylaws or other governing instrument must not include purposes that aren't directed toward pleasure and recreation.

An organization won't qualify for exemption if its organizing documents or any written policy statement contains a provision that discriminates based on race, color or religion.

A club's members must share common goals and interests that are furthered through its social and recreational activities. The fellowship among members that grows through this participation is a key component of a social club.

A veterans' organization isn't exempt under IRC Section 501(c)(7) if it offers commercial services, such as the sale of packaged liquor or carry out food. Such activities aren't traditionally engaged

in by social clubs.

The club may specify voting and non-voting members and may choose to limit member benefits, such as using the club facilities based on membership categories. Eligibility requirements, formal admittance procedures and a dues structure are internal matters to decide according to the club's charter and by-laws.

Note: A club whose membership categories serve as a way to permit the general public to use the facilities will fail to qualify for this reason.

An IRC Section 501(c)(7) veterans' organization can't offer its members sickness, death or similar benefits. These types of benefits aren't social or recreational in nature and aren't permitted under IRC Section 501(c)(7).

As a general rule, an IRC Section 501(c)(7) club may receive up to 35 percent of its gross receipts from sources outside its membership. This includes investment income. Within the 35 percent limitation, no more than 15 percent of the gross receipts may be derived from the general public's use of a club's facilities or services. Gross receipts are from the normal and usual activities of the club.

Requirements to Qualify as a Veterans' Organization Under IRC Section 501(c)(8) or Section 501(c)(10)

To qualify for exemption under IRC Section 501(c)(8), a veterans' organization must:

- Be fraternal in nature.
- Operate under the lodge system.
- Pay life, sick, accident or other benefits to its members.

An IRC Section 501(c)(8) veterans' organization may create a separate insurance subsidiary for its members' benefits. These subsidiary organizations may also qualify for exemption under IRC Section 501(c)(8).

A fraternal veterans' organization exempt under IRC Section 501(c)(10) is one described in IRC Section 501(c)(8) except that it doesn't provide benefits to its members. An IRC Section 501(c)(10) veterans' organizations' net earnings must be devoted to charitable, religious, scientific, literary, educational or fraternal purposes.

"Fraternal" means brotherly or friendly. The IRC Section 501(c)(8) or IRC Section 501(c)(10) veterans' organization members must share common ties and come together to pursue common goals. An organization with mostly veteran members joined to pursue common goals is fraternal in nature.

Note: The shared experience of serving in the Armed Forces establishes that the members share a common bond.

Operating under the lodge system means carrying on activities under an organization made up of local branches chartered by a parent organization. Requirements include:

- The local branches, called lodges or chapters, must be separately organized and self-governing but operated under the general control and supervision of the parent lodge and subject to its rules, laws and edicts.
- Both the parent and local organizations must be active.
- Each organization holds regular meetings at a designated place, adopts a representative form

of government, and performs its work per a set ritual.

To qualify for exemption, an IRC Section 501(c)(8) veterans' organization must offer some type of insurance benefits such as life insurance, accidental death and dismemberment insurance or health insurance. Benefits don't have to be limited to insuring members against personal risk, but may also include property loss insurance. An organization is not required to offer all types of insurance benefits.

The organization doesn't have to cover all members in its benefits program or require that all eligible members purchase policies for the benefits offered. Organizations may have two classes of members (beneficial and non-beneficial). Most of the members must however be entitled to participate in the benefits program.

Fraternal veterans' organizations may operate a bar and/or a restaurant for its members and their bona fide guests. Operating this type of facility for members is a fraternal activity and doesn't jeopardize exemption under IRC Section 501(c)(8) or IRC Section 501(c)(10).

Veterans' Organizations and Formation of Organizations Exempt Under IRC Section 501(c)(2)

Veterans' organizations exempt under IRC Section 501(c)(19), IRC Section 501(c)(4), IRC Section 501(c)(7), IRC Section 501(c)(8) and IRC Section 501(c)(10) may form separate title holding organizations, recognized as exempt under IRC Section 501(c)(2), to hold title to their facilities. This may be necessary in states in which non-incorporated entities can't hold title to real property.

An IRC Section 501(c)(2) organization must be organized for the exclusive purpose of holding title to property, collecting income from that property, and turning that income over to the exempt organization that controls it. This type of organization shouldn't engage in any unrelated trade or business.

A title holding corporation whose purposes are identical to the veterans' organization it supports, but whose only activity is holding title to the post, lodge or clubhouse, collecting rent from the supported organization, and using the rent to pay for the upkeep of the facility can qualify for exemption under IRC Section 501(c)(2).

A title holding organization may not operate "video poker machines" or other forms of gambling for the veterans' organization members who form it. The operation of casino nights, video poker machines or other forms of gambling are considered recreational activities and outside the scope of IRC Section 501(c)(2).

An IRC Section 501(c)(2) organization may receive an incidental amount of its income from operating vending machines, such as a soft drink machine, on its property without jeopardizing its exemption. To be incidental, the amount of income from all unrelated activities can't exceed 10 percent of the organization's gross receipts.

Renting personal property is considered conducting a trade or business and may jeopardize exemption under IRC Section 501(c)(2) if, along with other unrelated receipts, their income exceeds 10 percent of gross receipts.

Exception: Renting personal property as part of a mixed lease doesn't affect exemption but may result in tax under IRC Section 511 on some or all of the lease's income.

Group Rulings for Veterans' Organizations

A central organization may apply for a group ruling for itself and all of its affiliated organizations. Subordinates covered by a group ruling don't have to file an application for recognition of tax-exemption. A central veterans' organization may have subordinates that are not tax-exempt.

When a post exempt under IRC Section 501(c)(19) fails to meet the membership requirements, it must notify its parent that it doesn't qualify for tax-exemption and shouldn't be listed in the group exemption roster. The post may continue to maintain its affiliation with the parent, but it may not maintain exemption as a subordinate post under its group ruling.

If the auxiliaries meet the criteria for exemption under IRC Section 501(c)(19), they may be included in the group ruling.

Members of the various posts exempt under the same group ruling may use the facilities of and participate in activities of the other posts without jeopardizing exemption of the host post.

Adding new posts or dropping non-qualifying posts from a group ruling doesn't affect the parent's exempt status as long as the parent organization continues to satisfy the legal requirements for exemption.

A subordinate must have the same fiscal year as the parent organization to be included in its consolidated information return.

A subordinate must also have the same exempt status as all subordinates. A subordinate's status must be revoked if it doesn't meet the qualification of the other subordinates. Change its status to 28, No longer covered under a group ruling.

A revoked subordinate that wants to be exempt must file its own application for exemption.

IRC Section 170(c)(3) – Deductibility of Contributions to “War Veterans” Organizations

Contributions are deductible to a post of “war veterans” (or an auxiliary unit of that organization) if organized in the U.S. or any of its possessions, and no part of its net earnings inures to the benefit of any private shareholder or individual (IRC Section 170(c)(3)). For the contributions to be deductible, a veterans' organization may be exempt under IRC Section 501(c)(19) or any other appropriate Code section, but must also satisfy both a membership requirement and a purpose requirement.

To meet the membership requirement, at least 90 percent of the members must be war veterans. Also, substantially all the other members must be either veterans (but not war veterans), or cadets, spouses, widows, or widowers of these three groups. For the 90 percent test, war veterans may include members of expeditionary forces who actually served in combat situations in foreign countries between the war periods below.

Note: The war veterans membership requirements are in Treas. Reg. 1.501(c)(19)-1, which has not been updated for the Military Family Tax Relief Act of 2003, P.L. 108-121, which expanded the membership categories to include two degrees of relationship.

A war veteran is a person who served in the USAF during any of these periods:

- April 21, 1898 - July 4, 1902
- April 6, 1917 - November 11, 1918
- December 7, 1941 - December 31, 1946

- June 27, 1950 - January 31, 1955
- February 28, 1961 - May 7, 1975, for a veteran who served in the Republic of Vietnam
- August 5, 1964 - May 7, 1975
- August 2, 1990 – to end on the date prescribed by Presidential Proclamation or by law.

Note: See 38 CFR 3.2 for the definitions of the periods of war.

A war veterans' organization must also be organized and operated primarily for the following narrower purposes:

- Furthering comradeship among persons who are or have been members of the Armed Forces
- Honoring the memory of deceased veterans and members of the Armed Forces and helping and comforting their survivors
- Encouraging patriotism
- Helping hospitalized, disabled, and needy war veterans and their dependents

Unrelated Business Income

Veterans' organizations, regardless of the code section of exemption, are subject to tax on unrelated trade or business income (UBI). To be considered unrelated, a trade or business must be regularly carried on and not substantially related to performing an organization's exempt purposes other than its need to raise money to carry on its programs.

Exceptions to UBI treatment per IRC Section 513 that apply to all exempt veterans' organizations:

- Volunteer labor
- Selling donated merchandise
- Certain bingo games
- Low cost articles
- Exchange or rental of members lists between posts of war veterans eligible to receive tax deductible contributions

A bingo game operated by a veterans' organization must be legal and conducted in a jurisdiction that doesn't permit commercial bingo. The game must be one in which wagers are placed, the winners determined, and prizes distributed in front of everyone who placed a wagers in that game. Bingo isn't the sale of pull-tabs, instant bingo or similar raffles or any other gambling activities.

The operation of a bar and restaurant with paid staff for the members or the general public use isn't an exempt activity for an IRC Section 501(c)(4) organization. Because this activity is a trade or business, regularly carried on, and not substantially related to exempt purposes, all of the income is taxable.

Social activities, such as the operation of the bar and restaurant, are appropriate for veterans' organizations exempt under IRC Section 501(c)(19), IRC Section 501(c)(7), IRC Section 501(c)(8) and IRC Section 501(c)(10), if the activities are limited to members and their bona fide guests.

A "bona fide guest" for IRC Section 501(c)(7) and IRC Section 501(c)(19) is an individual a member invites to participate in an activity and pays for his expenses. If the guest pays for his own recreation or food, he isn't a bona fide guest. Income generated by nonmember participation in the organization's activities is considered UBI and ordinarily taxable under IRC Section 511.

Substantial unrelated activities including those listed below, may adversely affect exempt status:

- Renting out facilities to the general public

- Opening bar and dining facilities to the general public
- Selling liquor and/or food to members and/or the public for consumption off the premises
- Gaming activities with nonmembers

See Pub. 3386, Tax Guide Veterans' Organizations for guidance on UBI activities for the various exemption code sections (IRC Section 501(c)(4), IRC Section 501(c)(7), IRC Section 501(c)(8), IRC Section 501(c)(10), and IRC Section 501(c)(19)).

Taxes Associated With Gaming Conducted by Veterans' Organizations

A Veteran's organization may incur various taxes in gaming activities' operation. Some taxes, such as withholding and employment taxes, apply regardless of whether the income is subject to unrelated business income tax. Other taxes, such as unrelated business income tax (UBIT), occupational, and wagering taxes apply depending on the situation.

Organizations frequently conduct gaming activities in connection with the veterans' organization's bar. Some other examples of gaming activities include:

- Bingo gaming sessions held at either the organization's facility or an offsite bingo hall, frequently open to the public
- Pull-tab sales to members and nonmembers, either at a bar or during bingo gaming sessions.
- Coin operated pull-tab vending machines in either the bar or a bingo hall
- Food or other prize raffles, involving members and/or the public.
- Keno games, either operated on site by a Keno caller, or via a computerized satellite Keno number calling system.
- State lottery ticket sales obtained from the state lottery commission.

UBI Considerations – Gaming

Income from the sale of "Instant Bingo" or "Mini Bingos" doesn't qualify for the bingo exception under IRC Section 513. Instant Bingo or mini bingos are considered pull-tab games, not regular bingo games. See *Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner*, T.C. Memo 1995-439, aff'd, 98 F.3d 190 5th Cir. (1996).

The organization may consider payments to bartenders, servers, snack bar staff, maintenance workers, security, etc. to determine "substantially all" for the "volunteer labor exception." Consider free drinks or food to workers compensation if it's evident that the free items are more than a mere gratuity and intended to compensate workers for their services.

Compensation also includes workers tips from patrons at the gaming session. Many local jurisdictions strictly prohibit tipping at game functions. If tipping is allowed, the "volunteer" labor exception doesn't apply.

Workers' fee waivers or reduced fees for items or services normally charged to non-workers are also compensation.

Sales of bingo daubers, food, beverages, cigarettes, or other materials are subject to UBIT, if sold to the public, and it doesn't otherwise meet one of the UBI exceptions. Sales of the bingo cards themselves are not subject to tax.

Withholding Taxes – Gaming

Organizations are subject to the withholding and backup withholding rules for games such as bingo, pull-tabs and raffles.

See below for when withholding and backup withholding is required:

Game	Regular gambling withholding	Backup withholding Applies on
Bingo	No withholding	\$1,200
Instant Bingo, Pull Tabs, Raffles	\$5,000	\$600, and 300 times as large as the amounts wagered

Withholding refers to regularly withholding income tax from prizes paid. This withholding is required at the third lowest rate for unmarried individuals, adjusted in a Revenue Procedure each year. For 2017 that rate is 25 percent.

Backup withholding refers to withholding tax for reportable prizes when the recipient doesn't give a taxpayer identification number. The backup withholding rate is the fourth lowest rate for an unmarried individual, and for 2017, is 28 percent.

If the prize is not cash, consider the fair market value of the item won for the prize amount. Apply the withholding and backup withholding rates, if required, to the fair market value of the item won. The organization should collect the amount to be withheld from the prize winner.

The exempt organization reports regular withholding from gaming winnings on Form 945, line 1 and backup withholding on line 2.

Certain wagering transactions require an organization to file Forms 945 and 1096. Form W-2 G is filed when an individual(s) wins a prize with a minimum specific dollar amount at a gaming event. The winner must provide the game operator with proper identification including his/her social security number.

See the following chart for when to issue a Form W-2 G:

Type of game:	Amount of prize paid is equal to or greater than:
Bingo or Slot machines	\$1,200 not reduced by wager

Instants/Pull-tabs	\$600 not reduced by wager; At least 300 times the amount of the wager
Keno	\$1,500 reduced by wager

Employment Taxes – Gaming

If the gaming workers receive compensation from either the organization or patrons' tips, the organization must file and pay employment taxes.

In addition to gaming workers, the organization may have other individuals that should be treated as employees, such as security watchmen, snack bar workers or janitors.

All tips an employee receives are taxable income subject to federal income tax. If an employee receives tips in cash (or checks or other cash equivalent), including charged tips of \$20 or more in a calendar month while working for any one employer, they're wages subject to Social Security and Medicare taxes, federal unemployment tax (FUTA), and income tax withholding.

Tips less than \$20 an employee receives in a calendar month while working for a particular employer aren't wages for Social Security and Medicare taxes, FUTA or federal income tax withholding purposes, even though these tips are taxable income.

Once the amount of tips an employee receives in a calendar month reaches \$20 from any one employer, they must include the entire tips in wages, not just the amount over \$20. An employee who receives \$20 or more in tips must report them in writing to the employer by the tenth day following the month in which they receive them.

Gaming Excise Taxes

All organizations that conduct gaming activities may be subject to a wagering excise tax and an occupational tax per IRC Sections 4401 and 4411.

There are two types of wagering taxes:

- An excise tax imposed on the amount of the wager.
- An occupational (or stamp) tax imposed on the persons engaged in receiving wagers.

The wager is the amount the person placing the bet risks, not the amount the person stands to win. The term "wager" doesn't include exempt organization drawings if its net proceeds does not inure to any private shareholder or individual's benefit.

Pull-tabs, raffles and tip jars meet the definition of taxable wagers placed in a lottery. Bingo Games (not Instant Bingo) are specifically excluded from the wagering tax.

Drawing or lottery proceeds an organization uses for its general operating expenses inure to the benefit of members and are subject to the wagering tax.

Example: Post ABC, a IRC Section 501(c)(19) organization, sells pull tabs to raise money to members and nonmembers, as the post does not observe the bona fide guest rule. The pull-tab sales proceeds go into the General Fund and are used to pay the Post's general operating expenses. The wagering tax applies because the members of the Post are receiving a benefit from the pull tab sales. Specifically, using the pull-tab proceeds to offset the general expenses of the Post's social or recreational activities, or to reduce the members' dues, constitutes inurement.

The IRC Section 4401 wagering excise tax is on the gross amount of the wagers received. The amount of the tax depends on whether the wager is authorized under state law.

If the wager is authorized under state law, the amount of the tax is 0.25 percent of the amount of the wager. So, if the gross wagers were \$1,000, the amount of the tax would be \$2.50 ($\$1,000 \times .0025$).

If the wager is not authorized under state law, the amount of the tax is 2 percent of the amount of the wager. So, if the gross wagers were \$1,000, the amount of the tax would be \$20 ($\$1,000 \times .02$).

The organization pays the IRC Section 4401 excise tax with Form 730, Monthly Tax Return for Wagers, is a monthly tax return due each month by the last day of the month following the month for which the veterans' organization is reporting wagers.

The IRC Section 4411 occupational or stamp tax is an annual fee on each person liable for the tax on wagers, or on any person engaged in receiving wagers for or on behalf of any person so liable.

If the wager is authorized under state law, the amount of the occupational tax is \$50 per year per person receiving wagers. If the wager is unauthorized under state law, the amount of the tax is \$500 per year per person receiving wagers.

The tax is due from a "principal," a person or organization in the business of accepting wagers, or an employee agent of that organization (for example, a paid bartender who sells pull-tabs over a veterans' organization's bar). Both the bartender and the organization would each be subject to the tax.

An organization must file Form 11-C, Occupational Tax and Registration Return for Wagering, before they/an individual begins accepting wagers. After they file the return and pay the fee, the IRS issues a letter as proof of registration and payment.

Pre-audit Guidelines for a Veterans' Organization

Before you begin an audit of a veterans' organization:

- Determine the code section of exemption and whether the organization is under a group ruling. Use command code INOLES or BMFOLO. For organizations with a group exemption number (GEN), the first name line on INOLES or BMFOLO is the parent organization, and the second line is the name of the specific audited organization. Include both names in all reports and letters in the mailing address. Organizations under a group ruling don't have a separate determination application file. The organization keeps a copy of the group ruling letter. Many posts also have affiliated auxiliaries listed under the same group ruling and share the same address. If there is an auxiliary, the two entities often split the income based on the type of activity performed.

- Look for listings of all of the various posts and auxiliaries under a group ruling on the organization's national headquarters' website. Many organizations have websites, but not all. Those that have gaming activities open to the public frequently have a website in which they advertise activities' location and times.
- Search for the national organization's articles and bylaws online. Review them before the audit. Organizations under the group ruling often use the same bylaws.
- Visit the state gaming (or gambling) commission/agency website for records of the types of gaming licenses obtained, whether any employees are registered for gaming licenses, and the upper limit of the gaming proceeds permitted per type of license. Some states even list organization provided reports and internal records, such as ledgers and cancelled checks.
- See state gaming/gambling commission/agency websites for records of administrative actions taken against veterans' organizations for noncompliance with state laws, such as reporting, payouts, or failure to use gaming proceeds.
- See state liquor control boards', (or equivalent agencies') websites for records to see if the organization has a liquor license, and the number of employees permitted to sell liquor on the premises.
- Review the organization's filing history via command code BMFOLT. Lack of various returns may indicate the organization doesn't have an activity (bar operation, gaming) or is unaware of its reporting requirements. Forms 990 and 990-T are recorded as MFT 67 and 34. Forms 940, 941, and 945 are listed as MFT 10, 01, and 16. Forms 11-C and 730 are reported under MFT 63 and 64.
- Research the prior and subsequent years Forms 990 and 990-T via Statistics of Income Exempt Organization Return Imaging Net (SEIN), if filed. SEIN gives images of the actual filed returns scanned at the Ogden Service Campus. See <http://sein.osc.irs.gov>.
- For 2007 and prior years, revenues from gaming activities was reported under special events, with the box checked for gaming activities. Separate schedules were required for inventory sales (typically from bar operations,) and gaming activities.
- For 2008 and subsequent years, gaming activities are in the Form 990 Parts IV, V, and VIII, and Schedule G.
- Form 990-T is used to report taxable sales of merchandise and taxable gaming revenues. Other types of income may also be reported, depending on the code section of the veterans' organization.
- Comparative balance sheet analysis shows whether the organization's activities are shrinking, expanding, or staying constant.
- Get your manager's approval if you decide to expand the audit to prior and/or subsequent years.
- Many organizations offset gaming revenues with "lawful purpose expenditures" as being required under state law. These often incorrectly generate net operating losses.
- Lawful purpose expenditure requirements under *South End Italian Independent Club, Inc. v. Commissioner*, 87 T.C. 168 (1986), acq. in result, 1987-2C.B. 1, are subject to state law requirements. Retaining gaming revenues in a gaming account instead of transferring amounts to subsidize the organization's operations doesn't meet the requirements for lawful purpose expenditure deductions.
- Lawful purpose expenditure deductions are limited to the extent to which the organization has taxable gaming revenues. Taxable sales of food and beverages aren't subject to the state gaming laws.
- While there may not be a UBIT after deducting lawful purpose expenditures from taxable gaming revenues, the fact that this revenue is taxable will often trigger a gaming excise

tax liability.

- Use command code IRPTR at least three weeks before the audit to get the Forms W-2 and 1099 information. You can use electronic copies with the Large Business and International Operating Division (LB&I) Form W-2/W-2 G/1099/AP Data Analysis tool.
- Compare the list of officers on the Form 990 to the individuals who received Forms W-2 and 1099. Among the officers, an adjutant may frequently be listed as receiving the largest amount of compensation, as he or she is typically a veteran who serves as the office administrator.
- Other individuals who receive Forms W-2 and 1099 may be bar managers, bartenders, wait staff, and gaming employees. Address bar and wait staff tip reporting in any veterans' organization that has a bar, and gaming staff if operating bingo.

Required Forms W-2 and 1099 and/or 1099-MISC may be missing:

- If different people administer various bank accounts, such as a bar manager in charge of the bar account, a gaming manager handling the gaming account, while the adjutant manages a post account.
- For services rendered by bands performing at dinner dances, building trades contractors who make repairs, janitorial services, and grounds keeping services.

Tailor the initial interview to the type of veterans' organization you're auditing using these areas of focus:

- Whether the organization meets the membership requirements.
- The kinds of records retained as proof of veteran status.
- Whether there is a related auxiliary (either a separate entity or one that uses the same EIN).
- If there is an auxiliary, how the activities and income are divided between the two entities.
- Whether the post provides insurance directly, or has benefits provided through a separate trust or foundation.
- The existence and purpose of a set-aside account.
- The activities conducted by the organization.
- How many sets of account books (post, bar, gaming, general, etc.) are maintained by the organization.
- Who is responsible for managing each account.
- Whether the organization has social members.
- The rights permitted for social members.
- Whether the organization has true "bona fide guests."
- Whether access to the facility is restricted.
- Who pays for meals and drinks (Form 990-T).
- Whether membership cards or other identification is requested at the time of purchase (Forms 730, 990-T).
- The amount of tips the bartender and wait staff receive (Form 941).
- The types of gaming activities conducted at the facility.
- Who is permitted to pay to play the gaming activities (Form 730)
- Whether the activities (bar and gaming) are fully licensed (Form 730).
- Whether the bartenders or others selling pull-tabs, lottery tickets, raffle tickets, or other non-bingo sources of gaming revenue have their own EINs (Form 11-C).
- The portion of the facility accessible by the public (Form 990-T).

- The portion of the facility used for the operation of a bar and/or restaurant (Form 990-T).
- The portion of the facility used for gaming activities (Form 990-T).

For auxiliary organizations, focus interview questions on:

- If the auxiliary isn't separately established, whether the post and auxiliary jointly meet the membership test.
- If separately established, whether the auxiliary meets the membership test for just auxiliaries.
- The auxiliary's activities.
- The types of income.
- The division of labor, income, and expenses between the post and the auxiliary.
- As the trust and foundations are significantly different in nature from the posts and auxiliaries, interview questions to consider include:
 - The types of insurance provided.
 - The types of membership for which insurance is provided.
 - The existence and purpose of a set aside account.
 - The number and names of posts and auxiliaries participating in the insurance programs.
 - The number and names of posts and auxiliaries otherwise supported by the trust or foundation.

Field Audit Guidelines

Review the following to determine the composition of membership of the organization:

- Articles of incorporation, charter, bylaws, and meeting minutes.
- Membership list(s) containing the names of the members, the military service dates, and the status of each member. This status information shows whether the member is active duty, veteran, cadet, or spouse. The organization may provide list(s) from its affiliated parent organization.
- A document that shows the dues structure and classes of memberships.
- The documentary information the organization used to create the membership list(s) noted above. Inform organizations that to satisfy this request, they may provide membership applications, member ship cards, or other similar documents, *other than* DD Form 214.
- Documents showing the organization's policies and procedures on how it decides an individual is eligible for membership, including documents which show the way it enforces its membership requirements.

Note: The organization must maintain members' military service dates to establish that contributions to the organization are deductible, if a war veterans' organization under IRC Section 170(c)(3).

Caution: Social members are considered nonmembers if not specified in the bylaws, and so any income from them is subject to UBIT.

If you have information that contradicts provided documented information or if the organization doesn't satisfy a reasonable request, you may *then* request DD Forms 214 or other discharge documents to determine compliance with the federal tax laws. DD Forms 214 must include the name, department, component and branch of service, and record of service dates. All other personal information may be redacted.

Caution: DD Forms 214 and other discharge documents, contain personal and private information, including social security numbers and medical information.

Note: Active duty members don't receive DD Forms 214. The Department of Defense issues Common Access Cards (CAC) to active and reserve duty members. The CAC resembles a Homeland Security Presidential Directive (HSPD-12) badge. Retirees, disabled veterans, and dependents may acquire DD Forms 2, 1173 and 1173-1, which are color coded (blue, tan, or red).

Treat these documents with the same sensitivity as DD Forms 214.

If there is an affiliated auxiliary, determine whether it was separately established or operates under the post's EIN.

Perform the membership test, if a IRC Section 501(c)(19) organization.

- Count the number of members who are active service persons or are veterans.
- Count the number of spouses, dependents, parents, grandparents, and grandchildren who are members.
- Count the social/associate members.
- Determine whether any of the social members would otherwise qualify as members by their relationship to veterans who aren't members of the post.
- For auxiliaries who operate under the same EIN, include their members in the count for the veterans' organization.
- Divide the numbers in the categories above by the total membership to arrive at the membership percentage:
 - At least 75 percent of the organization's members must be present or former members of the USAF (veterans).
 - Of the remaining 25 percent, substantially all (90%) must be cadets who are students in a college or university ROTC program or at an Armed Services academy, or spouses, widows, widowers, ancestors, or lineal descendants of veterans or cadets.
 - No more than 2.5 percent of the total membership may consist of individuals who aren't veterans, cadets, spouses, widows, widowers, ancestors, or lineal descendants of veterans or cadets.

Example: Post A is chartered by a national organization, and adopted its governing instruments. Post A is exempt under the national organization's group ruling. Post A has 969 individuals participating in its bar and gaming activities. Of the 969, 730 are veterans, 25 are children of veterans, 6 are parents of veterans, and 17 are cadets. All of these members participate per the national and post governing instruments. The remaining 191 individuals are social nonmembers, who aren't defined in either the national or post's governing instruments, and pay for their own drinks and pull-tabs. The organization meets the membership test requirements: $730 \div 778 = 93.8\%$. The social nonmembers don't count against the membership totals. The social nonmembers are considered a member of the general public for IRC (19) purposes.

Example: Post A has a related Auxiliary B, also chartered by the same national organization. Due to a decline in membership, Post A merges Auxiliary B into the post. Auxiliary B ceases to have a separate exemption. Post A now has 730 veterans, 205 spouses of veterans, 25 kids of veterans, 6 parents of veterans, and 17 cadets. The post no longer meets the membership test because $730 \div 983 = 74.2\%$.

Note: The lineal descendant connection must be within two degrees of relationship by descent from the same ancestor. So, you count children and grandchildren of veterans, as long as the veteran was not dishonorably discharged.

Interview the bartender(s) and wait staff.

- If the bylaws don't define social members, determine whether the social members are permitted to purchase food, beverages, merchandise, and/or non-bingo gaming tickets (pull-tab, raffle, lottery, etc.)
- Determine if guests are purchasing their own meals, drinks, or merchandise.
- Request an explanation of the recording system for purchases (cash box, cash register, journal, etc.).
- Determine whether there is a sign in book for members bringing guests and/or visiting members from other posts under a group ruling.
- Obtain copies of tip journals, if maintained. If not, ask about the amount of daily tips received. See IRM 4.23.7, Employment Tax on Tip Income.
- Ask about the procedures and paperwork for renting the hall.
- Get an explanation of the processes for pull-tab, raffle, and/or lottery ticket sales.
- Identify all of the wait staff and bartenders.
- Determine whether the staff (or other paid employees) provides catering services during hall rentals.

Review the organization's journals and ledgers.

- Prepare a spreadsheet tracking payments the organization made for services provided, listing the payee, dates, amounts, and check number.
- Compile totals for each payee.
- Match the payees who received \$600 or more against amounts reported on Forms 1099-MISC.
- Review the ledger for bonuses or other fringe benefits provided to the employees of the organization.
- Determine whether the fringe benefits paid out are reported with the other compensation on Forms W-2.
- Identify and record the gross receipts from the bar and gaming activities.
- Calculate the amount of direct expenses attributable to the bar and gaming activities.
- Record all instances of hall rentals, along with the names of renters, the amounts received for rent, and the dates of the rentals.
- Look for indications of private benefit or inurement.

Review the bank and/or brokerage statements. These may include scanned images of bank checks, or the actual checks if returned by the bank.

- Determine the amount of funds transferred from the gaming account to the general, bar, post, or other accounts.
- If there are no transfers from the gaming account, identify all expenditures made from the gaming account for purposes under IRC Section 501(c)(19).
- Track any electronic transfers from the accounts, and verify whether they were transfers between accounts, or to an external account.
- Request additional information on transfers identified as made to external accounts.
- For IRC Section 501(c)(7) veterans' organizations, identify the total amount of investment

income.

- Determine whether any withdrawals were made in cash, or checks written to cash.
- Obtain further information as to the disposition of any cash withdrawn from the accounts.
- Look for indications of private benefit or inurement.

Request and review the records of the hall rentals.

- Determine whether the renters were members.
- Identify the frequency of hall rentals, to determine whether the organization is regularly carrying on the activity.
- Review the hall rental agreements to identify all services such as catering or the rental of personal property included in the agreement.

Analyze the newsletters (both print and online) to check for advertising income and mention of other potential UBI generating activities.

Review contracts and agreements for indications of benefits to officers or other individuals.

Example: Rental of personal or real property to the organization at greater than fair market value.

Review and analyze the balance sheet. Look for receivables from officers, or unusual increases in assets or liabilities.

Concluding the Audit

Make determinations based on the material and information you gathered during the pre-audit and field audit phases Consider:

- Revocation of exempt status.
- Unrelated business income tax.
- Employment taxes.
- Withholding taxes.
- Gaming taxes.

Note: Even if an organization loses exemption, the entity is still subject to employment, withholding, and/or gaming taxes.

Revocation of Exempt Status

Factors that cause revocation of the exemption of a veterans' organization include:

- Failing the membership test under IRC Section 501(c)(19)
- Not operating exclusively for any of the enumerated exempt purposes (IRC Section 501(c)(19))
- Operating a bar as a substantial activity (IRC Section 501(c)(4))
- Exceeding the nonmember and/or investment income limits of IRC Section 501(c)(7)
- Failing to provide any insurance benefits under IRC Section 501(c)(8)
- Having members with no fraternal connection (social members) (IRC Section 501(c)(8) and IRC Section 501(c)(10))
- Active conduct of unrelated trade or businesses (IRC Section 501(c)(2))
- Organized after 1880 (IRC Section 501(c)(23))

Inurement also prevents exemption under IRC Section 501(c)(4), IRC Section 501(c)(7), and IRC Section 501(c)(19).

Agreed Revocation Procedures

For an agreed revocation of tax-exempt status:

- Fully discuss the issue with the taxpayer to verify that they will agree.
- Issue a report using Letter 3618, Forms 886-A, 4621-A, and 6018. Give the taxpayer 30 days to respond.
- Prepare Form 2363-A for revocation of exempt status.
- Solicit Form 1120 (or 1041). See IRM 4.75.31, Conversion of Returns Upon Revocation of Exemption, for complete instructions.
Close the case to Mandatory Review, through your manager on Reporting Compliance Case Management System (RCCMS).

Unagreed Revocation Procedures

- If not otherwise excluded from Fast Track Settlement, issue a report of preliminary findings (draft RAR), with a drafted cover letter, Forms 886-A, 6018- A, and 14017. Issue with Publication 4539. Allow 30 days for a response.
- For cases not entered into the Fast Track Settlement process, issue the final report using Letter 3618, Forms 886-A, 4621-A, and 6018. Give the taxpayer 30 days to respond.
- Prepare Form 2363-A for changing the filing requirement to Form 1120 (or Form 1041) and revocation.
- For certain unagreed revocations, prepare income tax return case file on Non- Master File (NMF) See IRM 4.75.31, Conversion of Returns Upon Revocation of Exemption, for complete instructions
- Close the case to Mandatory Review, through your manager on RCCMS.

Unrelated Business Income Tax (UBIT)

For cases involving unrelated business income:

- If not already open on RCCMS, obtain your manager's permission to open the Form 990-T for each year under audit on RCCMS. Use push code 036 to open unfiled Forms 990-T on RCCMS.
- Verify any amounts reported on Form 990-T, if filed, for accuracy.
- Identify all sources of UBI (nonmember bar sales, nonmember gambling, advertising, etc.)
- Determine the amount of direct expenses to apply to the UBI.
- If amounts from the gaming accounts have been expended to subsidize the organization's other activities, calculate the lawful purpose expense deduction to apply against the taxable gaming revenue.
- Using the square footage of the facility, the days of operation, or other methods of allocation of fixed expenses, calculate the depreciation, insurance, and utilities to deduct.
- Deduct the specific deduction (not to exceed \$1,000), if not already claimed on the Form 990-T. The specific deduction applies when the business doesn't have a net operating loss.
- Input the adjustments into Report Generation Software (RGS) to calculate the tax and generate a Form 4549 with attachments.

For an agreed adjustment to the Form 990-T:

- Discuss the adjustment fully with the taxpayer to determine whether they will agree to the adjustment.
- Prepare an audit report, issued via Letter 3621, Forms 886-A, and 4549.
- Collect payment at the time of agreement. If taxpayer indicates an inability to pay the tax due at closing, discuss alternative payment methods. Offer an installment agreement if the

taxpayer meets the requirements. Use Form 9465, Installment Agreement Request, to solicit a payment agreement. See IRM 4.10.7.5.8, Payment Expectations.

- Process any received payments using Form 3244-A. Send the payment with the voucher to the appropriate Service Campus within 24 hours of receipt.
- When closing agreed cases, prepare Letter 3607, with a copies of the audit report (including Form 886-A) and the signed Form 4549. Close the case to the EO Closing Unit, through your manager on RCCMS.

For an unagreed adjustment to the Form 990-T:

- If not otherwise excluded from Fast Track Settlement, issue a report of preliminary findings (draft RAR), with a drafted cover letter, Forms 886-A, 4549, and 14017. Issue with Publication 4539. Allow 30 days for a response.
- For cases not entered into the Fast Track Settlement process, issue the final report using Letter 3621, Forms 886-A, 4549-A and Form 870. Allow the taxpayer 30 days to respond.
- Close unagreed cases to Mandatory Review at the end of the 30 days.

Employment Tax Cases

Follow these specific IRM procedures:

- Worker classification: IRM 4.23.5, Technical Guidelines for Employment Tax Issues, IRM 4.23.6, Classification Settlement Program (CSP) and IRM 4.23.8, Determining Employment Tax Liability
- Tip reporting: IRM 4.23.7, Employment Tax on Tip Income
- Taxable fringe benefits not included on Forms W-2: IRM 4.23.5.15, Fringe Benefits

Withholding Tax Cases

For withholding tax issues, such as non-filed Forms W-2 G, identify all payouts giving rise to a Form W-2 G filing requirement.

- Request the organization to obtain the winners' taxpayer identification numbers. They may use Form W-9 for this.
- Obtain delinquent filed Forms W-2 G from the organization.
- Prepare Forms 4668, 4666, and 2504 to assess backup withholding on the organization for any Forms W-2 G they don't obtain.
- Prepare Forms 4668, 4666, and 2504 to assess withholding for any amounts not regularly withheld when prizes for pull-tabs or other lottery style games equal or exceed \$5,000.
- If you prepared reports for any of the above adjustments, obtain your manager's permission to open Form 945 on RCCMS. Establish unfiled Forms 945 with push code 036, and MFT 16.
- Discuss with the taxpayer whether they will agree to the withholding taxes.

For agreed withholding tax cases:

- Issue an audit report using Letter 3596, with Forms 886-A, 2504, 4666, and 4668.
- Collect payment at the time of agreement. If taxpayer indicates an inability to pay the tax due at closing, discuss alternative payment methods. Offer an installment agreement if the taxpayer meets the requirements. Use Form 9465, Installment Agreement Request, to solicit a payment agreement. See IRM 4.10.7.5.6.
- Process any received payments using Form 3244-A. Send the payment with the voucher to the FAST within 24 hours of receipt.
- Prepare Letter 3607, with copies of Forms 886-A, 4666, 4668, and the signed Form 2504.

The case will be closed to ESS, via management on RCCMS.

For unagreed withholding tax cases:

- If not otherwise excluded from Fast Track Settlement, issue a report of preliminary findings (draft RAR), with a drafted cover letter, Forms 886-A, 2504, 4666, 4668, and 14017. Issue with Publication 4539. Allow 30 days for a response.
- For cases not entered into the Fast Track Settlement process, issue the final report using Letter 3596, Forms 886-A, 2504, 4666, and 4668.
- Allow the taxpayer 30 days to respond.
- Close unagreed cases to Mandatory Review at the end of the 30 days. For short statute cases, follow statutory notice procedures.

Cases with Gaming Excise Tax Issues

Gaming excise tax issues involve the sale of pull-tabs, instant bingo, raffles, lottery tickets and other non-bingo wagers to nonmembers (or social members if not defined in the bylaws). For gaming excise taxes:

- Verify whether Forms 730 were filed by the organization.
- Verify whether Forms 11-C were filed by the organization and all liable agents (employees who sold the taxable pull-tabs or other wagers).
- For filed Forms 730, verify that the taxable gross receipts matches the total gross receipts collected from all non-bingo gaming open to the public. These amounts will already have been reported to the state on monthly or quarterly reports.
- Have the agents (employees) who are liable for Forms 11-C obtain EINs via the online Form SS-4.
- For delinquent Forms 730 or 11-C, or underreported taxes, get your manager's permission to open the modules on RCCMS. Forms 730 are monthly returns, while Forms 11-C have an annual tax period ending in July for master file purposes.
- Prepare an audit report using Forms 886-A and 5384, and Form 2769 to compute deposit penalties, if applicable. See instructions to complete Form 5384 are below.
- Discuss with the taxpayer(s) whether they will agree to the gaming excise taxes.

For agreed gaming excise taxes (Forms 730 and/or 11-C):

- Issue the audit report using a drafted letter modeled on Letter 950-E, sent certified mail, with the prepared Forms 886-A and 5384. Include Form 2769 if you're assessing penalties for failure to deposit.
- Collect payment at the time of agreement. If taxpayer indicates an inability to pay the tax due at closing, discuss alternative payment methods. Offer an installment agreement if the taxpayer meets the requirements. Use Form 9465, Installment Agreement Request, to solicit a payment agreement.
- Process any received payments using Form 3244-A. Send the payment with the voucher to the Cincinnati Service Campus within 24 hours of receipt.
- Prepare Letter 3607 with copies of the Form 886-A and the signed Form 5384. Close the case to ESS, through your manager on RCCMS.

For unagreed gaming excise taxes (Form 730 and/or 11-C):

- If not otherwise excluded from Fast Track Settlement, issue a report of preliminary findings (draft RAR), with a drafted cover letter, Forms 886-A, 2504, 5385, and 14017. Issue with

Publication 4539. Include Form 2769 if you're assessing penalties for failure to deposit. Allow 30 days for a response.

- For cases not entered into the Fast Track Settlement process, issue the final report using the drafted cover letter modeled on Letter 950-E, Forms 886-A, 2504, and 5385. Include Form 2769 if you're assessing penalties for failure to deposit. Allow the taxpayer 30 days to respond.
- Close unagreed cases to Mandatory Review at the end of the 30 days. For short statute cases, follow statutory notice procedures.

If you close the case as a no change, prepare Letter 3594 and close. Follow the procedures in IRM 4.75.16, Case Closing Procedures.

Instructions for Completing Form 5384, Excise Tax Examination Changes and Consent to Assessment & Collection

Complete Forms 5384 and 5385 as follows:

Field Title:	What To Enter:
Name and address:	Show current address
Social Security or EIN:	Use the organization's EIN or agent's EIN
Form Number (5385):	Form 730 or Form 11-C (Only applicable to 5385)
Person with whom examination changes were discussed:	Self-explanatory
Period Ended:	Input tax period in MM/DD/YYYY format.
IRS No. (5384) / IRS No. or CRN (5385)	Form 730: 198, Form 11-C: 197
Kind of Tax:	WAG
Correct Liability (5384) / Corrected Tax Liability per Exam (5385):	Total amount of tax per tax period determined
Previous Assessment (5384) / Tax per Return or Previous Assessment (5385):	Amounts as reported, if any
Tax (5384) / Tax Due or (Refund) (5385)	Difference between exam and reported
Penalties:	Input any penalties computed for the
Total (5384) / Total Tax & Penalties Due or (Refund) (5385):	Add the tax due to the penalties
Other Information:	See below
Examiner's Signature:	Self-explanatory
District (5384)/ SB/SE Excise Territory (5385):	Replace with TE/GE EO Exam Area using Adobe Touch Up Text tool
Grp (5385):	Input group number

Include statements in the report's "Other Information" section as needed. If you need additional space, use Forms 886-A and add "See Forms 886-A attached." Use the examples below as statements to clarify the audit results:

- For Form 5384, identify the type of form (730 or 11-C)

- Statement on corrected or revised reports such as “This report supersedes report dated.”
- References to attachments
- Statements regarding the disposition of claims
- Statement on applying any penalties or additions to tax (or reference to attachments). Include the IRC section, title of the penalty, and the dollar amount.
- Statement on applying IRC 6404(g) (suspension of interest provisions) and the date on which the notice was given. See IRM 4.10.8.15.12, Notice Under IRC Section 6404(g) – Suspension of Interest.

List only taxes reported on the same type of return on Form 5384. For example, if you audit a Form 730 and a Form 11-C for the same taxpayer, you must complete two Forms 5384 and two forms 5385.