Deductibility of Gambling Fund Transfers

Unrelated Business Income Tax Fact Sheet 2

This information will help exempt 501(c)3 and 501(c)4 festival organizations determine when a transfer of gambling funds is deductible on their Unrelated Business Income Tax (UBIT) return.

When can I deduct contributions and expenditures?

Exempt 501(c)3 and 501(c)4 festival organizations that are licensed to conduct lawful gambling are allowed to spend profits from gambling proceeds on lawful purpose expenditures (donations). These organizations are able to donate to themselves. These donations—in the form of transfers—from the gambling account to the general account are deductible as business expenses on the UBIT return under Internal Revenue Code, section 162. However, the organization is only allowed to deduct the amount of the transfers that were spent by the end of its fiscal year (using the cash basis of accounting) or incurred within its fiscal year (using the accrual basis of accounting). The mere transfer of funds from the gambling account to the general account is not deductible until the organization spends the funds to further its exempt purpose.

Transfer Examples

Example 1

Organization A (cash basis) transferred $10,000 from its gambling account to its general account at the beginning of its fiscal year. This organization has until the end of its fiscal year to spend $10,000 on general fund expenses. If the entirety of the $10,000 that was transferred at the beginning of the year is spent by the end of the year, the organization can claim the full $10,000 transfer amount on the UBIT return.

Organization B (cash basis) transferred $10,000 from its gambling account to its general account in the last week of its fiscal year. Like Organization A, they have until the end of its fiscal year to spend $10,000 on general fund expenses. If this organization does not spend all of the $10,000 transfer within the final week of its fiscal year, the organization cannot claim the full $10,000 transfer amount on the UBIT return. In this instance, the organization can only claim the portion of the $10,000 transfer that was spent after the transfer was made and before the fiscal year end.

Example 2

Organization C is saving to purchase an asset. The organization transfers $50,000 in year one from its gambling account to its general account. They do not spend the $50,000 in year one. The organization cannot claim this transfer as an expense on the UBIT return. The organization can continue to save money for the asset but must not include the unspent transfers as business expenses on the UBIT return.

In year two, the organization transfers $40,000 from its gambling account to its general account at the beginning of its fiscal year. The organization purchases an asset for $90,000 before year two's fiscal year end. In year two, the organization can claim the entirety of the $40,000 transfer.

The transfer from year one is not eligible as a business expense on the UBIT return because the transfer was not made in year two. For transfer expenses to be deductible on the UBIT return, both the transfer and expense must occur during the fiscal year (cash basis). For accrual basis organizations, the transfer must be made and the expense must be incurred during the fiscal year.

Example 3

Organization D (accrual basis) transfers $70,000 from its gambling account to its general account to prepay for an expense by its June fiscal year end. However, the expense was incurred in October, November, and December following its fiscal year end. The $70,000 is not deductible as an expense because the expense was not incurred by its fiscal year end.

Questions?

If you need more information, call 651-297-5199 or go to www.revenue.state.mn.us and enter **UBIT** in the Search box.

Legal References

Minnesota Statutes, section 290.05, Exempt Individuals, Organizations, Estates, Trusts

Minnesota Statutes, section 290.06, Rates of Tax; Credit

South End Italian Independent Club, Inc. v. Commissioner, 87
T. C. 168 (1986). The court held that claimed items of deduction must qualify for deduction as business expenses under IRC Section 162 rather than as charitable contributions under section 170.

Women of the Motion Picture Industry, et al. v. Commissioner
T. C. Memo 1997-518. The court held that the transfer of funds from an exempt organization's segregated bingo (lawful gambling) account to its general account is not an ordinary and necessary business expense under IRC Section 162 until the funds are disbursed by the organization for a charitable purpose.

Unrelated Business Income Tax
Phone: 651-297-5199 Fax 651-297-5192
Mail Station 1257, 600 N. Robert St.
St. Paul, MN 55146-1257
Email: ubi.taxes@state.mn.us