UNRELATED BUSINESS INCOME
INTERNAL REVENUE SERVICE (IRS) DEFINITION OF UNRELATED BUSINESS INCOME (UBI)

“The term ‘unrelated trade or business’ means any trade or business the conduct of which is not substantially related to the exercise or performance of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.”

GENERAL RULES
Sales of goods or services to members are automatically tax-exempt and are not unrelated business income (UBI). Sales of goods or services to non-members will be presumed by the IRS to be taxable UBI, although there are several exceptions that, if met, will make those sales tax-exempt. The IRS begins with the position that if a member pays the bill it will ordinarily be considered income from members. Payment for goods or services for a guest must come from a member, and not from the non-member guest or else the income will be UBI. The tax exemption does not apply to sales to the general public. The IRS says, “Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business...” The IRS treats a member’s spouse as a member. Some IRS examiners have questioned whether sales to members from other lodges are UBI. The Grand Lodge disagrees, but suggests that Visiting Members not sign the Guest Book because they are Members not Guests. It is suggested that a separate book for Visiting Elks be used. Subject to state and local laws, the use of the Home or Club facilities shall be limited to Members in good standing in the Order, their spouses and guests of Members, and those receiving Identification Cards under Section 14.140, as provided in the House Rules, so as to preserve the privacy of the use of such facilities to the Members of the Order. Local Lodges shall take appropriate action to conform to the provisions of this Section.

TAX EXEMPT SALES TO GENERAL PUBLIC
BINGO
Charitable, nonprofit, or veterans organization means an organization which has qualified for exemption from federal income tax as an exempt organization under provisions of § 501(c) of the Internal Revenue Code of 1954 or § 528 of the Internal Revenue Code of 1986, as amended; which is engaged in charitable, civic, community, benevolent, religious, or scholastic works, or Similar Activities or Similar

1 Grand Lodge Auditing and Accounting Committee Manual and Report Form Revisions, February 2016, Chapter 10-103, p. 22.
2 Ibid. p. 23.
3 Elks USA Annotated Statutes 2018, XIV, Sec. 14.130.
Endeavors and which has been in existence and active for a period of 3 years or more. Bingo games and instant bingo (pull-tab) proceeds less actual business expenses essential to the operation, conduct, and playing of the games must be donated in accordance with the Activities of or Endeavors described above. In no case may the net proceeds be used for any other purpose whatsoever. The proceeds derived from the conduct of bingo or instant bingo shall not be considered solicitation of public donations.

A lodge can provide bingo games to the public without generating UBI provided IRS requirements are followed. This exemption applies only if the game is legal under state and local law and not in direct commercial competition with a similar game conducted by for-profit organizations. It does not matter if bingo customers are non-members, but it may matter if paid personnel conduct the bingo. The bingo exception does not automatically apply to instant bingo, pull-tabs, or raffles.\(^4\)\(^5\)

**IRS Section 501(c)(8) – Fraternal Organizations**

The exempt function of organizations classified under these sections includes providing social and recreational activities for members and their bona fide guests. Thus, fraternal organizations may engage in gaming involving only members without jeopardizing their exempt status.

Gaming open to the public does not further the exempt purposes of fraternal organizations. Section 501(c)(8) organizations whose primary activity is public gaming jeopardize their exempt status and the gaming income may also be subject to the tax on unrelated business income.\(^6\)

Section 501(c)(7) social clubs endanger their exempt status when receipts from nonmembers – including those from gaming activities – exceed certain thresholds. A social club may receive no more than 35 percent of its gross annual receipts (including investment income) from sources outside of its membership. Within that 35 percent, no more than 15 percent of gross receipts can come from the public’s use of club facilities or services. If those limits are exceeded, the club’s exempt status may be in jeopardy.\(^7\)

**VOLUNTEER WORKER EXCEPTION**

Goods and services provided by volunteer workers will not be UBI, even if customers include non-members. This exception applies when substantially all the work is performed without compensation. According to the IRS, the substantially all test is met when 85% of the work is performed by unpaid volunteers. The volunteer worker exception can apply to


\(^7\) Ibid. IRS Tax Exempt Organizations and Gaming. Although Elks Lodges are not Section 501(c)(7) social clubs, this information is provided as guidance.
any Lodge fund-raising activity open to the public, including, for example, instant bingo, pull-tabs, raffles, etc.\(^8\)

**RENTS FROM LODGE REAL PROPERTY**
Rents of Lodge real property only, without providing other services, can be tax-exempt, in whole or part, even if a non-member makes payment for the occupancy. The rental can include incidental personal property, such as chairs, tables, etc. and can include services necessary for use of the property, such as setting up the room, cleanup, etc. The rental exception does not apply where the rental encompasses *both occupancy and other services*, such as food and beverage as part of the rental package, and the IRS will likely take the position that none of the income comes under the rental exception. However, the IRS has said the catering may be analyzed separately from the rental space if there is a separate charge paid in accordance with a separate agreement between the parties. In that case, the rental income would not be UBI, but income from catering would be taxable as unrelated business income, unless the volunteer workers exemption applied. There is a provision related to debt-financed property.\(^9\) Typical examples of such income are rental of debt-financed property (property subject to a mortgage), and regularly operating a commercial parking lot. Although catering events that are open to other than Elks and guests has previously involved unrelated business income for many Lodges, compliance with the provisions of Section 14.130 of the Statutes will eliminate most of this. It is a very dangerous practice to list 100% of Club Revenue as Unrelated Business Income. This indicates that your doors are open to the Public.\(^10\)

**RECOMMENDATIONS FOR RECORDING LODGE REVENUES**
If a member sponsors a private function and that member directly makes full payment for rental, food, and beverages, then the income from that function should be recorded as member income. However, when payments are received from non-members, that income should be recorded as non-member income. If one of the exceptions is applicable, the income can be recorded as non-taxable per that exception. If the income is generated from service with a non-member and none of the exceptions apply, the income should be recorded as taxable UBI, subject to filing IRS form 990-T and paying the income tax.\(^11\)

Absent a separation and accounting for non-member income, an IRS examiner may classify all Lodge income as UBI—essentially endangering the tax-exempt status of the Lodge. It is the responsibility of the exempt organization to demonstrate that a non-member is a *bona fide guest* so that the income is not taxable. The Lodge must maintain adequate books and records to identify members and their *bona fide* guests and distinguish them from non-members.\(^12\)

**MEMBERSHIP DRIVES**

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\(^12\) Ibid. Grand Lodge Auditing and Accounting Committee Manual, p. 25.
UNRELATED BUSINESS INCOME

Income derived from events held specifically to encourage new members will not create UBI tax liability, under certain conditions. Using regular lodge events, such as Friday Night Fish Fry or Saturday Night Steak Dinner, could result in UBI liability. A member must be present to engage the public with information about Elks, record names and contact information of the attendees, and distribute applications. It is suggested that a volunteer sheet be signed to show the member/s doing that job. Copies of any applications generated from that dinner/event should be maintained in a folder and any members initiated as a result of that event should be tracked. Additionally, any open house with a special liquor license can be a membership drive event. There must be some advance advertising that states membership drive. What the IRS is looking for is whether regular Elks dinners and events are used as membership drives to attempt to avoid UBI. The IRS will require documentation that the special event was advertised as a membership drive; that membership applications were distributed; and that new members were initiated as a result of the event. Do not confuse UBI with liquor laws. Non-members cannot be served liquor unless they are bona fide guests signed in by a member who is also responsible for payment.13

BYLAWS

Bylaw changes must be reported on the 990 Tax Return.14

IMPLICATIONS FOR LODGES – ADVICE TO CONSIDER

1. Never run a tab in the name of a non-member.
2. Only accept credit and debit cards from members and visiting members.
3. Ensure that all non-members are signed in as bona fide guests of members. On slow nights, the bartenders may be able to control the sign-in process. On busy nights and Lodge events, consider assigning a volunteer who would be responsible for signing in guests and quickly explaining the rules members with guests must follow.
4. Ensure that payments are received only from members. If members want to run tabs for their guests list them under the member’s name: Smith, Smith Guest 1, Smith Guest 2, etc. The Guest tabs can be cleared either with the member’s credit/debit card or cash, but never with a guest’s card. This procedure should also apply to services accompanying hall rentals.
5. Hall rentals and food and beverage services should be provided under separate contracts in order to implement possible Rental and/or 85% Volunteer Worker UBI Exceptions.
6. Insurance, to include liquor liability, must be provided by renters of facilities—both members and non-members.
7. Monitor percentage of income sources derived from outside Lodge membership.
8. All Lodges should File a 990-T Tax Return even if there is no Unrelated Business Income because the IRS can generally audit back only three years from the date a tax return was filed. In the absence of filing a 990-T, there is no limit to their reach back

13 December 7, 2018 Kate Kelley e-mail reporting what one IRS examiner stated.
14 990 Tax Return Page 6, part VI, item 4 asks about changes. Recommend disclosure on Schedule O.
authority. Also, should a lodge be audited and found to have failed to file a required 990-T there could be penalties for failing to file.

9. Bingo must operate in accordance with state law.

10. Profits from Bingo and Instant Bingo (pull tabs) must be deposited in the Restricted Charity Account to be used for the Activities of or Endeavors of the Lodge.

11. Profits from Queen of Hearts may be deposited in the General Account.

12. The safest position to take is that lodges would limit participation in 50/50, Super Bowl, basket raffles etc. to members, although strictly documenting the 85% volunteer exemption could permit wider participation.

13. Open to the public Membership Drives should normally be distinct from recurring social events sponsored for members and bona fide guests.

14. Use of the term “recommended donation” not sale, price, cost, or similar words should appear on raffle flyers and they should never be advertised to the general public.

15. Consider providing a separate sign-in book for visiting members.


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Date: 3/30/19 8:28 PM

\(^5\) Presenters are not attorneys or certified public accountants. Consult legal counsel or CPA prior to incorporating details presented herein into lodge practices or procedures.