Smith-Dodd Businessman's Association, Inc. v. Commissioner, 65 T. C. 620 (1975)

Income from regularly conducted bingo games by an exempt organization is subject to unrelated business income tax if not substantially related to the organization's exempt purposes.

Summary

In Smith-Dodd Businessman's Association, Inc. v. Commissioner, the U. S. Tax Court ruled that income from weekly bingo games operated by a tax-exempt civic organization was subject to unrelated business income tax under Sections 511-513 of the Internal Revenue Code. The Association argued that the games were not a trade or business and that workers were uncompensated volunteers, but the Court found the bingo operations to be a regularly conducted business with paid workers, thus not falling within any statutory exemptions. The decision clarifies the scope of the unrelated business income tax and its application to fundraising activities of exempt organizations.

Facts

Smith-Dodd Businessman's Association, Inc. , a civic organization exempt under IRC Section 501(c)(4), operated profitable bingo games open to the public each Thursday evening from 1971 to 1973. The games were held at a rented Veterans of Foreign Wars hall in St. Paul, Minnesota, and managed by 7-10 paid workers. The Association reported no taxable income from these games, relying on its exempt status. The Commissioner of Internal Revenue determined deficiencies in the Association's federal income tax for those years, asserting the bingo income was taxable as unrelated business income.

Procedural History

The Commissioner issued a notice of deficiency for the taxable years ending January 31, 1971, 1972, and 1973, asserting that the bingo income constituted unrelated business income. The Association petitioned the U. S. Tax Court to contest the deficiencies. The Tax Court upheld the Commissioner's determination, ruling that the bingo operations were subject to unrelated business income tax.

Issue(s)

1. Whether the operation of weekly bingo games by an organization exempt under IRC Section 501(c)(4) constitutes an "unrelated trade or business" under IRC Section 513.
2. Whether income from such a trade or business is subject to tax under IRC Section 511.

Holding

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1. Yes, because the bingo games were regularly conducted for the production of income and were not substantially related to the organization’s exempt purposes.
2. Yes, because income from an unrelated trade or business is subject to tax under IRC Section 511.

Court’s Reasoning

The Court applied the three-part test from Section 1. 513-1(a) of the Income Tax Regulations to determine if the bingo operations were an unrelated trade or business: (1) the activity was a trade or business, (2) it was regularly carried on, and (3) it was not substantially related to the organization’s exempt purposes. The Court rejected the Association’s argument that state law classification of bingo as a game negated its status as a trade or business under federal tax law, citing Section 1. 513-1(b) of the Regulations. The Court also found that the bingo workers were compensated, thus not falling within the volunteer work exception of Section 513(a)(1). The Court emphasized that the unrelated business income tax applies to income-generating activities of exempt organizations not substantially related to their exempt purposes, regardless of the absence of unfair competition.

Practical Implications

This decision impacts how tax-exempt organizations should analyze and report income from fundraising activities like bingo games. Organizations must ensure that such activities are either substantially related to their exempt purposes or fall within statutory exceptions to avoid unrelated business income tax. The ruling may lead to increased scrutiny of fundraising methods by exempt organizations, particularly those involving regular, income-generating activities. Subsequent cases have cited Smith-Dodd in determining the taxability of income from similar activities, reinforcing the principle that the unrelated business income tax applies broadly to exempt organizations’ income-generating endeavors.

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