INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

October 09, 2019

Third Party Communication: None
Date of Communication: Not Applicable

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Index (UIL) No.: 513.05-00, 512.01-00
CASE-MIS No.: TAM-100554-19

Director, Exempt Organizations Examinations

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Adverse Conference:

LEGEND:

Taxpayer =
City =
State =

ISSUE(S):

1) Does the game of standard flash, as described below, qualify as a bingo game within the meaning of Section 513(f) of the Internal Revenue Code (the Code) in whole or in part?

2) May the game of standard flash be divided or bifurcated so that a part of the game may be classified as bingo within the meaning of 513(f) of the Code?

CONCLUSION(S):

1) The game of standard flash, as described below, does not qualify as a bingo game within the meaning of section 513(f) of the Code.

2) The game of standard flash may not be divided or bifurcated so that a part of the game may be classified as bingo within the meaning of section 513(f) of the Code.

FACTS:

Taxpayer is an organization described in section 501(c)(3) of the Code with public charity classification as described in section 509(a)(2). Taxpayer was incorporated as a State nonprofit public benefit corporation in and was recognized as a tax-exempt organization by the Internal Revenue Service (IRS) in .

In and , Taxpayer engaged in two activities:
1) Conducting two sessions per day at a gaming hall operated by Taxpayer in which certain games of chance were played for fundraising purposes and constituted Taxpayer's sole source of income, and
2) Making grants to nonprofit entities in City.

Taxpayer's games of chance included a bingo game played on a paper or electronic 5x5 grid ("traditional bingo"), the game of "lightning flash" and the game of "standard flash." In the audit years, only a small amount of net income remained after overhead and expenses associated with making grants were considered.

In addition to traditional bingo, two additional games of chance are played: “lightning flash”[1] and “standard flash”. At issue in this memorandum is only the tax treatment of standard flash.

Description of Standard Flash

A “flash” game consists of a box of cards (usually called a “deck or a “deal”). The number of flash cards included in a box typically ranges between 500 and 2,000 and may be separated into smaller decks or deals (hereinafter, “decks”). Each card is made of cardstock or thin cardboard. The size of each card varies from approximately the size of a business card to the size of two business cards placed end to end. Flash cards are sold for $ on the floor of the bingo hall during traditional bingo sessions. All cards in a deck must be sold and played in a single bingo session.[2]

Each standard flash deck contains individual cards. Each card in a standard flash deck has one or more tabs or flaps that must be lifted to reveal the face of the card. When a player at a bingo session buys a standard flash card, the player first opens the card and removes the tab or flap that conceals the face of the card to reveal whether they possess an “instant” winning card (as occurs on average approximately % of the time), an “instant” losing card (as occurs on average approximately % of the time) or a “hold” card (as occurs on average approximately % of the time).[3]

[1] “Lightning flash” is a game sold from a deck during bingo sessions which does not include any instant win cards.
[2] It is unclear whether during “one bingo session” refers to during the playing of one bingo game or, for example, during a 2 hour “bingo session” in which multiple bingo games are played.
[3] These percentages are calculated using manufacturer’s game description sheets, which were provided by Taxpayer.

If the player has an “instant” card, the player may immediately compare the numbers and/or symbols on the face of the card to the winning combinations of numbers and/or symbols preprinted on the back of the card to determine if they have won or lost.[4]

If the card is a “hold” card, the player waits until all the cards in a deck are sold[5] and the bingo caller announces that the numbers for a particular game of standard flash[6] will be called. Hold cards typically depict a grid printed with numbers and may include a “free” spot. The caller then calls numbers from balls randomly selected by a bingo blower or bingo machine. The standard flash players with hold cards mark or dab the corresponding numbers on their cards until the first players to mark or dab a series of numbers and call “bingo” win the game. A hold card may include one or more opportunities to win and each winner receives a pre-determined amount ranging from $ to $.

LAW AND ANALYSIS:

Section 501(a) of the Code provides, in part, for exemption from federal income tax for organizations described under section 501(c).

Section 501(c)(3) of the Code describes, in part, organizations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition … or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

[4] The manufacturer’s game description sheets provided by Taxpayer indicate that instant prize winners may collect from $ to $ for an instant winning card, depending on the deck.
[5] This memorandum addresses only standard flash games in which all cards in the deck are sold and played in a single bingo session.
[6] Standard flash cards from multiple decks can be for sale at a time, so that standard flash games are started throughout the session. Once all the cards from a particular game/deck, identified by name or image, are sold numbers for that particular game may be called.

Section 511(a)(1) of the Code provides for a tax to be imposed for each taxable year on the “unrelated business taxable income” (as defined in section 512) of most organizations described in section 501(c).

Section 512(a)(1) of the Code provides that the term “unrelated business taxable income” means the gross income derived by any organization from any “unrelated trade or business” (as defined in section 513) regularly carried on by it, less certain deductions and computed with the modifications provided in subsection 512(b).

Section 513(a) of the Code provides that the term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that the term “trade or business” includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Treas. Reg. Section 1.513-1(a) provides that the term "unrelated business taxable income" means the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less the deductions and subject to the modifications provided in section 512 of the Code. Therefore, unless one of the specific exceptions of sections 512 or 513 is applicable, gross income of an exempt organization subject to the tax imposed by section 511 is includible in the computation of unrelated business taxable income if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the organization's performance of its exempt functions.

Section 513(f)(1) of the Code provides that an unrelated trade or business does not include any trade or business which consists of conducting bingo games.

Section 513(f)(2) of the Code provides that, for purposes of section 513(f)(1), the term "bingo game" means any game of bingo—
(A) of a type in which usually—
(i) the wagers are placed,
(ii) the winners are determined, and
(iii) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game,
(B) the conducting of which is not an activity ordinarily carried out on a commercial basis, and
(C) the conducting of which does not violate any State or local law.

Treas. Reg. Section 1.513-5(a), in part, provides that under section 513(f), the term "unrelated trade or business" does not include any trade or business that consists of conducting bingo games (as defined in §1.513-5(d)).

Taxpayer and the IRS agree that the game of standard flash is an unrelated trade or business under section 513 subject to the tax imposed by section 511 unless the game is a bingo game described under section 513(f).

1) Does the game of standard flash, as described below, qualify as a bingo game within the meaning of section 513(f) of the Code, in whole or in part?

Treas. Reg. Section 1.513-5(d) defines a bingo game as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first

participant to form the preselected pattern wins the game. As used in this section, the term “bingo game” means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term “bingo game” does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

In Julius M. Israel Lodge of B’nai B’rith No. 2113 v. Comm’r, 98 F.3d 190 (5th Cir. 1996), the Fifth Circuit upheld the Tax Court’s conclusion that the income derived from “Instant Bingo” did not qualify for the exception under Section 513(f) of the Code and, therefore, constituted unrelated business taxable income. Instant Bingo involved the selling of tickets which were preprinted with patterns and then covered with pull-tabs. Individuals purchased the tickets, pulled back the sealed tabs on the front of the card, and then compared the patterns under the tabs with the winning patterns printed on the back of the card. The circuit court held that:

> (T)he plain language of the code creates two predicates to determining whether any bingo game qualifies as the type of "bingo game" to which the paragraph (1) exclusion applies. First, a "bingo game" must qualify under the definition of "any game of bingo" (paragraph (2)). Only after we have determined that a "bingo game" is "any game of bingo" must we then look to the limiting factors upon such "game of bingo" outlined in subsection (2) (A) (i), (ii) and (iii).
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> Julius M. Israel at 192.

On that basis, the court held that Instant Bingo was not “any game of bingo.”

> In its ordinary, everyday sense, “any game of bingo” refers to a specific game of chance in which numbers corresponding to preprinted numbers on a card are called out by random selection, the participants place markers over the corresponding numbers on their cards, and the first person to form a preselected pattern on his card

> wins the game. *See, e.g.,* The American Heritage Dictionary 180 (2d College ed. 1985) (defining bingo as “a game of chance in which players place markers on a pattern of numbered squares according to numbers drawn and announced by a caller”); Webster's Seventh New Collegiate Dictionary (1963 ed.) (defining bingo as “a game like lotto played usually by many players all at once for prizes;” defining lotto as “a game of chance played with cards having numbered squares corresponding with numbered balls drawn at random and won by covering five such squares in a row”).
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> Julius M. Israel at 192.

Instant Bingo involved “only the player's purchase of a prepackaged card from a series of similarly situated cards, and winning cards are those in which the preprinted appearance of numbers on the front of the card—which appearance is determined by the player's removing pull-tabs from the card—matches the preprinted winning arrangements indicated on the reverse side of the card.” Julius M. Israel at 192-193.

Instant Bingo involved no random selection of numbers by a caller, nor did it require the player to participate in the game by covering the squares on his card that correspond to randomly drawn numbers. The court held that “an Instant Bingo player's participation in the game was wholly independent of any other's and required only that he remove a pull-tab to determine whether he has a winning card. A bingo game by any other name is not a bingo game. As the Commissioner contends, Instant Bingo is, for all practical purposes, a lottery. Thus, we find that Instant Bingo does not comport with even the preliminary requirement under § 513(f) that it be ‘any game of bingo.’” Julius M. Israel at 193.

The court held that Instant Bingo also failed “to meet the secondary requirement of subsection (A)(ii)—that the winners be determined in the presence of all persons placing wagers in such games…. the taxpayer's Instant Bingo fails to satisfy subsection (A)(ii) under any reasonable definition of the ‘in the presence’ phrase.”

The winners in the Instant Bingo games were "determined at the time the deck of cards is manufactured, and thus the winners are already predetermined outside the presence of any persons placing wagers in such game. … Although one must wait until the actual bingo session to determine which player will select and purchase which specific card, the cards already have been vested with independent significance... much as they are in any other instant-win lottery game under any other name." See Julius M. Israel, at 193.

The court stated that "[i]n contrast, in a traditional bingo game, the bingo cards that the player purchases are not predetermined as winners or losers, but rather are the conduit by which the winners may be determined in the presence of all others placing wagers in such game… See H.R. Rep. No. 1608, 95th Cong., 2d Sess. 4, reprinted in 1978 U.S.C.C.A.N. 3716, 3718." Julius M. Israel, at 193.

Although standard flash may include a prize that entitles the winner to further play of the hold cards, standard flash, similar to the game in Julius M. Israel, is a game of chance in which cards are purchased for a chance of uncovering a prize (either an instant cash prize or a hold card) by removing a tab. Instant cards are determined immediately by comparing the numbers and/or symbols on the face of the card to the winning combinations of numbers and/or symbols preprinted on the back of the card. Therefore, standard flash does not qualify as "any game of bingo" within the meaning of section 513(f) of the Code.[7]

Even if we assume arguendo, as assumed in regard to the game in Julius M. Israel, that standard flash satisfies the threshold definition of "any game of bingo" for purposes of section 513(f)(2) of the Code, standard flash fails to meet the secondary requirement of section 513(f)(2)(A)(ii), that the winners be determined in the presence of all persons placing wagers in such games. The face of every standard flash card sold is obscured

[7] We also note that hold cards from certain standard flash games, displaying only a single line of 3 to 4 numbers, as some of the manufacturers' game description sheets supplied by Taxpayer depict, do not "generally" resemble a 5x5 card on which a pattern may be formed as described in § 1.513-5(d).

by a tab or flap. The player does not know what type of card they will win when they purchase the card. When a player opens his or her card, the type of card is revealed to the player he or she has, whether the player has instantly won an instant cash prize (as occurs on average about % of the time) , won an opportunity for further play of hold cards (as occurs on average about % of the time), or has a card with no value, i.e., an instant loser (as occurs on average about % of the time).

Like the Instant Bingo cards in Julius M. Israel, instant winning cards in standard flash were determined at the time the deck of cards was manufactured, thus winners were already predetermined outside the presence of any persons placing wagers in such game, and, therefore standard flash fails to satisfy section 513(f)(2)(A)(ii).

Accordingly, the game of standard flash, as described above, is not “any game of bingo” within the meaning of section 513(f)(2) of the Code, fails to satisfy section 513(f)(2)(A)(ii) of the Code, and, therefore, does not qualify as a bingo game within the meaning of section 513(f) of the Code.

2) May the game of standard flash be divided or bifurcated so that a part of the game may be classified as bingo within the meaning of section 513(f) of the Code?

As discussed above, standard flash is not bingo as defined under section 513(f) and the regulations thereunder. Standard flash generates a single undivided income stream. Every receipt is attributable to the sale of a card, which represents an opportunity for an instant win, a hold card, or an instant lose, to be revealed by the player after purchase. None of the dollars received are demonstrably allocable to the instant aspect of the game versus allocable to the hold aspect of the game. All of the dollars are necessarily allocable to the full game.

There is no provision in section 511 through 513, related regulations, or in case law that addresses the Taxpayer’s claim that a single stream of income from a game of chance

must be bifurcated to exclude a portion of that income from unrelated business income. On the contrary, "[s]tatutory exclusions from income are matters of legislative grace and are narrowly construed. Consequently, taxpayers bear the burden of proving that they are entitled to any exclusion claimed." Bussen v. C.I.R., 108 T.C.M. (CCH) 267 (T.C. 2014) (citing Commissioner v. Schleier, 515 U.S. 323, 328 (1995) and Robertson v. Commissioner, T.C. Memo.1997–526 (citing Interstate Transit Lines v. Commissioner, 319 U.S. 590, 593 (1943)), aff'd, 190 F.3d 392 (5th Cir.1999)).

Income from standard flash comes from one stream of income—specifically, from the sale of a deck that makes up the game. Each sale or wager is a dollar received for a card that is part of the full game--both the removal of the tab or flap that reveals whether the card is an instant winner, instant loser or a hold card and the subsequent play of any hold card. There is no legal basis for bifurcating either the total game income or individual dollars between the opportunity to win a cash prize revealed as the player opens a tab on the one hand and the opportunity to play a hold card on the other hand. Accordingly, standard flash may not be divided or bifurcated so that any part of the game may be classified as bingo within the meaning of section 513(f).

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.