

Charity Raffles – Tread Carefully!

As the recession deepens, we get more and more creative ideas from people wanting to conduct complex raffles. In Arizona, some of the most popular questions involve [raffles of real estate](#). While raffles can be great revenue generators for charitable organizations, many charities do not realize that in most states, including Arizona, raffles are illegal gambling. [Cautionary tales](#) abound. Most states have specific exceptions for charitable raffles but require the charity and the raffle to meet specific criteria to qualify. For example, a raffle is not gambling in Arizona if:

- it is sponsored by a nonprofit that has been in existence for 5 years;
- no insider receives a direct or indirect pecuniary benefit other than participation on an equal basis with all other participants; and
- no person participates directly or indirectly in the management, sales or operation of the raffle other than the nonprofit's employees and agents.

Many jurisdictions require nonprofits to obtain a permit to conduct a raffle. Permits can take weeks or even months to process. In addition, there are number of tax issues that must be considered when planning a raffle. Tax issues include the following:

Deductibility of Ticket Price. A ticket purchaser has not made a deductible gift. The consideration paid is considered equal to the "chance" to win a prize therefore there is no disinterested gift and thus no contribution deduction.

Deductibility of Prizes Contributed. Those contributing prizes to the raffle may be entitled to a deduction depending upon whether the contribution is an interest in property (as opposed to a non-deductible service or right to use property). The charitable deduction for in-kind contributions that are raffled off in support of a charity are generally going to be limited to the taxpayer's basis in the property (rather than fair market value).

Nonprofit's Obligation to Report Prize Income. The prizes are taxable income to the winners so the nonprofit must ensure it properly reports the raffle prizes to the I.R.S. Generally, raffle prizes must be reported on Form W-2G with a copy to the winner if a) the amount paid (i.e. value of the prize), reduced by the amount the person paid for the chance to win a prize, is \$600 or more; and b) the payout is at least 300 times the amount of the wager.

Nonprofit's Obligation to Withhold from Prize Income. If the fair market value of winnings amount to more than \$5,000, the nonprofit must withhold taxes from the winnings and report this amount to the I.R.S. on Form W-2G. The nonprofit is liable for any tax it fails to correctly withhold.

Back-up Withholding. If the prize is reportable (the amount paid, reduced by the amount the person paid for the chance to win a prize, is \$600 or more; and b) the payout is at least 300 times the amount of the wager) and the winner fails to supply a taxpayer identification number, then the nonprofit must withhold 31% of the total proceeds.

Federal Laws. Federal law strictly limits nonprofits conducting multi-state raffles. If the nonprofit plans to use the U.S. mails for any part of the raffle – *e.g.* for mailing entry cards or raffle tickets – there are federal laws and regulations that bear consideration. Also, the FTC is empowered to regulate certain types of sweepstakes and contests.

Nonprofits sponsoring raffles should consider creating raffle rules and treating them as contracts. Drafting detailed rules permits the nonprofit to set defined limits on the giveaway – who may participate, what laws apply, warranty and liability disclaimers, etc. Raffle rules also provide a way for nonprofits to cancel or modify their obligations in the event that too few tickets are purchased or there are other technical problems. We have also advised nonprofits running raffles to have the raffle winner (or winners) sign an affidavit of eligibility and a release of liability. This is a good place to start to ensure the winner understands his or her tax reporting obligations and is eligible to accept the prize.

Constructing a legal and compliant raffle takes time and may require the advice of a professional. Nonprofits that take care to do it right will avoid embarrassing and costly legal mistakes and have a model that they can use to raise funds again and again.