



Memorandum - Gaming and Raffles

Regarding: Raffles and Other Gaming Activities

Date: August 11, 2010

Even though raffles and other gaming can be a way for not-for-profits to raise funds, it is important the organization have a good understanding of the process, the laws and regulations, and the internal controls required for these types of activities.

Internal Controls

Not-for-profit organizations sponsoring raffles or other gaming should adopt very specific rules and treat them as contracts. Drafting detailed rules permits the not-for-profit 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 not-for-profits to cancel or modify their obligations in the event that too few tickets are purchased or there are other technical problems.

It is suggested that not-for-profits running raffles have the raffle winner (or winners) sign an affidavit of eligibility and a release of liability. This is a good method to ensure the winner understands his or her tax reporting obligations and is eligible to accept the prize.

Gaming and raffles can be an internal control problem unless very specific controls are put in place to control tickets (numbering tickets; signing out and signing in books or groups of tickets; and reconciling cash sales to tickets sold), securing sold tickets until the raffle, having an independent certification of the raffle process and the drawing. You will need to maintain records of who purchased tickets and their contact information in case you need to end the raffle and return ticket sales. Involving a CPA or other independent professional in designing and monitoring the process is advisable.

Gaming/Raffles and the State of Arizona:

In most cases a not-for-profit is not required to register its raffle with the Arizona Attorney General's office if they meet the following exceptions:

- 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 non-profit's employees and agents.

You can call the Arizona Attorney General's office to confirm your raffle does not need to be registered



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Gaming and the IRS:

The IRS specifically states that gaming of any sort (including raffles) does not further the exempt purpose of most not-for-profit organizations, including most 501(c)(3) entities. Gaming of any sort is not a charitable activity. Individuals purchasing raffle tickets do not receive a charitable deduction on their tax return for the purchase. It is considered a recreational and business activity by the IRS. If a not-for-profit organization receives too much of their income from gaming activities they may fail the public support test and could be classified as a public foundation.

Gaming can be considered unrelated business income and be taxed to the organization. For an activity to be unrelated business income and taxable:

- The activity must be considered a trade or business - gaming meets this requirement.
- The activity must be regularly carried on - gaming may meet this requirement if it is conducted with a frequency and continuity similar to a non-exempt organization. If it is conducted only at an annual fundraiser, it would not be considered regularly carried on. If it occurs weekly or on an ongoing basis, it might be considered regularly carried on.
- The activity is not related to the organization's exempt purpose - this is true of most not-for-profit 501(c)(3) organizations by definition from the IRS.
- If the activity is substantially carried on by volunteers, it would be exempt from unrelated business income status.

To Report Winnings/Prizes

Not-for-profit's Obligation to Report Prize Income. Prizes are taxable income to the winners so the not-for-profit must ensure it properly reports the raffle prizes to the IRS. Generally, raffle prizes must be reported on Form W-2G with a copy given to the winner if:

- the amount paid, reduced by the amount the person paid for the chance to win a prize, is \$600 or more; and
- the payout or value of the prize is at least 300 times the amount of the wager.

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

Back-up Withholding. If the prize is reportable on a W-2G (see above requirements) and the winner fails to supply a taxpayer identification number, then the not-for-profit must withhold 31% of the total proceeds.



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Federal Laws. Federal law strictly limits non-profits from conducting multi-state raffles. If the not-for-profit 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.