

RAFFLES

Some branches use “Opportunity Drawings” and “Raffles” to raise money. It is often an easy way to get income. We want to inform you of important compliance requirements under California State law as well as under Federal income tax law.

California State Law

Most opportunity drawings are actually raffles which are regulated under CA State law (Penal Code Section 320.5 and related regulations). The State stipulates that you can hold an opportunity drawing (and not have to file with the State) if all of the following are true:

1. It involves a general and indiscriminate distribution of the tickets.
2. The tickets given away have the same winning opportunities as the tickets for which a donation is given.
3. The scheme does not require any of the participants to pay for a chance to win and that fact is clearly advertised.

Selling tickets and stating that you will give a ticket away for free “if asked” does not comply with these requirements and really is a raffle. Regardless, prizes awarded in an opportunity drawing are treated the same way as prizes won in a raffle in the eyes of the IRS (more on that later).

Ticket sales are not a charitable donation, as they represent the purchase of a chance to win, and are considered 100% quid pro quo. You must state on the tickets that “ticket price is not tax deductible”.

If participants are required to purchase a ticket in order to have a chance to win a prize, the drawing is subject to the provisions of Penal Code section 320.5 and related regulations as a raffle. According to State law, all raffles must be registered with State of CA at least 60 days before holding the raffle. In addition to filing a registration statement, a financial report must be filed annually with the State. The financial forms, informative FAQ’s and other information about conducting raffles in California can be found at the State’s website:

<http://oag.ca.gov/charities/raffles>.

All raffles must comply with the “90/10 rule” where 90% of the proceeds must go to charity and only 10% of the proceeds may be expended on winnings or raffle related expenses. This is very difficult to achieve, obviously, unless all, or nearly all, of the prizes are donated, in addition to getting the ticket sales proceeds. You may recall “50/50” raffles where you award 50% of the raffle proceeds as a prize to the winner? They are now illegal in California for a charitable entity to conduct under these new rules. They don’t comply with the 90/10 rule. So, if you plan to purchase prizes or award cash from the proceeds of the raffle ticket sales, it is very likely you cannot meet the 90/10 rule.

Federal Income Tax Regulations

The IRS defines raffles as a form of a lottery. As such, a raffle generally refers to a method for the distribution of prizes among persons who have paid for a chance to win such prizes, usually determined by the numbers, or symbols, on tickets drawn. Therefore, opportunity drawings also fall under this definition. The IRS has 1) filing requirements and 2) tax withholding requirements for raffle prizes.

Filing requirements

If you plan on raffling 1) items over \$600 in FMV or a cash prize over \$600 and 2) if the prize value is 300 times larger than the “wager” (the price for one raffle ticket), the Branch is responsible for reporting the winner of the prize, their social security number and the value of the prize to the IRS.

Example 1:

Jane Triton buys 1 raffle ticket for \$20. Her ticket wins the raffle and gets a prize worth \$1,000.

- Test 1: The prize is over \$600 in value
- Test 2: 300 times her wager of \$20 is \$6,000, less \$20 or \$5980.

Must we obtain her Tax ID information and report on her prize winnings to the IRS? NO, because the value of her prize was less than 300 times the value of her wager.

Example 2:

Joe Triton buys 20 raffles tickets at \$1 each for \$20. He wins the raffle and gets a prize worth \$1,000.

- Test 1: The prize is over \$600 in value
- Test 2: Note: we only look at one wager because only one ticket won. So 300 times his wager of \$1 is \$300

Must we report on his prize winnings? YES, because the value of his prize was more than \$600 and more than 300 times the value of his wager.

If we need to report the prize winnings to the IRS, we will need the winner of the prize to complete a tax identification form (form 5754) before they take possession of the prize. Any raffle or opportunity drawing brochures (distributed to patrons prior to a drawing) that describe the prizes and their values, must also have language stating that the winners of the raffle prizes may be subject to gambling winnings reporting and income tax withholding. We do not want our patrons to be surprised.

Tax withholding requirements

In addition to winnings reporting there is also a tax withholding requirement. Simply put, if the value of the prize is over \$5,000 (net of the value of one wager), we must withhold or collect taxes from the winner before they take possession of their prize, whether the prize was cash or non-cash. As you can see, this criterion “supersedes” the filing requirements test number “2” if the value of the item is over \$5,000.

Cash prizes

If the prize is cash, a withholding tax of 25% (as of 2010) must be withheld from the winnings. The tax will be on the cash value less the value of the wager.

Example:

Jane Triton purchases a raffle ticket for \$1. She wins a cash prize of \$6,000. Because the proceeds from her wager are greater than \$5,000 (\$6,000 less \$1), we must withhold \$1,599 (\$5,999 times 25%) from the winnings.

We also have filing requirements. We must complete a W2-G form and have the prize winner sign it before we give them their prize.

Non Cash prizes

There are two other methods for collecting withholding taxes from non-cash prizes (such as cars, luxury vacations, etc.), if the prize is over \$5,000, net of the wager.

1. The winner pays the withholding tax via cash, check or credit card. The amount withheld for taxes is 25% of the fair market value of the noncash item, less the value of the wager. We must receive the tax payment before the winner takes possession of their prize.
2. The Branch is willing to pay the withholding tax on behalf of the winner. In this case the tax withholding amount is 33.33% (as of 2010) of the fair market value of the noncash item, less the value of the wager. The withholding tax is higher because the winnings are now higher – they include BOTH the value of prize and of the tax payment made on their behalf.

As with cash prizes, the winner will need to sign a completed W2-G form before taking possession of the prize. As a result, proper and reasonable efforts to determine the fair market value of non-cash prizes, and to document them in detail with sources (such as prices published on websites for services, rooms, dinners, etc., or on eBay if a tangible item, or by formal appraisal if a valuable item) is critical. The valuation of the non-cash prizes is the primary determiner of the reporting requirements.

In summary, we must comply with State and Federal law when holding opportunity drawings or raffles. If we hold a true opportunity drawing (giving away chances to win) we may avoid having to file a financial report with the State. However, depending upon the value of the opportunity drawing prizes, we may still have reporting and tax withholding requirements under Federal IRS law. As noted above, under Federal IRS law, there are different tax rates required for different types of prizes. Additionally there are specific tax forms that must be collected from the prize winners at the raffle as well as other forms that must be remitted to the IRS within a designated time period.

Finding out about a raffle after it was held does not excuse us from following the State and Federal regulations. If tax reporting is required or if we were responsible for collecting withholding tax, we cannot use ignorance of the laws as a justification for non-compliance. We must comply, even if it is after the fact. This could create an embarrassing situation for the

Branch to ask donors for social security numbers as well as inform donors their prize winnings will be remitted to the IRS.

If a Branch decides to hold a raffle (opportunity drawing) after reading this entire section, make sure you follow not only State but IRS guidelines and all the documentation and reporting requirements you will need to comply with the law.

This description of raffles has been extracted from a document originally created by Donna Mertens in 2014.