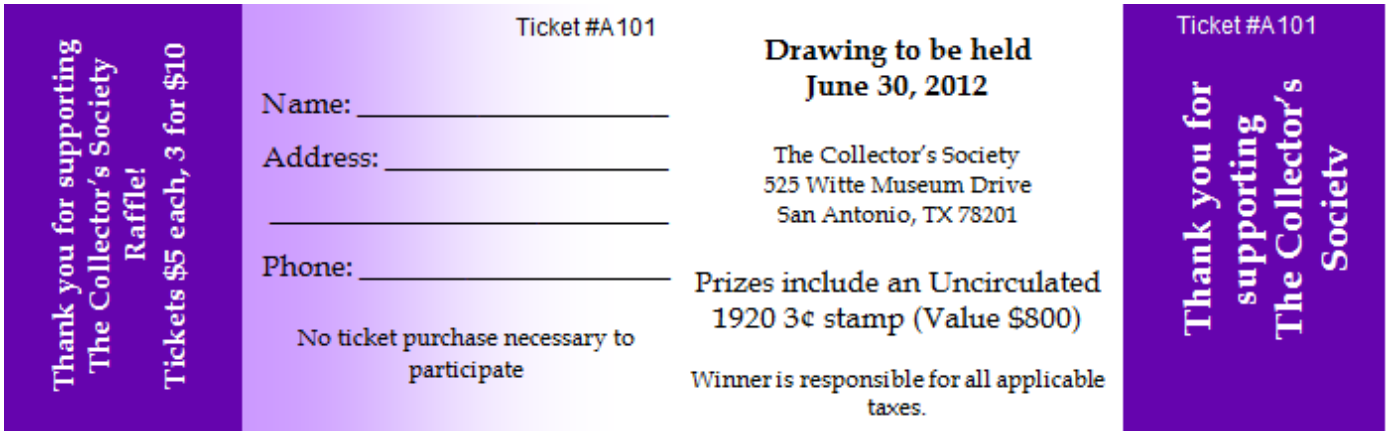
CHARITABLE RAFFLES:

Your Ticket To A Winner!



This article will explain why this may be an ideal charitable raffle ticket.

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Mr. Yale thanks colleagues and clients alike whose questions, suggestions, helpful inquiries, and articles over the years have contributed to this article

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If you have questions about charitable raffles that is not answered by this article, Glen Yale would like to hear from you.

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I. Introduction.

A charitable raffle can be a fun and profitable way for an organization qualified to conduct a raffle to earn funds for its charitable activities. While fun and profitable, there are legal and regulatory requirements that must be met to properly conduct a charitable raffle.

Like most legal and regulatory issues applicable to tax-exempt organizations, the conduct of a raffle is governed both by the Federal Internal Revenue Code and its regulations, as administered by the IRS, and by Texas state law as administered by the Texas Attorney General. Compliance with just one or the other will not be sufficient, as a charitable raffle must comply with the requirements of both. Moreover, failure to comply with Texas state law may result in increased regulatory requirements and increased taxes and penalties owed to the IRS.

Whether a large prize or a small prize is awarded in the raffle, you must comply with Texas state law for raffles, but the Federal tax rules will vary depending upon the value of the prize.

A. Texas state law.

The Texas law is the Charitable Raffle Enabling Act[1] (CREA), its very name indicating that raffles are for charity.

> The Charitable Raffle Enabling Act was enacted under a specific constitutional exception to the general constitutional prohibition against gambling. Article III, section 47(a) of the Texas Constitution prohibits "lotteries and gift enterprises" in the state except those expressly authorized by the constitution. TEX. CONST. art. III, § 47(a). Prior to 1989, any raffle was a prohibited lottery, even a raffle for charity. *See* Tex. Att'y Gen. Op. No. JM-513 (1986). In 1989, the voters approved an amendment to the constitution – article III, section 47(d) – that allows the legislature by general law to permit a qualified religious society, qualified volunteer fire department, qualified volunteer emergency medical service, or a qualified nonprofit organization to conduct raffles subject to the conditions imposed by law. *See* TEX. CONST. art. III, § 47(d). The Charitable Raffle Enabling Act is the general law authorizing and regulating charitable raffles. Tex. Att'y Gen. Op. 1999, No. JC-0111.[2]

Restrictions and limitations in the CREA are designed to make charitable raffles an infrequent fundraising event conducted primarily by volunteers or as a de minimus portion of a paid employee's duties rather than an ongoing fundraiser operated by professional fundraisers for their own benefit.

B. Federal law.

The federal tax requirements, as stated, are based on the Internal Revenue Code and its regulations, but the best source for information is "Tax-Exempt Organizations and Gaming," IRS Pub. 3079 (Rev. 6-2010) (*Gaming*)[3]. Its introduction states that raffles are included in the term *gaming.* All exempt organizations conducting or sponsoring gaming activities, whether for one night out of the year or throughout the year, whether in their primary place of operation or at remote sites, must be aware of the federal requirements for income tax, employment tax and excise tax. As to raffles as well as other gaming, three important points from *Gaming* may be summarized: (1) Gambling is not a charitable activity; (2) Tax-exempt organizations may be subject to tax: unrelated business income tax, employment taxes, excise taxes, and withholding taxes; and (3) Records of gross revenue and expenses must be maintained. These will be discussed in more detail later.

There are also US postal restrictions applicable to charitable raffles.

C. Summary.

CREA § 2002.001(6) defines a raffle as the award of one or more prizes by chance at a single occasion among a single pool or group of persons who have paid or promised a thing of value for a ticket that represents a chance to win a prize.

A charitable raffle must:

(i) be conducted by a *qualified organization*,

[1] Chapter 2002, Texas Occupations Code. Available online at http://www.capitol.state.tx.us/statutes/oc.toc.htm

[2] Attorney General's opinions are available online at http://www.oag.state.tx.us/opinopen/opinhome.shtml.

[3] Available online at http://www.irs.gov/charities/index.html under "Forms and Publications." The previous version of IRS Pub. 3079 (4-98) was called "Gaming Publication for Tax-Exempt Organizations." The new version appears to have few substantive changes but is more readable.

(ii) its proceeds must be spent for a c*haritable purpose*,

(iii) be conducted according to specific statutory requirements,

- time and frequency limitations,
- advertising limitations,
- geographic limitations,
- ticket seller requirements,
- ticket requirements,
- prize restrictions, and

(iv) meet federal tax requirements including

- recordkeeping, and
- regular and backup withholding depending upon the monetary value of the prize and ticket value.

II. Qualified organizations.

One of the most important concepts in the CREA is the concept of a "qualified organization," which means a "qualified religious society, qualified volunteer fire department, qualified volunteer emergency medical service, or qualified nonprofit organization." In Texas, a charitable raffle must be conducted by a qualified organization. Each of these types of organizations are defined, with the first three being rather specialized and the fourth rather broad.

A. Qualified religious society, volunteer fire department, volunteer emergency medical service.

These three organizations are defined in CREA § 2002.002.

(3) "Qualified religious society" means a church, synagogue, or other organization or association organized primarily for religious purposes that:

(A) has been in existence in this state for at least 10 years; and

(B) does not distribute any of its income to its members, officers, or governing body, other than as reasonable compensation for services or for reimbursement of expenses.

(4) "qualified volunteer emergency medical service" means an association that:

(A) is organized primarily to provide and actively provides emergency medical, rescue, or ambulance services;

(B) does not pay its members compensation other than nominal compensation; and

(C) does not distribute any of its income to its members, officers, or governing body other than for reimbursement of expenses.

(5) "Qualified volunteer fire department" means an association that:

(A) operates fire fighting equipment;

(B) is organized primarily to provide and actively provides fire fighting services;

(C) does not pay its members compensation other than nominal compensation; and

(D) does not distribute any of its income to its members, officers, or governing body other than for reimbursement of expenses.

Of the three organizations defined above, the qualified religious society will be the largest in terms of number of organizations. While the requirement of 10 years existence in Texas may disqualify some organizations or an otherwise qualified religious society, they may qualify as a qualified nonprofit organization, discussed below.

A church may have multiple qualified religious societies that meet the definition. They may include the formally organized church, but also the Sunday school, the adult choir, the youth choir, the women's group, the men's group and even a Sunday school class, provided they meet the 10 year requirement. Identifying the qualified organization conducting the raffle may be important for the frequency rules, discussed below.

Interestingly, the qualified volunteer emergency medical service and the qualified volunteer fire department need not be organized nor operated in Texas but the qualified religious organization must have been in existence at least 10 years in Texas. Note the difference between "reasonable" compensation and "nominal" compensation. Some volunteer fire departments pay a nominal amount to firemen who appear at a fire scene as reimbursement for travel and missing their normal work duties.

B. Qualified nonprofit organizations.

As for "qualified nonprofit organizations," there are three basic types, and this is the "catch-all" provision that will gather in many nonprofit organizations as qualified organizations that can conduct charitable raffles.

Nonprofit corporations covers organizations incorporated or holding a certificate of authority under the Texas Non-Profit Corporation Act, and unincorporated associations includes "Unincorporated organization, association, or society." CREA § 2002.003(c). Nonprofit corporations and unincorporated associations share three requirements,

have a fourth that is similar, and nonprofit corporations have one additional requirement. The three shared requirements are:

> (l) does not distribute any of its income to its members, officers, or governing body, other than as reasonable compensation for services;
> (3) does not devote a substantial part of its activities to attempting to influence legislation and does not participate or intervene in any political campaign on behalf of any candidate for public office in any manner, including by publishing or distributing statements or making campaign contributions;
> (4) qualifies for and has obtained an exemption from federal income tax from the Internal Revenue Service under Section 501(c) Internal Revenue Code of 1986.

Requirement (3) is further defined in Section (d). They are "considered to devote a substantial part of its activities to attempting to influence legislation for purposes of this section if, in any 12-month period in the preceding three years, more than 10 percent of the organization's expenditures were made to influence legislation." CREA § 2002.003 (d). On first reading, it might appear that this definition does not apply to incorporated organizations, but it should apply because they are termed "an organization incorporated." CREA § 2002.003.

The second requirement is slightly different between the two. It is required that a nonprofit corporation:

> (2) has existed for the three preceding years;

For an unincorporated organization, association or society, it is required that it:

> (2) for the three preceding years has been affiliated with a state or national organization organized to perform the same purposes as the unincorporated organization, association, or society.

Prior to the 2005 Legislature, the second requirement for nonprofit corporations read:

> (2) has existed for the three preceding years and during those years has had a governing body or officers elected by a vote of its members or by a vote of delegates elected by its members.

This required the nonprofit corporation to have voting members. A nonprofit corporation without members, with a self-perpetuating board of directors, would not meet this requirement. Unincorporated organizations typically have members.

Requirement (2) for unincorporated organizations, associations, or societies required that it have a governing body or officers elected by a vote of members or by a vote of delegates elected by the members, until that was eliminated as an alternative by the 2005 Legislature. Now an unincorporated organization, association, or society must be affiliated with a state or national organization. An unincorporated organization, association, or society that is not affiliated is not a qualified organization.

For incorporated organizations, there is a fifth requirement:

> (5) does not have or recognize any local chapter, affiliate, unit, or subsidiary organization in this state.

This fifth requirement would appear to disqualify an organization that has a local chapter, affiliate, unit, or subsidiary, even if that local chapter, affiliate, unit or subsidiary is not itself a qualified organization or chooses not to conduct charitable raffles. This limitation may be an aspect of the requirement that an organization not conduct a state wide raffle, discussed below.

Local chapters, affiliates, units, or subsidiary organizations, have their own definition:

> (b) An organization that is formally recognized as and that operates as a local chapter, affiliate, unit, or subsidiary organization of a parent organization incorporated or holding a certificate of authority under the Texas Non-Profit Corporation Act (Article 1396-1.01 et seq., Vernon's Texas Civil Statutes)[4] is a qualified nonprofit organization if:
> (1) neither the local organization nor the parent organization distributes any of its income to its members, officers, or governing body, other than as reasonable compensation for services;
> (2) the local organization has existed for the three preceding years and during those years:
> (A) has had a governing body or officers elected by a vote of its members or by a vote of delegates elected by its members; or
> (B) has been formally recognized as a local chapter, affiliate, unit, or subsidiary organization of the parent organization;

[4] The Texas Non-Profit Corporation Act has been replaced by the Texas Business Organizations Code.

(3) neither the local organization nor the parent organization:

(A) devotes a substantial part of its activities to attempting to influence legislation; or

(B) participates or intervenes in any political campaign on behalf of any candidate for public office in any manner, including by publishing or distributing statements or making campaign contributions; and

(4) either the local organization or the parent organization qualifies for and has obtained an exemption from federal income tax from the Internal Revenue Service under Section 501(c), Internal Revenue Code of 1986, or other applicable provision.

The 2005 Legislature amended the CREA to provide another category of qualified nonprofit organization, a local chapter or subordinate lodge of a grand lodge. CREA § 2002.003(b-1) states:

An organization that is formally recognized as and that operates as a local chapter, affiliate, unit, or subordinate lodge of a grand lodge or other institution or order incorporated under Title 32, Revised Statutes, as authorized by Article 1399, Revised Statutes, is a qualified nonprofit organization if:

(1) neither the local organization nor the incorporated grand lodge or other institution or order distributes any of its income to its members, officers, or governing body, other than as reasonable compensation for services;

(2) the local organization has existed for the three preceding years and during those years;

(A) has had a governing body or officers elected by a vote of its members or by a vote of delegates elected by its members; or

(B) has been formally recognized as a local chapter, affiliate, unit, or subordinate lodge of the grand lodge or other institution or order;

(3) neither the local organization nor the incorporated grand lodge or other institution or order;

(A) devotes a substantial part of its activities to attempting to influence legislation; or

(B) participates or intervenes in any political campaign on behalf of any candidate for public office in any manner, including by publishing or distributing statements or making campaign contributions; and

(4) either the local organization or the incorporated grand lodge or other institution or order qualifies for and has obtained an exemption from federal income tax from the Internal Revenue Service under Section 501(c) Internal Revenue Code of 1986, or other applicable provision.

Organizations claiming to be qualified nonprofit organizations by being other than a qualified religious society, qualified volunteer emergency medical service, or qualified volunteer fire department, must have made application and have obtained a tax exemption letter from the IRS. Charitable organizations with annual receipts of less than $5000 need not make that application to be exempt, but would need to do so if it wished to operate a charitable raffle. Also, a church need not make application as a tax exempt organization, but would need to do so and receive its tax exemption letter if it attempts to qualify as a qualified nonprofit organization that has existed 3 years rather than a qualified religious society that has existed 10 years.

The 2009 Legislature added new subsection CREA § 2002.003 (e) providing as a qualified nonprofit organization a "nonprofit wildlife conservation association and its local chapters, affiliates, wildlife cooperatives, or units" if the parent association meets the eligibility criteria of Section 2002.003 except as to not devoting a substantial part of its activities to attempting to influence legislation or intervene in any political campaign on behalf of any candidate for public office in any manner. However, an association or local chapter, affiliate, wildlife cooperative, or unit that is eligible under the subsection may not use any proceeds from a raffle to attempt to influence legislation or participate or intervene in a political campaign on behalf of a candidate for public office in any manner including by publishing or distributing a statement or making a campaign contribution. A nonprofit wildlife conservation association includes an association that supports wildlife, fish, or fowl.

C. Federal exemptions.

1. Section 501(c).

The CREA requires that a qualified nonprofit organization has obtained recognition of tax exemption as an IRC Section 501(c) organization, but does not require that it necessarily be a 501(c)(3) charitable organization. *Gaming* lists the types of

organizations most likely to engage in gaming consistent with their exemption.

Section 501(c)(3) – Charities, Schools, Churches, and Religious Organizations

For Section 501(c)(3) organizations, their sole purpose cannot be to conduct charitable gaming. Federal exemption may be jeopardized when the gaming results in inurement or private benefit to individuals or where funds from the activity are diverted for private purposes. *Gaming* at 6.

The Organized Crime Control Act, 18 U.S.C. § 1955, prohibits certain gambling businesses, but exempts from its application any bingo game, lottery, or similar game of chance conducted by an organization exempt from tax under paragraph (3) of subsection (c) of section 501 of the Internal Revenue Code of 1954, as amended, if no part of the gross receipts derived from such activity inures to the benefit of any private shareholder, member, or employee of such organization except as compensation for actual expenses incurred by him in the conduct of such activity. Bruce Hopkins states that this advantage for tax exempt charitable organizations, is "relatively minor in scope." HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS, §3.2(h) (8th ed., 2003).

Section 501(c)(4) – Social Welfare Organizations

Section 501(c)(4) organizations, may not conduct gaming as a primary activity, as it is considered a business and a recreational activity that does not ordinarily promote social welfare. Rev. Rul. 66-150, 1966-1 C.B. 147, ruled that an organization operating social facilities (including a bar, restaurant, and game room) as its primary activity is not exempt. Gaming may be appropriate for a (c)(4) organization when it furthers its exempt purpose. Rev. Rul. 74-361, 1974-2 CB 159, ruled that social activities engaged in for the purpose of increasing camaraderie of firemen promote social welfare as they encourage better performance. *Gaming* at 7.

Section 501(c)(5) and 501(c)(6) – Labor and Agricultural Organizations and Business Leagues

Gaming activities do not serve exempt purposes of IRC Section 501(c)(5), labor, agricultural, and horticultural organizations, and IRC Section 501(c)(6), business leagues and similar organizations, according to the IRS. Conduct of gaming activities may result in unrelated business taxable income or jeopardize exemption. *Gaming* at 7.

Section 501(c)(7), 501(c)(8) and 501(c)(10) – Social Clubs and Fraternal Organizations

For IRC Section 501(c)(7) social clubs, IRC Section 501(c)(8) fraternal beneficiary societies, and IRC Section 501(c)(10) domestic fraternal societies, their exempt function includes providing social or recreational activities for members and their bona fide guests. Gaming involving only members directly further exempts social/recreational purposes for these organizations. Gaming open to the general public may result in unrelated business taxable income (UBTI) or adversely affect exempt status. *Gaming* at 7.

Section 501(c)(19) – Veterans' Organizations

The same tax aspects applicable to social clubs and fraternal organizations apply to veterans' organizations. *Gaming* at 8.

2. Private foundations.

Every 501(c)(3) organization has a second important tax classification as either a private foundation or a public charity. While certain types of organizations, such as schools, hospitals, and churches, are specifically listed in the IRC as public charities, many organization must show and maintain a broad base of financial support from the general public in order to be classified as public charities. *Gaming* at 7.

Gross receipts from gaming activities that are not from an unrelated trade or business are counted as public support. Hence, gaming that is an unrelated trade or business may adversely affect organizations described as public charities due to public support as they may be determined to be private foundations. If an organization is determined to be a private foundation because a substantial source of support is from an unrelated trade or business, it may have excess business holdings in a business enterprise within the meaning of IRC Section 4943(a)(1) and may have to divest them. *Gaming* states that private foundations may have to cease gaming to avoid on excise tax on unrelated business enterprises. *Gaming* at 7. The long and the short is that a private foundation may have unrelated business income tax (UBIT) and so cannot engage in charitable raffles.

As stated earlier, the IRS maintains that the conduct of gaming, including charitable raffles, is not in itself a charitable activity.

> A common misconception is that gaming is a "charitable" activity. There is nothing inherently charitable about gaming. It is a recreational activity and a business. Although a charity may use the proceeds from gaming to pay expenses associated with its charitable programs, gaming itself does not further exempt purposes. Thus, the sole purpose of a 501(c)(3) organization cannot be to conduct gaming. *Gaming* at 6.

3. Unrelated business income tax.

An exempt organization is subject to tax on UBIT from revenues derived from conduct of a regularly carried on trade or business that is not substantially related to its exempt purposes. Income from a regularly conducted gaming is treated as UBIT, unless a specific exclusion applies. For charitable raffles the two relevant exclusions are the volunteer labor exception, IRC Section 513(a)(1) and the qualified public entertainment activities, IRC Section 513(d)(2). As discussed below, charitable raffles are limited to two and would not appear to be regularly conducted gaming.

D. Independent school districts.

Independent school districts have been ruled to not be authorized to conduct charitable raffles. Tex. Att'y Gen. Op. No. 1990, JM-1176. That ruling specifically dealt with independent school districts, but would also apply the lack of authorization to all political subdivisions. *Id.* This prohibition would not apply to an educational foundation formed to support an independent school district.

But, there is nothing that would authorize a school, such as an elementary school or a high school within an independent school district, to conduct a charitable raffle.

III. Proceeds.

The CREA explicitly states, "All proceeds from the sale of tickets for a raffle must be spent for the charitable purposes of the qualified organization." In Tex. Att'y Gen. Op. 1999, No. JC-0046, it was ruled that an organization may use a portion of the gross "raffle proceeds to pay the reasonable, incidental, and necessary expenses of conducting the raffle from which the proceeds were raised." Ordinarily, no raffle proceeds may be used to fund subsequent raffles; and the net proceeds of the raffle must be spent for the charitable purposes of the organization.

"Charitable purposes" are defined in the CREA, and means:

> (A) benefiting needy or deserving persons in this state, indefinite in number, by:
>
> > (i) enhancing their opportunities for religious or educational advancement;
> >
> > (ii) relieving them from disease, suffering, or distress;
> >
> > (iii) contributing to their physical well-being;
> >
> > (iv) assisting them in establishing themselves in life as worthy and useful citizens; or
> >
> > (v) increasing their comprehension of and devotion to the principles on which this nation was founded and enhancing their loyalty to their government;
>
> (B) initiating, performing, or fostering worthy public works in this state; or
>
> (C) enabling or furthering the erection or maintenance of public structures in this state.

Helping a single person or a small closed class of persons is not itself a charitable purpose. Still, a charitable organization with an otherwise legitimate charitable purpose may help an individual person or a small closed class of persons. Yet, notice the language in the statute that charitable purpose means benefiting needy or deserving persons *indefinite in number*. A reasonable reading of the CREA is that the proceeds must be applied to an indefinite group rather than a definite group.

> Example: First Church holds a raffle to raise funds to send a member to seminary to study for the ministry. This may not meet the charitable purposes requirement of the CREA because the group to be benefited is definite in number but would if it was revised to provide scholarships for First Church members to attend seminary.

> Example: The South Texas Library & Museum was organized for general charitable purposes and to operate a library and museum. Its executive director dies suddenly and a charitable raffle is proposed to raise funds for the director's family. As proposed, this raffle does not have a charitable purpose consistent with the CREA.

The attorney general has opined that whether funds are used for a charitable purpose under the CREA is a question of fact. Tex. Att'y Gen. Op. 1990, No. JM-1180 at 3. Whether a particular use of funds is for a charitable purpose is a question that generally cannot be answered in an attorney general's opinion. Tex. Att'y Gen. Op. 1999, No. JC-0046. In that opinion, the attorney general's office refused to conclude that fundraising itself is a charitable purpose, yet it was not prepared to say that it may never be a charitable purpose, as there may be organizations who do nothing but raise funds for other charitable organizations and in those instances they were not prepared to say whether fund-raising is a charitable purpose under section 2 of CREA.

Organizations not themselves charitable, must nevertheless spend the proceeds for charitable purposes

and cannot use raffle proceeds to pay the general operating expenses of the organizations.

> Example: The Greater Citywide Chamber of Commerce sponsors a raffle to apply the proceeds to general operating expenses. The proceeds are not applied to a charitable purpose.
>
> Example: First Church sponsors a raffle to apply the proceeds to its general budget. The proceeds are applied to a charitable purpose.
>
> Example: The Greater Citywide Chamber of Commerce sponsors a raffle to apply the proceeds to erecting a monument that the City was the first place that something wonderful happened. That would be a charitable purpose of furthering the erection of public structures.
>
> Example: The Orchestra League, formed to support the Orchestra, sponsors a raffle for the Orchestra's music library fund. That does not appear to meet a charitable purpose, but would if the proceeds were applied to underwrite children's concerts.

If the proceeds are not spent on charitable purposes, then the organizations will be subject to wagering and occupational taxes, discussed below.

For a charitable organization or a Section 501(c)(3) organization the proceeds generally can go to operations, but some charities do not exactly correspond to the charitable purposes listed in the CREA. As shown in the example above, the general purposes of a symphony orchestra organization or any adult musical organization are not contained in the charitable purposes in the CREA. Yet, a charitable raffle could be designed that would meet the requirements of the CREA – such as to support young people's concerts.

Another type of charitable organization that does not represent a charitable purpose under the CREA is an animal welfare organization. But, if a program involving both animals and youth or animals and the elderly could be designed that may meet the charitable purpose requirements of the CREA.

Notice that the proceeds must be spent for the charitable purposes of the qualified organization conducting the raffle. Nothing in the CREA permits one organization to conduct a raffle to benefit the charitable purposes of another organization.

IV. Specific statutory requirements.

A. Time and frequency limitations.

Raffles are subject to time and frequency requirements. CREA § 2002.052. The limit on raffles is calculated based on a calendar year running from January 1 to December 31, regardless of whether the organization is on a fiscal year. CREA § 2002.052(a). Each organization is limited to selling tickets and awarding prizes in two raffles a year. CREA § 2002.052(b). Selling tickets or offering to sell tickets for one raffle cannot overlap selling or offering to sell tickets for a second raffle, or they are both unauthorized. CREA § 2002.052(c). This prohibition on two raffles simultaneously would not prohibit a raffle in conjunction with another fundraising event such as a silent auction or entrance tickets to attend a fundraising event.

Under CREA § 2002.003(e) a nonprofit wildlife conservation association and its local chapters, affiliates, wildlife cooperatives or units have their own frequency rules. A nonprofit wildlife conservation association may conduct two raffles each year and each local chapter, affiliate, wildlife cooperative, or unit may conduct two raffles each year.

The statutory definition of a raffle supports the frequency limits. "'Raffle' means the award of one or more prizes by chance at a single occasion among a single pool or group of persons who have paid or promised a thing of value for a ticket that represents a chance to win a prize." CREA § 2002.002(6). The single pool requirement means that once the drawing begins, no new tickets can be purchased.

Before selling or offering to sell tickets, the organization must set the date for the raffle. CREA § 2002.052(d). Here the statute appears to contemplate a calendar date, rather than a date that depends upon occurrence of an event, such as "ten calendar days after all tickets are sold."

The organization must award the prize or prizes on the selected date unless the "organization becomes unable to award the prize or prizes on that date." *Id.* If the charitable organization becomes unable to award a prize on the date set, then it must set another date not later than 30 days from the date originally set, CREA § 2002.052(e), and if the prize or prizes are not awarded within the 30 days, the charitable organization must refund or offer to refund the amount paid by each person who purchased a ticket for the raffle. CREA § 2002.052(f). To facilitate offering a refund, the ticket stub should solicit a name and address of the purchaser.

B. Advertising limitations.

Advertising limits are imposed on charitable raffles. An organization may not directly or indirectly use paid advertising to promote a raffle through a

medium of mass communication, including television, radio, or newspaper. CREA § 2002.054(a)(1). The statute specifically lists television, radio and newspaper. Advertising secured by trade for services or barter is still paid advertising and would fall within the prohibition. Donated advertising is permitted.

The Texas Legislature in 2011 amended CREA § 2002.054(a)(2), which previously was limited to prohibiting an organization to promoting or advertizing a raffle statewide, to the following:

> (a) The organization may not:
>
> (2) promote or advertise a raffle statewide, other than on the organization's Internet website or through a publication or solicitation, including a newsletter, social media, or electronic mail, provided only to previously identified supporters of the organization;[5]

Website promotion to the general public is permitted but other electronic promotion is limited to those who are previous supporters.

The CREA limitations would not prohibit traditional means of promotion such as posters, mailings, word of mouth, brochures, and flyers. Limited email promotions should also be permissible.

C. Geographic limitations.

There are geographic limits. The organization may not promote and advertise a raffle statewide, nor sell or offer to sell tickets for a raffle statewide. CREA § 2002.054(a) (2) and (3). It is possible to read CREA § 2002.056(d) as requiring that the raffle be held within one county.

CREA § 2002.054(a)(2) permits the promotion of a raffle statewide on the organization's Internet website, but nothing authorizes the sale or the offering to sell tickets on the organization's website.

This author has occasionally seen websites where raffle tickets are offered for sale with the ticket available by print on the purchaser's computer or through the U.S. mail. Such sales are not authorized by the CREA.

D. Ticket seller requirements.

Until June 2011, this article stated that the enabling statute requires that the organization may not directly or indirectly compensate a person for organizing or conducting a raffle or for selling or offering to sell tickets to a raffle, CREA § 2002.054(b), and a reasonable reading of this would prohibit paid staff of an organization from organizing or conducting a raffle or even from selling tickets as an additional duty and not necessarily as their sole responsibility. The article went on to state that unpaid volunteers should conduct the raffle and sell tickets. In probably the most significant amendment to the CREA since it became law in 1989, the Texas Legislature in 2011 amended CREA § 2002.054(b) to read as follows:

> (b) Except as provided by this subsection the organization may not compensate a person directly or indirectly for organizing or conducting a raffle or for selling or offering to sell tickets to a raffle. A member of the organization who is employed by the organization may organize and conduct a raffle, but the member's work organizing or conducting a raffle may not be more than a de minimus portion of the member's employment with the organization.[6]

This exception to the prohibition on compensation, is limited to employees who are also members of the organization. The exception does not apply to employees who are not members of the organization and certainly would not apply to an organization that did not have members.

The first part of the subsection states a prohibition on a compensated person "organizing or conducting a raffle" or "selling or offering to sell tickets to a raffle," while the exception only addresses "organizing or conducting a raffle" and does not provide an exception for a compensated person "selling or offering to sell tickets to a raffle." That leaves us to finding the meaning for the statutorily undefined term "de minimus."[7] The Merriam-Webster Dictionary online says de minimus is "lacking significance or importance: so minor as to merit disregard." De minimus is defined on thefreedictionary.com as "inconsequential, insignificant, meager, moderate, modest, negligible, of minor importance, of no account, paltry, petty, obscure, scanty, slight, trifling, trivial, unworthy of serious consideration."

"Substantially all" may provide us a corollary for "de minimus" and mean that an employee may spend up to 15% of his or her time on organizing and conducting the raffle.

[5] Underscored text was added by the 2011 Legislature.

[6] Underscored text was added by the 2011 Legislature.

[7] The only other statutory use of the adjective located was in the Texas Tax Code, Sec.162.001(31)(31) "Gasoline blended fuel" means a mixture composed of gasoline and other liquids, including gasoline blend stocks, gasohol, ethanol, methanol, fuel grade alcohol, and resulting blends, other than a de minimus amount of a product such as carburetor detergent or oxidation inhibitor, that is offered for sale, sold, used, or capable of use as fuel for a gasoline-powered engine.

Even if 15% gives us a guideline for de minimus, it leaves unanswered over what period of time it is to be spent.

> Example: Jane S. is employed 1200 hours a year by First Church (of which she is a member) and she is to organize and conduct the raffle for the church festival as part of her duties. If she spends 180 hours (15% of her annual time) on the raffle is that de minimus?

> Example: Mary B. is employed 1750 hours a year (35 hours a week times 50 weeks) by Community Church (of which she is a member) and during the month of June she is to organize and conduct the raffle for the church festival. If Mary B. spends all of her time in June (140 hours) is that de minimus because it is less than 9% of her annual workload?

It seems to your author that if a paid employee works 15% of his or her time on organizing or conducting a raffle spread over one or two months at the time of the raffle that will be perceived as de minimus, but jamming 15% of annual hours worked into one or two months goes beyond de minimus.

Recall that volunteer labor is an exception to UBTI. Unrelated trade or business does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation. The term "substantially all" is not defined in the context of unrelated trade or business, but an unofficial guideline is 85%, meaning that 85% or more of the labor must be volunteer or uncompensated, according to the IRS.

Compensation is given a broad interpretation by the IRS. Free drinks or food provided to workers may be considered compensation if the facts show that the free items are more than a mere gratuity and are intended to be compensation for the workers' services. *Gaming* at 11.

The limitation on use of paid employees saves the organization from the employment tax filing requirements imposed when paid workers are used. *Gaming* at 17. But, if the organization makes an error in paying raffle workers, then the employment tax requirements must be met. Also, the use of volunteers helps the organization avoid the federal wager excise tax and occupation tax, discussed below.

In Tex. Att'y Gen. Op. 2003, No. GA-0097, it was held that the CREA does not authorize raffle ticket resales. A sale of a block of tickets to a resaler making a profit from the resale would not be authorized. This would also prohibit selling tickets at a premium over the printed price. There is a limited exception for resale of tickets for reverse raffles, discussed below.

Let's look at some examples:

> Example: A qualified organization conducts a charitable raffle to raise funds for a charitable purpose and the member selling the most tickets will win a prize. Such a prize is probably permissible under the CREA as long as it is nominal.

> Example: A qualified organization conducts a charitable raffle to raise funds for a charitable purpose and each member who sells 50 tickets will win a prize. Such a prize is probably permissible under the CREA as long as it is nominal and it is not monetary.

> Example: Enlisted Private Military School conducts a charitable raffle and students sell tickets. Each student can retain 25 cents on each $2 ticket. That probably violates the CREA.

> Example: The Grand Lodge of Armadillos holds a charitable raffle and sells its members books of tickets at a discount that they may sell at the full face amount of each ticket and pocket the difference. That violates the CREA.

> Example: First Church has a charitable raffle at its annual festival and assigns the church receptionist to sell tickets during the week and at the festival as part of her duties, because she is trusted to handle large sums of cash. She is not a volunteer and should not sell the tickets.

> Example: Hill Country Education Foundation conducts a charitable raffle for its programs that support the Hill Country ISD. Many of the tickets are sold to Hill Country ISD elementary students by the district school teachers and staff. That would be permissible under the CREA because the teachers and staff are paid by the district but volunteers as to the foundation.

This provision, not statutorily required, yet helpful, was located on a ticket: "Employees and their immediate family members of the [Charitable

Organization] are not eligible to win."

Your author is reminded of growing up as a child of a printer and my father's hard and fast rule that he and members of our family never bought a raffle ticket in a raffle for which he printed the tickets.

E. Ticket requirements.

The statute CREA § 2002.055 requires that eachraffle ticket sold or offered for sale must contain the following:

> (1) the name of the organization conducting the raffle;
> (2) the address of the organization or of a named officer of the organization;
> (3) the ticket price;
> (4) a general description of each prize having a value of more than $10 to be awarded in the raffle; and
> (5) the date on which the raffle prize or prizes will be awarded.

Since first researching this topic, your author has looked carefully at raffle tickets and found that virtually all fail in at least one of these requirements.

One of the most important qualifying requirements of the CREA is missing from the ticket requirements, but might be useful from a ticket selling requirement ---What is the charitable purpose to which the proceeds will be spent.

The ticket price should be stated as a dollar amount and should not contain the word "donation" or anything else to indicate that the ticket price is an income tax deductible charitable contribution. No properly deductible contribution is made by the purchaser, because the purchaser receives consideration equal to the ticket price, the chance to win a prize. *Charitable Contributions*, IRS Pub. 526 (2010), p. 7.

> "[You cannot deduct] costs of raffles, bingo, lottery, etc. You cannot deduct as a charitable contribution amounts you pay to buy raffle or lottery tickets or to play bingo or other games of chance."

If the raffle ticket price is more than $75 the ticket must contain a disclosure that the price is not deductible as a charitable contribution. A penalty of $10 per contribution, not to exceed $5,000 per raffle, is imposed on the charity that failed to make the required disclosure. The charity can avoid the penalty if it can show that the failure was due to reasonable cause. *Tax-Exempt Status for Your Organization*, IRS Pub. 557, (Rev. 10-2010) p. 15.

Here is a price stated on a ticket for an automobile raffle: "Raffle Ticket – Cost $50.00. If minimum number of tickets are not sold $40 will be refunded and $10 will be considered a donation. All other prizes will be awarded." In such a situation, it would appear that even if the automobile raffle occurred, the true cost of the ticket is $40 for tax purposes and $10 is a donation for federal income tax purposes.

There is no requirement that the value of the prize to be awarded be listed on the ticket, just that the ticket contain "a general description of each prize having a value of more than $10." We will see below that various tax and tax reporting consequences may attach depending upon the value of the prize, and it may be helpful to place the value on the ticket.

It goes without saying that double tickets, consecutively numbered and sold in rolls at office supply stores do not meet the ticket requirements of the CREA.

Say the charitable organization conducts a raffle at a one day event and players must be present to win. The tickets are the double tickets consecutively numbered, sold in rolls *and* posters containing the name of the organization, address, ticket price and a general description of each prize over $10 in value. The problem with this is that the information on the posters must be on each ticket under the CREA.

Say the charitable organization conducts a raffle at a one day event and you need not be present to win. The tickets are slips of paper with blank lines next to "Name," "Address," "Phone," and "Email," and a poster containing the name of the organization, address, ticket price and a general description of each prize over $10 in value. This combination "ticket" too does not comply with the CREA.

Tickets not containing all of the required information, especially the name of the organization and the drawing date, make it difficult if not impossible to police the qualified organization and the frequency requirements of the CREA.

After the discussion below on federal income taxes on charitable raffle winnings, a suggested legend on every raffle ticket is "Winner responsible for all applicable taxes."

The title page contains a sample ticket with required and suggested items for an ideal charitable raffle ticket.

Raffle ticket printers can be located by searching on the Internet.

F. Prize restrictions.

1. Money prohibited.

Money is prohibited as a raffle prize. CREA § 2002.056(a). What is money? In Tex. Att'y Gen. Op.

1999, No. JC-0111, it was held that a certificate of deposit may not be offered as a prize in a raffle. This opinion noted that the statute at the time did not define the term money, but "the term generally refers to coins and currency of the United States accepted as a medium of exchange." The opinion went on to reason that under the CREA money also included money equivalents that could be readily converted into money, such as a personal, traveler's or cashier's check or a money order.

In 2005 the Legislature amended the CREA to include a definition of money. " 'Money' means coins, paper currency, or a negotiable instrument that represents and is readily convertible to coins or paper currency." CREA § 2002.002 (1-a). This new statute was opined on by Tex. Att'y Gen. Op. 2005, No. GA 0341, as permitting the offer of a savings bond or a prepaid bank credit card as a prize. The opinion noted that neither savings bonds nor prepaid credit cards are coins or paper currency nor are they negotiable instruments that represent, and are readily convertible to, cash. So, an organization may award a prepaid credit card, which is readily convertible to cash. Savings bonds have a minimum 12 month holding period, after which they are convertible to cash.

> Example: The Collector's Society is a qualified organization. It will conduct a raffle to raise funds to sponsor an exhibit at a local museum. Two prizes will be awarded, an uncirculated 1920 issue U.S. stamp and a U.S. silver dollar. The coin is not a permitted prize because it is "money" within the CREA.

How about numismatic currency? Collectible U.S. currency that is still an acceptable medium of exchange would still be legal tender, but not so a Republic of Texas or Confederate dollar bill. The former would not be an acceptable prize, but the latter would be.

A prepaid credit card as a permissible prize seems hard to distinguish from the prohibited prize of paper currency. Although this distinction between paper or plastic may seem less meaningful than the "paper or plastic" question at the supermarket, the meaningfulness of the distinction is discussed fully in Tex. Att'y Gen. O. 2005, GA-0341.

Gift certificates, not readily convertible to cash, are not prohibited.

The prohibition on coins or currency does not appear to be limited to U.S. coins and currency. It also prevents a prize of pounds, euros, pesos, Canadian dollars, etc., unless in a prepaid credit card.

The prohibition on money as a prize, would also prevent refund of the ticket price as a potential prize. Tex. Att'y Gen. Op. 2003, No. GA-0097. This opinion addressed whether certain reverse raffle features violated the CREA. This opinion was effectively overruled by the Legislature in 2005, discussed below. New CREA § 2002.0541 states that notwithstanding the prohibition on money, a refund of the purchase price of a ticket may be awarded as a raffle prize in a reverse raffle. In a regular raffle, such a prize would be prohibited.

One charitable raffle ticket listed as a prize, "Brand new Nissan Versa (tax, title, and license included)." While the tax, title or license would not at first appearance seem to be "money" as defined under the statute, they are normally obligations of the purchaser of an automobile, and they would also be obligations of the winner of a raffle the prize of which is an automobile. The discharge of the obligation for the tax, title or license will be by the dealer or the charitable organization paying something that is "money" within the definition of the CREA. Thus, it seems awarding tax, title or license to the winner can be seen as awarding of "payment of tax, title and license," and may actually be an impermissible awarding of money as a prize. A preferable route may be to award a prepaid credit card that the winner may use to pay the tax, title and license. The actual procedure in which the prize is awarded may make a difference.

Because of the withholding tax requirements, discussed below, which will not be unsubstantial for a new automobile, many times the automobile is sold by the winner back to the automobile dealer.

2. Value limits.

Under the CREA, the value of a prize offered or awarded at a raffle that is purchased by the organization or for which the organization provides any consideration may not exceed $50,000. CREA § 2002.056(b). This provision raises interesting questions regarding prizes that may be on the fringes of the authorized dollar limit. Consider a prize of an automobile. Is it the value of what the charitable organization pays for the vehicle, including sales tax, title expenses and delivery charges or is it the value of the vehicle in the hands of the charitable organization? There is a vast difference in value between a motor vehicle from the dealer and a motor vehicle from someone not a new automobile dealer.

The 2005 Legislature amended the CREA to include a higher dollar limit on residences as prizes. CREA § 2002.0569(b-1) states, "The value of a residential dwelling offered or awarded as a prize at a raffle that is purchased by the organization or for which

the organization provides any consideration may not exceed $250,000." This effectively overruled Tex. Att'y Gen. Op. 1999, No. JC-0046, which enforced the $50,000 cap where the organization purchased a residence with donated funds.

The fair market value of the item won is considered the amount of the winnings. It would seem that any value associated with the prizes listed on the ticket would be taken as a representation of value. For example, if the ticket lists a home entertainment system and gives a value of $8,500, then the organization will have made a statement against interest that will make it difficult for the organization to comply with withholding or backup withholding rules at a lesser amount.

There is an exception to the $50,000 limit for state lottery tickets. A raffle prize may consist of one or more tickets in the state lottery with a face value of $50,000 or less, without regard to whether a prize in the lottery game to which the ticket or tickets relate exceeds $50,000. CREA § 2002.056(c).

The $50,000 limit does not apply if the prize was *entirely* donated to the organization. If the organization purchases a prize, the prize is subject to the limitation even if the funds used for the purchase were themselves donated. Tex. Att'y Gen. Op. 1999, No. JC0046. "A qualified organization may raffle a prize valued in excess of $50,000, but only if the prize was not purchased by the organization and the organization gave no consideration for the prize. It makes no difference that the funds used to purchase the prize were donated to the organization." *Id.*

The IRC §170 rules apply for persons who donate prizes for raffles to Section 501(c)(3) organizations. Tangible personal property donated for raffle prizes are not property used by the charity in an activity related to its exempt purpose, and any deduction will be limited to the lesser of cost or fair market value. Items purchased and then immediately donated for raffle should have a fair market value for deduction equal to cost. For self-created items donated as auction items, the deduction is ordinarily limited to the cost of goods consumed in creating the goods. No deductions are permitted for the contribution of services by the contributor as a raffle item, but a donation of purchased services such as airline tickets, hotel stays, or vacation packages, should be deductible by the contributor.

In addressing the $250,000 limit on the value of a residential dwelling awarded as a prize at a raffle, Tex. Att'y Gen. Op. 2011, No. GA-0837, opined that the cap does not vary according to the amount of donated or purchased items used to construct a residential dwelling if the organization provides any consideration, citing Tex. Att'y Gen. Op. No. 1999, JC-0046, with approval.

This dollar limitation applies to a single prize and not to the combined value of all prizes to be awarded. For example, one raffle could include a $40,000 automobile and a $30,000 automobile as separate prizes.

Can a charitable organization combine a $50,000 prize under CREA §2002.056(b), say a prepaid credit card, and a $250,000 residential dwelling under CREA §2002.056(b-1) into one prize? The language of CREA §2002.056 seems to permit it. We will see later the federal income tax withholding rules may encourage the inclusion of a prepaid credit card with the award of a residential dwelling or any prize with a value over $5000.

3. Prize in possession or post bond.

The organization must have the prize to be offered in the raffle in its possession or ownership or it must post bond with the county clerk of the county in which the raffle is to be held for the full amount of the money value of the prize. CREA § 2002.056(d). The text of this statute is not entirely clear as to whether the ownership or possession requirement must be met throughout the raffle period or only on the day of the raffle. Some have posted that, because the purpose of this provision is to ensure that the organization can actually deliver the prize to the raffle winner, the ownership or possession requirement must be met throughout the raffle period. K. Myers, "Charitable Raffles in Texas", "The Texas Tax Lawyer", p.33, Oct. 2008, vol. 38, No.1. If that is the proper understanding, this requirement means that the proceeds from ticket sales cannot be used to finance purchase of the prize ultimately delivered, and unless prizes are donated, prizes require up front money for the purchase of the prizes or for the bonds.

This bond requirement may be burdensome for the organization that does not have the prize in hand. Tex. Att'y Gen. Op. 1990, No. JM-1277, held that the bond requirement is met when acceptable bond is furnished or delivered to the county clerk, but the county clerk may not accept a "cash bond" in fulfillment of the bond requirement. The bond must be issued by a surety company authorized to do business in Texas under the Insurance Code. The difficulty and expenses of obtaining a bond under $50,000 makes this a burdensome requirement for any organization conducting the raffle.

As discussed above, a savings bond does not constitute money and is a permitted prize. But, savings bonds must be purchased in the name of an individual so the purchase cannot be made until the winner is determined. Thus, the purchase after the drawing invokes the bond requirement. Information about

savings bonds can be found at http://www.publicdebt.treas.gov.

Your author found this provision on one ticket. "Presenter reserves the right, at its sole option, to substitute prizes of comparable value." Because the prize must be in possession, what is the legitimate reason for such a provision? Nothing under the CREA would explicitly authorize this.

G. Reverse raffles.

The 2005 Legislature amended the CREA to overrule Tex. Att'y Gen. Op. 2003, No. GA-0097, which invalidated reverse raffles. CREA § 2002.002 was amended to provide a new subsection and definition. "(7) 'Reverse raffle' means a raffle in which the last ticket or tickets drawn are considered the winning tickets." A new § 2002.0541 was added authorizing reverse raffles.

H. State enforcement.

An organization is not required to register with the state or county or obtain a permit before conducting a raffle. CREA § 2002.058 authorizes a county attorney, district attorney, criminal district attorney, or the attorney general to bring an action in county or district court for a permanent or temporary injunction or a temporary restraining order prohibiting conduct involving a raffle that violates or threatens to violate state law relating to gambling and is not authorized by the CREA.

An unauthorized raffle is considered gambling under the Texas Penal Code. Conducting such a raffle is a Class A misdemeanor and participating in an unauthorized raffle is a Class C misdemeanor.

The actions of a member, officer or agent may be imputed to the organization. An organization performs an act if a member, officer or agent of the organization performs the act with the consent or authorization of the organization. CREA § 2002.004

I. Variations on a theme.

1. Duck races.

A rubber duck race is a charitable fundraising event in which a person pays a certain amount to enter a rubber duck in a race and the winner of the race wins a prize. It would seem that a rubber duck race could be structured to meet the requirements of a charitable raffle under CREA, with the race being used as the "drawing." The winning duck is the winning number that is drawn. The tickets would need to meet all of the other requirements of the CREA for tickets and the race would need to meet the other requirements of a charitable raffle.

Your author has seen unfortunate instances in which duck races cast the CREA requirements to the wind: (1) do not conduct the raffle by a qualified organization; (2) do not spend the proceeds on a charitable purpose; (3) do not meet the CREA ticket requirements; (4) do not meet the CREA advertising requirements; (5) do not meet the CREA volunteer ticket seller requirements; or (6) otherwise violate the CREA. Some organizations seem to think that because they buy a duck race from an out of state company claiming that it is legal, they have a license to do all that is right in their own eyes and the CREA restrictions otherwise be damned.

At some point and time an organization offering a duck race with such reckless abandon of the requirements of the CREA will pay a terrible price. Your author would like to see the out of state provider of duck races also pay a price (not necessarily terrible, but appropriate).

See Section H. State enforcement, as a caution for those involved until these duck races that are not properly run as charitable raffles under the CREA.

2. Door prizes.

Do door prizes awarded at an event need to meet the requirements of the CREA? It would depend if awarding the door prize depends upon the attendee paying consideration to win the door prize beyond the price of entrance. The definition of a raffle in CREA §2002.001(6) requires that a person must pay or promise to pay a thing of value for a ticket for it to be a raffle. Usually there is no additional consideration paid for the chance to win the door prize beyond the price of entrance, and where that is the case, then there will be no raffle in awarding a door prize. But, if additional consideration is charged for a chance to win the door prize, then that will be a raffle under the CREA and must meet the requirements of the CREA.

V. Tax requirements.

A. Federal record keeping.

The IRS requires exempt organizations to maintain all books and records used to determine tax liabilities and to determine information reporting responsibilities. These include the same types of books and records that would be maintained by any other business, including cash receipt and disbursement journals, accounts payable journals, general ledgers, detailed source documents, and copies of any federal tax returns filed. *Gaming* at 14.

B. Federal tax withholding.

Under IRC Section 74, raffle prizes are included in the winner's gross income for federal income tax purposes.

Withholding and backup withholding may apply to a charitable raffle. Raffles are considered lotteries

for the purpose of withholding and backup withholding.

Withholding and backup withholding for gambling winnings are reported on Form 945, Annual Return of Withheld Federal Income Tax. The Instructions for 2011 Form W-2G and 5754, p.3, are explicit on this point.

Withholding refers to the regular withholding of income tax from prizes paid. This withholding is required at the rate of 25%, in 2011. (This rate can fluctuate from year to year so determine the correct rate for the year in which the raffle is held.) Regular withholding applies if the prize less the wager exceeds $5,000.00.

If the player buys one ticket, then the wager clearly is the ticket purchase price. If the player buys multiple tickets, resulting in a single win, the amount of the wager is not so clear, but appears to be the total price of the multiple tickets purchased rather than the purchase price of the single ticket that was drawn. Your author takes this from the Instructions for 2011 Forms W-2G and 5754, p. 3, when it states, "In the case of one wager for multiple raffle tickets, such as five for $1, the wager is considered as $.20 for each ticket."

Backup withholding refers to the withholding of tax that applies to reportable prizes when the recipient fails to provide a taxpayer identification number. The backup withholding rate is 28%, in 2011. (This rate can fluctuate from year to year so determine the correct rate for the year in which the raffle is held.) For charitable raffles, backup withholding applies if the prize less the wager equals or exceeds the greater of $600.00 or 300 times the ticket price and the prize winner fails to provide a taxpayer identification number.

This is how 2011 Instructions for Forms W-2G and 5754 describes backup withholding:

> You may be required to withhold [28%] of gambling winnings…for federal income tax. This is referred to as backup withholding. You should backup withhold at the [28%] rate if:
>
> · The winner does not furnish a correct taxpayer identification number (TIN) [EIN],
>
> · [25%] regular gambling withholder] has not been withheld, and
>
> · The winnings are at least $600 and at least 300 times the wager …
>
> Figure any backup withholding on the total amount of the winnings reduced, at the option of the payer [qualified organization], by the amount wagered. This means the total amount, not just the payment in excess of $600…is subject to backup with holding [28%]. Pp. 1-2

By the author's calculations a prize valued at $5016 with a ticket price no more than $16.72 will not require either regular withholding ($5016.00 – 16.72 = $4999.29 < $5000.00) or backup withholding ($16.72 x 300 = $5016.00).

The 2011 Instructions for Forms W-2G and 5754 states:

> You may use Form W-9, Request for Taxpayer Identification Number and Certification, to request the TIN of the recipient. p. 2.

When completing the Forms W-2G and 5754 the Instructions state:

> [E]nter the identification numbers from two forms of identification as verification of the name, address, and TIN of the person receiving the winnings. The identification may be from a driver's license, social security card, or voter registration. Enter the number and the state or jurisdiction.

If one were to solely rely on *Gaming* one would think that the $600 amount less the ticket price is the floor at which backup withholding begins. However the Instructions to the Form W-2 G, Certain Gambling Winnings, make it clear that it is the greater of $600.00 or 300 times the ticket price.

For a prize won by a non-resident alien, there is no dollar threshold for withholding or reporting purposes. The withholding rate on nonresident aliens is generally 30%, unless the foreign country has a treaty with the United States for a lower rate. *Gaming* at 24. Raffle winnings paid to a non-resident alien are reportable by the organization on Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and Form 1042-S, Foreign Persons U.S. Source Income Subject to Withholding. For more information see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities.*

> Example: Good Works charity awards a raffle prize with a fair market value of $600. The raffle ticket price was $2. The net prize is worth $598 and there is no backup withholding.
>
> Example: We Are Just Wonderful charity awards a raffle prize with a fair market value of $800 and the raffle ticket costs $3. No backup withholding is required.
>
> Example: Better Than You charity awards a raffle prize with a fair market value of $700 and the raffle ticket costs $2. The winner provides a social security number by filing a Form W-9. No backup withholding is required.
>
> Example: Good Deeds Foundation conducts a raffle and draws the ticket for a prize valued at $700 and the ticket price was $2. The winner only gave his name as J. Doe and gave no EIN. Since the winner failed to supply a taxpayer identification number there must be backup withholding of

> $195.44 ($700 minus $2 equals $698 times 28%). The organization cannot deliver the prize until the winner either gives a properly completed Form W-9 or pays to the organization the withholding of $195.44.
>
> Example: Good Deeds Foundation conducts a raffle and draws the ticket for a $700 prepaid credit card and the ticket price was $2. The winner refused to give her EIN Since the winner failed to supply a taxpayer identification number there must be backup withholding of $195.44 ($700 minus $2 equals $698 times 28%). Can Good Deeds Foundation remove $195.44 from the card and deliver a card for $504.56? It would seem permissible because the prohibition on money is on the receipt by the winner not the retention by the qualified organization.

In our example, the organization cannot pay the withholding itself, because that would be to award a cash prize. In Tex. Att'y Gen. Op. 2003, No. GA-0097, it was held that the offer or award as a raffle prize of a cash refund of all or a portion of a ticket's purchase price violated the CREA § 2002.056(a) prohibition on awarding a prize of money. If the organization pays the federal tax required to be withheld without deducting the taxes from the prize, the prize is deemed to include the amount of the federal tax paid by the organization. *Gaming* at 23.

Because of the $600.00 threshold for backup withholding and the reporting hassle that brings, the organization might consider awarding prizes that do not exceed the greater of $600.00 or 300 times the ticket price in value. To save the prize winner the hassle of paying the regular withholding, the organization might consider awarding prizes that do not exceed $5,000.00 in value.

> Example: My Goodness organization will award a raffle prize valued at $6,000.00 when the ticket price was $1. The organization must withhold $1,499.75 ($5,999 times 25%). It will behoove the winner to give a completed Form W-9 so the tax withheld will properly be credited to the winner's social security number. The organization should not deliver the prize until the winner pays to the organization the withholding of $1,499.75.
>
> Example: My Goodness organization will award a raffle prize valued at $5,000.00 when the ticket price was $1. The winner willingly gave her completed Form W-9 and the organization delivered the prize without needing to collect any withholding tax from the winner.

If the holder of the winning ticket claims that someone else is the actual owner or if the holder is claiming as a member of a group of winners on the same winning ticket, then the holder of the winning ticket should file with the charitable organization a Form 5754, Statement by Person(s) Receiving Gambling Winnings. The charitable organization will prepare the Forms W-2G based on the Form 5754.

The previous edition of *Gaming* (4-98), p.15, contained this advice:

> The exempt organization will be responsible for paying regular gambling withholding or backup withholding, whether or not it collects the withholding from the prize recipient. The best time to collect withholding or backup withholding is before the prize is paid.

A further warning, *Id*., p. 16, was given.

> In addition, a trust fund recovery penalty may apply when income taxes that should be withheld are not withheld or are not paid to the IRS. Under this penalty, certain officers or employees of your organization become personally liable for payment of the taxes and are penalized an amount equal to the unpaid taxes. This penalty may be applicable when these unpaid taxes cannot be immediately collected from your organization. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. Willfully in this case means voluntarily, consciously and intentionally failing to pay.

Because of the requirement to collect withholding from the prize winner, the organization should consider the advantages of limiting the value of prizes to $5,000. If the value of the prize exceeds $5,000, the organization should consider printing on the tickets that the winner is responsible for all taxes. The winner is responsible for the taxes without a legend printed on the ticket saying so, but the legend may avoid a public relations problem in conducting the raffle.

If the organization does not pay the withholding, the person whose name and address are printed on the ticket may be a good candidate for the IRS to go after for the payment of the withholding.

Could the organization offer as a prize savings bonds or a prepaid credit card to meet the winner's withholding requirement? That has been the ruling of the Attorney General. Savings bonds must be held a minimum of 12 months, but a prepaid credit card has no such limits. *Gaming* states that if the organization pays the federal tax required to be withheld without deducting the taxes from the prize, the prize is deemed to include the amount of the federal tax paid by the organization. The organization must pay as tax deducted and withhold an amount equal to 33.33 percent of the amount actually paid to the winner. *Gaming* at 23.

> Example: Dress for Stomping the Competition conducts a charitable raffle with $75 tickets and the featured prize is a diamond cocktail ring valued at $37,500 along with a prepaid credit card for $12,475 making total prize value of $49,900. ($37,500 + $12,475 - $75 = $49,900). At a tax withholding rate of 25 percent $12,475 ($49,900 x .25 = $12,475). When the winning ticket holder picks up the prize, he or she may take the ring and leave the prepaid credit card.

The Instructions for Forms W-2G state that charity raffles must file Form W-2G for each person to whom is paid $600.00 or more in prize winnings if the winnings are at least 300 times the amount of the wager. Here too the wager must be subtracted from the total winnings to determine whether reporting is required.

These instructions provide a conflict to the instructions in *Gaming*, where the amount at which withholding is required is $600, but here backup withholding applies if the winnings are at least $600 but not more than $5,000 and are at least 300 times the wager. This suggests that if the value of the prize exceeds $600 make the ticket price at least one-three hundredth of the value of the prize so you can avoid the hassles of backup withholding and reporting.

C. Taxes on wagering.

If an organization does not properly conduct the raffle according to the CREA, the raffle may lead to the imposition of a wagering excise tax, IRC Section 4401, and an occupational tax, IRC Section 4411. The wager in the raffle is the price paid for the ticket, but an important exception is made for drawings conducted by exempt organizations so long as no part of the net proceeds of such drawing inures to the benefit of any private shareholder or individual. *Gaming* at 27. If the proceeds are not applied to charitable purposes as required by the CREA, and the raffle proceeds are used for the general operating expenses of an organization (other than a Section 501(c)(3) organization), that use constitutes inurement to the benefit of members for purposes of determining the application of the wagering tax. *Gaming* at 27.

> The tax rate depends on whether the wager is authorized under the law of the state in which it is accepted, in other words, on whether the wager is legal. The tax on legal wagers is 0.25% of the amount of the wager. The tax on unauthorized, or illegal, wagers is 2% of the amount of the wager. *Gaming* at 27.

Gaming sets forth the forms that must be filed to pay the wager tax, and states that an organization may be subject to a penalty for failure to file the form and for failure to pay the tax. *Gaming* at 28.

To avoid the federal wager tax and its filing requirements, is another reason to meticulously follow the raffle rules of the CREA.

If the rules of the CREA are not followed, then the ticket price becomes a wager, and there is an occupational or stamp tax imposed under IRC Section 4411 on any organization liable for the tax on wagers or upon any person engaged in receiving wagers for or on behalf of any person so liable. The tax is due from a principal, which is an organization in the business of accepting wagers or an employee agent of such an organization. A volunteer who sells raffle tickets is not a principal.

If the amount of the wager is authorized under state law, the amount of the occupational tax is $50 per year per person receiving wagers and if the wager is not authorized under state law, the amount of the tax is $500 per year per person receiving wagers. Where Texas state law only permits the sale of raffle tickets by volunteers, the sale by paid staff who are not members, will make the raffle unauthorized under the CREA and may subject the organization to the 2% wager tax and the $500 occupational tax.

An organization may be subject to a penalty for failure to file the form and for failure to pay the tax. *Gaming* at 28.

D. State sales tax compliance.

1. Possible state tax on purchase of raffle item by organization.

An organization created for religious, educational, or charitable purposes qualifies for exemption from Texas sales tax on its purchases if (i) no part of the net earnings of the organization benefits a private shareholder or individual and (ii) the items purchased, leased, or rented are related to the purpose of the organization. Tex. Tax. Code Section 151.310. Similarly, that is the case for an organization qualifying for exemption from federal income taxes under Section 501(c)(3), (4), (8), (10), or (19), if the item relates to the purpose of the exempted organization and the item is not used for the personal benefit of a private stockholder or individual. *Id.* Section 151.310 also exempts a company, department, or association organized for the purpose of answering fire alarms and extinguishing fires or for the purpose of answering fire alarms, extinguishing fires, and providing emergency medical services, the members of which receive no compensation or only nominal compensation for the services with respect to items used exclusively by the company, department, or association. *Id*.

The requirement that the item purchased be related to the purpose of the organization raises an interesting question as to whether an organization's purchase of an item to be raffled is exempt, since conducting raffles is not considered a "charitable activity," for federal tax purposes. Leslie Fossen, in "Conducting Charitable Raffles & Sheer Luck Is Not Enough" Governance of Nonprofit Organizations Course, August 2006, reports that in what were then two recent informal telephone conferences with the Texas Comptroller's office, her office was told that an organization need not pay sales tax on such purchases. This conflicted with earlier statements issued by the Comptroller. In a 1998 statement, the Texas Comptroller concluded, "Items purchased to be used as prizes in a raffle are generally subject to tax at the time of purchase." Tex. Comp. 9809136L (Sept. 22, 1998). In a similar 1993 letter (which has been superceded and is therefore of questionable authority), the Texas Comptroller more ambiguously stated that "sales tax is due on taxable items given away as prizes in a fundraising activity, *if fundraising is not the exempt purpose of the organization*." Tex. Comp. 9305055L (May 28, 1993) (superceded). Relatedly, as mentioned above, the office of the Texas Attorney General has refused to conclude as a matter of law that fundraising itself is a charitable purpose, although it was not prepared to say that it can *never* be a charitable purpose, particularly in the case of an organization that does nothing but raise funds for other organizations. Tex. Att'y Gen. Op. 1990, No. JM-1180.

2. Sales tax on sale of raffle tickets.

An organization apparently need not collect sales tax on the purchase of raffle tickets by participants. Tex. Comp. 200010791L (Oct. 13, 2000); Tex. Comp. 9809136L (Sept. 22, 1998); Tex. Comp. 9308078L (Aug. 11, 1993) (superceded) Tex. Comp. 9305055L (May 28, 1993) (superceded).[8]

3. Tax on motor vehicles awarded as prizes.

Sales tax issues may arise upon transfer of title to a new motor vehicle as a prize to the winner of a raffle.

Prior to October 1, 2006, upon transfer of title to the motor vehicle directly from the dealer to the winner, motor vehicle sales or use tax was due from the sponsor of the contest on the total consideration paid for the vehicle to the dealer. If no consideration was paid, motor vehicle sales or use tax was not due; however, a $10 gift tax was due. 34 TAC § 3.80.

Likewise, prior to October 1, 2006, if the dealer transferred title to a motor vehicle to the contest sponsor, then the sponsor subsequently transferred that title to the vehicle to the winner, the sponsor owed motor vehicle sales or use tax on the total consideration paid for the vehicle to the dealer and the winner owed a $10 gift tax. *Id.* If no consideration was paid for the vehicle, the sponsor and the winner each owed a $10 gift tax. *Id.*

Effective October 1, 2006, all vehicles sold in the state, other than those sold by a licensed dealer, are taxed based on the "Standard Presumptive Value" ("SPV") of the vehicle. TEX. TAX CODE ANN. § 152.0412 (Vernon 2006). If the purchase price of the vehicle is 80 percent or more of the SPV, then the sales tax will be computed based on the purchase price. *Id.* at § 152.0412(b). If the purchase price is less than 80 percent of the SPV, then the county tax assessor "shall compute the tax on the amount that is equal to 80 percent of the standard presumptive value of the vehicle." *Id.* at § 152.0412(c). The SPV is determined by providing the Vehicle Identification Number (VIN) and odometer reading.[9] There is no tax exemption in the law for transfer of a motor vehicle.

So now after September 30, 2006, upon transfer of title to the motor vehicle directly from the dealer to the winner, motor vehicle sales or use tax is due from the winner of the contest on the total consideration paid for the vehicle to the dealer by the sponsor. Payment of the tax by the contest sponsor would appear to be a disallowed cash gift.

[8] Texas Comptroller statements are available on-line at http://cpastar2.cpa.state.tx.us:8765/index.html.

[9] The Department of Transportation provides a web-based tool for determining the SPV at: http://www.dot.state.tx.us/services/vehicle_titles_and_registration/std_presumptive_value.htm.

After September 30, 2006, if the dealer transfers title to a motor vehicle to the contest sponsor, then the sponsor subsequently transfers that title to the vehicle to the winner, the sponsor owes motor vehicle sales or use tax on the total consideration paid for the vehicle to the dealer, *Id.* at § 152.0412(b), and the winner owes sales tax on 80 percent of the SPV, *Id.* at § 152.0412(c). If no consideration was paid for the vehicle, the sponsor and the winner each owes sales tax at 80 percent of the SPV. *Id.*

Thus, whether title is transferred directly to the winner or first to the organization conducting the raffle and then to the winner, will substantially increase the sales taxes actually paid. The organization may wish to make the payment of the sales tax by the winner a condition of receipt of the motor vehicle and, if so, should include this requirement on the raffle ticket. If the organization first takes title to the vehicle, then the requirement of sales tax being paid need not be a condition stated on the ticket, because the sales tax will be due when the winner obtains a registered title.

The tax rate on such sales is 6.25% of the total consideration. As indicated immediately above, an organization conducting a raffle may either take title to the motor vehicle or have the title to the motor vehicle pass directly from the dealership to the raffle winner. If the organization wishes title to pass directly to the winner, this is slightly complicated by the fact that a raffle is not authorized under Texas state law unless the organization has the prize in its possession or ownership (unless it posts bond). Arguably, an organization should be treated as in "possession" of the motor vehicle if all consideration has been paid and the dealer is willing to deliver a set of keys to the motor vehicle to the organization.

See the above discussion on the prohibition of money as a prize and the author's opinion that including tax, title and license as part of an automobile prize would be an impermissible award of money.

VI. United States Postal Service requirements.

18 USC §1302 provides that a person who uses the US mail to conduct a lottery, gift enterprise, or scheme for the distribution of money or of real or personal property by lottery, chance, or drawing of any kind commits a criminal offense. There is an exception for state governments running a state lottery, in 18 USC §1307, but no exemption for charitable organizations.

Specifically, 18 USC §1302 provides that:

> Whoever knowingly deposits in the mail, or sends or delivers by mail:
> Any letter, package, postal card, or circular concerning any lottery, gift enterprise, or similar scheme offering prizes dependent in whole or in part upon lot or chance;
> Any lottery ticket or part thereof, or paper, certificate, or instrument purporting to be or to represent a ticket, chance, share, or interest in or dependent upon the event of a lottery, gift enterprise, or similar scheme offering prizes dependent in whole or in part upon lot or chance;
> Any check, draft, bill, money, postal note, or money order, for the purchase of any ticket or part thereof, or of any share or chance in any such lottery, gift enterprise, or scheme;
> Any newspaper, circular, pamphlet, or publication of any kind containing any advertisement of any lottery, gift enterprise, or scheme of any kind offering prizes dependent in whole or in part upon lot or chance, or containing any list of the prizes drawn or awarded by means of any such lottery, gift enterprise, or scheme, whether said list contains any part or all of such prizes;
> ***
> Shall be fined under this title or imprisoned not more than two years, or both; and for any subsequent offense shall be imprisoned not more than five years.

As a result of the ruling in *Greater New Orleans Broadcasting Ass'n v. United States*, 119 S. Ct. 1923 (1999), that the prohibitions in 18 U.S.C. §1304 on broadcast advertising of legal casino gambling violated the First Amendment, the Attorney General informed the Speaker of the House[10] that application of 18 U.S.C. §1302 to prohibit the mailing of truthful advertising concerning lawful gambling operations would violate the First Amendment and accordingly the Department of Justice will refrain from enforcing the statute with respect to such mailings.

In March 2002, the US Postal Service issued Customer Support Ruling PS-307 that affirmed that raffles that incorporate "prize," "chance," and "consideratrion" are considered lotteries under the statute and postal standards, and tickets for such raffles are considered unlawful matter and remain nonmailable. But, it went on to note that when one or more of the three elements of prize, chance or consideration are eliminated from a raffle, the arrangement does not constitute a lottery for postal purposes. Consideration is eliminated if persons may

[10] www.justice.gov/olc/18usc1302.htm

enter without payment of a fee.

> Thus, a nonprofit organization that designs a raffle where it is clear that a donation is not required (e.g. via a check box, "Please enter my name in the drawing. I do not wish to make a donation at this time.") to participate in the raffle may use the mail to distribute the tickets for that raffle.

The word "donation" conflicts with the IRS prohibition on the use of that word in the context of raffle tickets. See the discussion above in "Ticket requirements." Your author suggests substituting the word "payment" for "donation" in the legend.

An alternative ticket legend would be: "No ticket purchase necessary to participate."

VII. Conclusion.

Raffles are extensively regulated activities, the requirements of which should be meticulously followed to avoid taxes and penalties on the organization and its officers. If conducted properly, which is reasonably possible, a charitable raffle offers a fun way to raise funds for the charitable purposes of the organization.