

It's Just a Little Raffle: What's the Big Deal?

06.29.15 | Linda J. Rosenthal, JD



At a conference table somewhere in California, yet another group of charity trustees is stepping, blindly, into a pile of trouble.

The topic: Fundraising. The plan: A raffle. “A 50/50 raffle,” suggests one trustee, “like the one the Detroit Lions had last year when I was home visiting the relatives. It raised a ton of money for a local nonprofit, and the fans loved it.” “Sounds great,” replied another. “No problem; let’s do it!”

It Is a Big Deal

But it *is* a problem. It *is* a big deal. There was a California constitutional amendment about it. Yes, really. A constitutional amendment.

Before 1998, California’s gambling industry was essentially unregulated. The Legislature passed fairly ineffective legislation in 1984. Then – in 1997 – lawmakers passed the much-broader “Gambling Control Act.”

There was a consensus, though, that the 1997 legislature had gone a bit too far; had made it a bit too controlled. In particular, certain exceptions needed to be made for tribal gaming, and for limited charitable activities and events including raffles and bingo.

(Without going into a big rigamarole about how complex lawmaking can be in California, and why items you’d think could be accomplished by a regular amendment in the Legislature, can’t be done that way), suffice it to say that the matter had to be approved by the voters in a March 2000 ballot initiative.

We, the citizens, voted to amend the State Constitution (Art IV, Sec. 19) to grant the legislature authority to enact a law permitting certain nonprofit organizations to hold certain types of raffles. The legislature then passed an amendment to Penal Code sec. 320.5, effective July 1, 2001, which

did just that: authorized certain types of raffles under certain limited conditions and with additional requirements and restrictions.

But not the 50/50 raffles that were – and continue to be – a big hit in many other states. We pointed that out in [*How Your 50/50 Raffle is Like Drinking a Beer When You Were in High School*](#). In California, despite the fact that it's done a lot, it's still illegal.

What's legal now is akin to drinking non-alcoholic beer, which has been described by some as only just a bit "[better than being left empty-handed at a party.](#)"

No more than 10% of the funds raised with a raffle can go to the expenses of running that raffle, and that includes any payout of the proceeds. The law now requires that at least 90% of a raffle's gross receipts be paid directly to beneficial or charitable purposes in California. So, in California, the only allowable raffles are 90/10 (or better) raffles. (That can be done if most or all of the raffled items are donated; the 50/50 device works by selling raffle tickets, and then splitting the take: 50% to the charity; 50% to the winning ticket-holder.)

Certain categories of nonprofit organizations [including 501(c)(3)s, of course] are allowed to conduct a raffle and sell raffle tickets if all of the following additional conditions are met:

- each ticket must have a detachable coupon or stub, marked with a matching identifier
- winners of prizes must be determined by draw
- the drawing must be held in California and supervised by an adult
- the raffle must be used to fund charitable works
- the money must be used in California
- any person receiving compensation for operating the raffle must be an employee of the nonprofit organization conducting the raffle
- the raffle can't benefit officers, directors, or members
- raffle tickets can't be sold at a racetrack, gambling establishment, satellite wagering facility or on the internet
- the nonprofit registers with the California Attorney General ahead of conducting the raffle and meets specific reporting requirements each year

There is a tiny exception from compliance with this law only if there is a "general and indiscriminate distribution of tickets" which are offered on the same terms as tickets for which a donation is given, and the raffle does not require any of the participants to pay for a chance to win. (This exception sounds as appealing as a plastic cup of warm San Diego tap water; by comparison, the nonalcoholic brew is tasty and exciting.)

All of the details about lawful charitable raffles are helpfully explained on the website of the California Attorney General [here](#). There is also a useful raffle checklist [here](#).

The IRS, Too

We mentioned – in [*Say What! We're Monitored by How Many Agencies?*](#) – that there are agencies at all levels of government poking their noses into the affairs of tax-exempt organizations.

Ordinarily, it's the Internal Revenue Service that is the poker-in-chief, with state and local officials taking a back seat.

But, in California, the most significant regulation of raffles comes from the California Attorney General. That's because (a) the law approving the raffle changes says so; (b) the Attorney General has broad oversight authority for charitable trust assets and activities, including fundraising; and (c) unlawful raffles are crimes and the Attorney General has a big interest in that area, too..

That's not to say the Internal Revenue Service doesn't have issues as well here. It does, but the concern is primarily with monitoring (and taxing) unrelated business income.

Gaming is one of the most common and successful types of fundraising engaged in by tax-exempt organizations. Organizations that conduct or sponsor gaming, whether for one night or throughout the year, whether in their primary place of operation or at a remote location, are subject to federal tax law requirements and must be aware of the requirements for income, employment, and excise taxes.

IRS Notice 1335, *Gaming Activities* (October 2004) explains these concerns about "gaming" activities including "...bingo, beano, raffles, lotteries, pull-tabs, . . . and a variety of other specified and unspecified "... games of chance." The reason: "Most forms of gaming, if regularly carried on, result in unrelated business income (UBI) and the income may be taxable."

We introduced the general topic of unrelated business income in *The Fourth Way to Sink Your Tax Exemption: Too Much Unrelated Business Income*.

Amid concerns from for-profit businesses that nonprofit organizations held an unfair competitive advantage over them when engaging in similar activities, the unrelated business income tax was introduced in 1950. Since then, unrelated business income has been a very big deal to the IRS.

Raffles and other gaming activities meet two prongs of the 3-part UBI test: namely, a "trade or business" that is "not substantially related to the organization's exempt purpose."

The reaction of many nonprofits is that this shouldn't matter because they are going to use the proceeds to further their exempt purposes. The IRS responds directly to this argument: "If an organization uses the income from gaming to pay expenses associated with furthering its exempt purpose, why is the income taxable? The income may be taxable because gaming is generally a business activity, not a charitable activity that furthers an organization's exempt purpose. The fact that an organization uses the proceeds from its gaming to pay for its charitable programs does not make gaming a charitable activity."

The primary way a nonprofit can wriggle out of the tax on UBI is to show that its gaming activity is not "regularly carried on." The facts and circumstances of each situation will determine whether a gaming activity is 'regularly carried on.' Some relevant factors are:

- The frequency of the activity,
- The length of time it has continually conducted the activity,
- How it promotes the activity, and
- How nonexempt businesses conduct similar activities.

There are also certain exceptions that “may be available to exclude gaming income from UBIT including when “substantially all of the work in carrying on the activity is performed for the organization without compensation.”

In addition to the UBI issue, there are certain other obligations that may apply, including the duty to report an individual’s winning to the IRS and withhold income tax. See IRS Publication 3079, Gaming Publication for Tax-Exempt Organizations.

Conclusion

Raffles can be a useful fundraising tool, but nonprofits should not jump into these gaming activities without knowing all of the rules and the pitfalls.

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[Update: See our most current post for certain changes in the law – Raffles, Revisited (October 29, 2021)]