



Department of the Treasury
Internal Revenue Service

www.irs.gov

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Tax-Exempt Organizations and Raffle Prizes - Reporting Requirements and Federal Income Tax Withholding

Tax-Exempt and Government Entities Division

This notice discusses federal tax reporting and income tax withholding requirements that apply to raffles conducted by organizations exempt under section 501 of the Internal Revenue Code. A tax-exempt organization that sponsors raffles may be required to secure information about the winner(s) and file reports on the prizes with the Internal Revenue Service. The organization may also be required to withhold and remit federal income taxes on prizes.

Reporting Raffle Prizes

“Raffle” Defined: In general, a raffle is considered a form of lottery. As such, a raffle generally refers to a method for the distribution of prizes among persons who have paid for a chance to win such prizes, usually determined by the numbers, or symbols, on tickets drawn.

Generally, an exempt organization must report raffle prizes if (a) the amount paid reduced, at the exempt organization’s option, by the wager (the amount a person paid for the chance to win a prize), is \$600 or more; and (b) the payout is at least 300 times the amount of the wager. The organization uses Form W-2G for this report.

Example 1: Wendy purchased a \$1 ticket for a raffle conducted by **X**, an exempt organization. On October 31, 2004, the drawing was held and Wendy won \$900. **X** must file Form W-2G with the IRS and give a copy of Form W-2G to Wendy.

A person receiving gambling winnings must furnish the exempt organization a statement on Form 5754 made under penalties of perjury stating his or her identity and the identity of any others entitled to the winnings (and their shares of the winnings.) When the person receiving winnings is not the actual winner, or is a member of a group of two or more winners on a single ticket, the recipient must furnish the exempt organization information listed on Form 5754, *Statement by Person(s) Receiving Gambling Winnings*, and the organization must file Forms W-2G based on that information. The organization must keep Form 5754 for four years and make it available for IRS inspection. (See the specific instructions for Form 5754 for more information.)

The exempt organization must file Forms W-2G with the IRS by the last day of February of the year after the year of the raffle. Use Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, to transmit Forms W-2G to the IRS. The organization must also issue Forms W-2G to prize recipients by January 31 of the year after the year of the raffle.

Withholding Tax on Raffle Prizes

Regular Gambling Withholding: An organization that pays raffle prizes must withhold 25% from the winnings and report this amount to the IRS on Form W-2G. This *regular gambling withholding* applies to winnings of more than \$5,000. If the organization fails to withhold correctly, it is liable for the tax.

Example 2: Lou purchased a \$1 ticket for a raffle conducted by **X**, an exempt organization. On October 31, 2004, the drawing was held and Lou won \$6,000. Because the proceeds from the wager are greater than \$5,000 (\$6,000 prize minus \$1 ticket cost), **X** must withhold \$1,499.75 (\$5,999 x 25%) from Lou’s winnings. If **X** fails to withhold \$1,499.75 before distributing the prize, **X** is liable for the withholding tax.

Backup Withholding: An organization is required to withhold 28 percent of the total proceeds if (1) the prize is otherwise subject to reporting (i.e., the amount of the prize, less the amount wagered, is \$600 or more and 300 times the amount of the wager), and (2) the winner fails to furnish a correct taxpayer identification number (social security number, individual taxpayer identification number, or employer identification number). This is called *backup withholding*.

Noncash Prizes: For noncash prizes, the winner must pay the organization 25% of the fair market value of the prize minus the amount of the wager.

Example 3: Jason purchased a \$1 ticket for a raffle conducted by X, an exempt organization. On October 31, 2004, the drawing was held and Jason won a car worth \$10,000 (fair market value). Because the prize exceeds \$5,000 and the fair market value of the car is \$10,000, the tax on the fair market value of the prize is \$2,499.75 [(\$10,000 minus \$1 ticket cost) x 25%]. Jason must pay \$2,499.75 to X to remit to the IRS on his (Jason's) behalf. X would indicate the fair market value of the prize (\$10,000) in box 1 and the amount of the withholding tax paid (\$2,499.75) in box 2 on Form W-2G.

Organization Pays Withholding Tax: If the organization, as part of the prize, pays the taxes required to be withheld, it must pay tax not only on the fair market value of the prize less the wager, but also on the taxes it pays on behalf of the winner. This results in a grossed up prize requiring the use of an algebraic formula. Under this formula, the organization must pay withholding tax of 33.33% of the prize's fair market value. The organization reports the *grossed up* amount of the prize (fair market value of prize plus amount of taxes paid on behalf of winner) in box 1 of Form W-2G, and the withholding tax in box 2 of Form W-2G.

Example 4: If in Example 3, X pays the withholding tax on Jason's behalf, the withholding tax is \$3,332.67 [(\$10,000 fair market value of prize minus \$1 ticket cost) x 33.33%]. X must report \$13,333 as the gross winnings in box 1 of Form W-2G, and \$3,334.67 withholding tax in box 2.

Reporting and Paying Tax to the IRS

The organization must use Form 945, *Annual Return of Withheld Federal Income Tax*, to report and send withheld amounts to the IRS. This is NOT the same form used to report Federal income tax withheld and FICA with respect to employees. Form 945 is an annual return, and is due January 31 of the year after the year in which the taxes were withheld (for example, for taxes withheld in 2004, the return would be due January 31, 2005). Separate tax deposits are required for payroll and non-payroll withholding. Be sure to mark the **Form 945** checkbox on Form 8109, the Federal tax deposit coupon.

The organization must list the EIN (employer identification number) of the organization conducting the raffle on Forms W-2G, 1096, and 945. If you have not secured an EIN, you may apply for one on Form SS-4, *Application for Employer Identification Number*, available from the IRS. You may also apply for an EIN on-line at www.irs.gov, under the topic Employer ID Numbers on the *Businesses Contents* page.

For more information, see IRS Publication 3079, *Gaming Publication for Tax-Exempt Organizations*, or call EO Customer Account Services at 1-877-829-5500 (toll-free). IRS forms and publications can be ordered by calling toll-free 1-800-TAX-FORM (1-800-829-3676) or from the IRS Web site (www.irs.gov).