

Internal Revenue Service memorandum

date: Dec 1 1999

to: Regional Chief Compliance Officers
District Director, Key District Offices (EP/EO)
Information Copy: EP/EO Division Chiefs

from: Director, Exempt Organizations Division OP:E:EO
signed Marcus S. Owens

subject: The Treatment of Raffle Income under IRC 527

Recently, political organizations have expressed concern about the treatment of raffle income under § 527 of the Internal Revenue Code. The purpose of this memorandum is to discuss this issue and other issues that may come into play in examinations involving such organizations.

Exempt function income of political organizations (including PACs) is not subject to tax under § 527 of the Code. Section 527(c)(3) defines exempt function income to include:

1. contributions,
2. membership dues and assessments,
3. proceeds from conducting bingo games as defined in section 513(f)(2),
4. proceeds from a political fundraising or entertainment event,
5. proceeds from the sale of political campaign materials, which are not received in the ordinary course of any trade or business.

Proceeds from a raffle are not membership dues, proceeds from conducting bingo games, or proceeds from the sale of political campaign materials. Raffle proceeds will be exempt function income only if considered contributions or proceeds from a political fundraising or entertainment event.

A. Are raffle proceeds contributions?

The purchase of a raffle ticket has been viewed by the Service as the purchase of an item for value rather than as a charitable contribution. Rev. Rul. 67-246, 1967-2 C.B. 104, specifically provides that amounts paid for chances to participate in raffles, lotteries, or similar drawings or to participate in puzzle or other contests for valuable prizes are not charitable contributions. In Rev. Rul. 83-130, 1983-2 C.B. 148, the Service explained that taxpayers who purchased raffle tickets from a charity “received a chance to win a valuable prize and, therefore, received full consideration for their payments.”

A similar principle was applied to raffle tickets purchased from political organizations under former § 24, formerly § 41). Until repealed in 1986, § 24 allowed an individual to claim a tax credit for all “political contributions” and “newsletter fund

The Treatment of Raffle Income under IRC 527

contributions.” In Rev. Rul. 72-411, 1972-2 C.B. 5, the Service determined that “an amount paid for a chance to participate in a raffle, lottery, or a similar drawing for valuable prizes is not a contribution or a gift. Such an amount is merely the purchase price of an item of value - the chance to win a valuable prize.” While § 24 has been repealed, the principle that the purchase of a raffle ticket is the purchase price of an item for value is still valid and is applicable to political contributions under § 527.

Thus, normally raffle proceeds are not contributions and will only be exempt function income if considered proceeds from a political fundraising or entertainment event.

B. Are raffle proceeds from a political fundraising or entertainment event?

Section 1.527-3(d)(1) of the regulations provides that amounts received from fundraising and entertainment events are eligible for treatments as exempt function income if the events are political in nature and not carried on in the ordinary course of a trade or business. Whether an event is “political” in nature depends on all facts and circumstances. One factor that indicates an event is a political event is the extent to which the event is related to a political activity aside from the need of the organization for income or funds.

Where there is no evidence that the sale of raffle tickets is closely related to a political event, it is hard to conclude that it constitutes exempt function income. For example, where the drawing is to be held at the annual meeting of a related non-§ 527 organization; the tickets are sold over a period of several months by telephone and through the mail; the only reference to an event is on the back of the raffle ticket and merely indicates the date, time, and location of the drawing; the raffle tickets do not constitute admission tickets to the annual meeting; and there is no expectation or requirement that ticket holders will attend the annual meeting at which the drawing occurs; and the annual meeting is not political in nature, the raffle proceeds are not exempt function income.

On the other hand, not all raffle proceeds are nonexempt function income. Proceeds of raffle tickets sold in the context of a political event may constitute exempt function income, even though the proceeds in the above example are not.

C. Separate segregated fund

Section 1.527-2(b)(1) of the regulations provides, in relevant part, that a segregated fund is a fund which is established and maintained by a political organization separate from the assets of the organization. The purpose of such a fund must be to receive and segregate exempt function income (and earnings on such income) for use only for an exempt function or for an activity necessary to fulfill an exempt function. This section of the regulations also provides that a segregated fund which expends more than an insubstantial amount for nonexempt function purposes will not be treated as a segregated fund. In those cases where the only funding for a PAC is from nonexempt sources, such as raffle income that is not closely related to a political event, proper segregation of the funds is not an issue.