

# **BEST PRACTICES: Prizes, Sweepstakes, Contests and Awards**

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# The Increasing Use of Sweepstakes, and Contests

- With the growth of the Internet and social media, the award of prizes (cash, experiences or goods) through Sweepstakes and Contests have increased in prominence and use by businesses *and* Tax-Exempt Organizations alike.
- Tax-Exempt Organizations promote their missions and objectives, seek to raise funds, and increase volunteers, members and engagement through these types of promotions.

# Orange County Heart Walk Promotion

- Raise \$1,000 in donations and be entered to win an IPAD, [www.ocheartwalk.kintera.org](http://www.ocheartwalk.kintera.org)

The screenshot shows the website interface for the Orange County Heart Walk. At the top, there are navigation buttons for REGISTER, DONATE, and LOGIN. Below these is an 'Event Info' button. The main content area features a large red heart icon and a message: 'From the bottom of our hearts, thank you for making the 2014 Orange County Heart Walk a success!'. It states that critical funds were raised and that fundraising continues until April 30, 2014. A promotion is highlighted: 'All participants who raise \$100 or more for the Heart Walk by the deadline (April 30, 2014) receive an official Heart Walk t-shirt. (T-shirts will be distributed in May after the fundraising deadline). Walkers who raise over \$250 are also eligible for additional Thank You Gifts.' Below this, there is a section titled 'Congratulations to Joel Nasers of McCarthy Construction' which details a promotion for an iPad Mini. It states that there were over 1,600 entries into the drawing, and Joel Nasers was the winner. The promotion rules are: 'Every Team Captain that recruited 10 walkers to their team that raised at least \$100 each received one entry to win the iPad mini!' and 'Every walker that raised \$200 received one entry to win the iPad mini. For every additional \$200 raised, you received another entry.' A link to 'Download the iPad mini flyer' is provided. On the right side of the page, there are two leaderboards: 'Top Fundraiser' and 'Company Rank'. The 'Top Fundraiser' list includes Joel Nasers, Michael Pappas, Ed Capponell, Chris Taylor, and Randy Highland. The 'Company Rank' list includes McCarthy Build..., Union Bank, Edwards Lifesc..., Community Team..., and SASCO. At the bottom left, there is a sidebar with various navigation links such as 'Find a Team', 'View Our Sponsors', 'Heart Walk Toolkit', 'Get Started Now', 'Parting and Registration', 'Sponsor Participant', 'Spread the Word', 'General Donations', 'My Webpage', 'Main Login', 'Enter My ID', 'Enter my ID', 'Edit my ID', 'Check Reports', and 'Use Tools'.

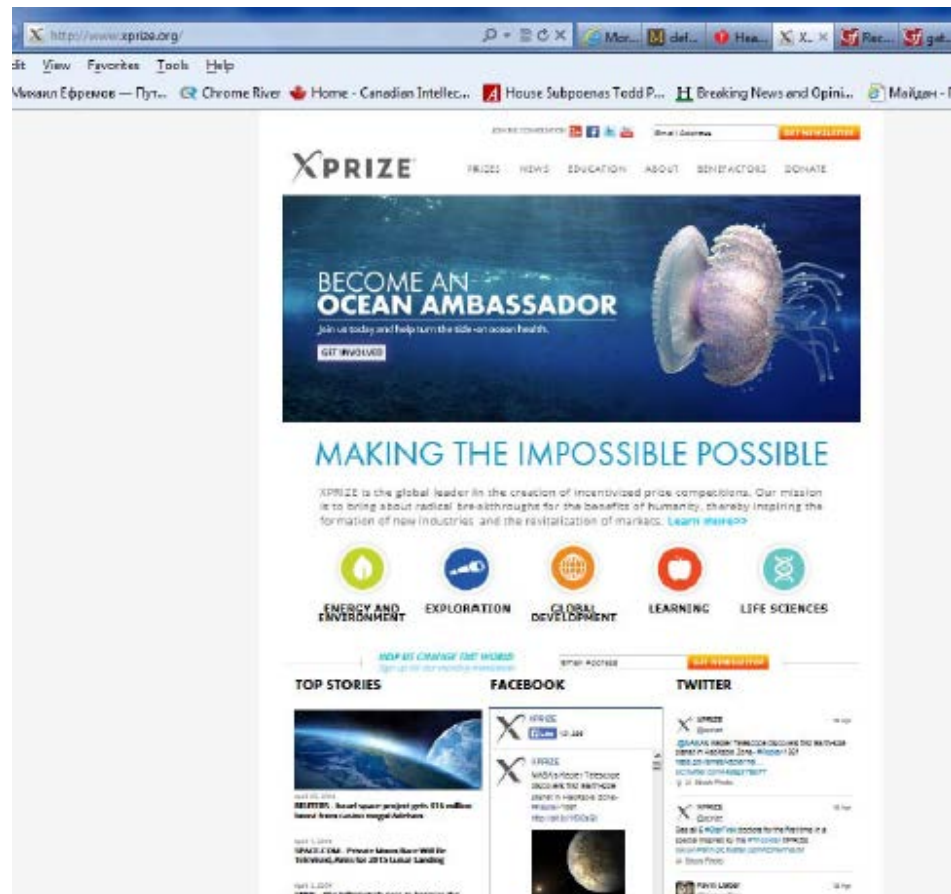
# AARP Contests and Sweepstakes

<http://www.aarp.org/entertainment/leisure-activities/sweeps/>

The screenshot shows the AARP website's 'Contests & Sweepstakes' page. At the top, there is a navigation bar with 'AARP The Magazine', 'AARP Bulletin', and 'In Your State'. Below this is a search bar and a 'JOIN AARP' button. The main content area features a large banner for 'The GRAND Adventure' with the text 'IT'S TIME FOR AN ADVENTURE OF A LIFETIME.' and a 'FIND OUT MORE' button. Below the banner, there are several promotional tiles: 'Amazon' (Members save 50% on select Kindle e-books), 'Regal Cinemas' (Members can save on movie tickets & more), 'Outback Steakhouse' (Members save every day), and a 'Join or renew today!' tile. A 'JOIN AARP' section on the left highlights 'most popular ARTICLES' and a 'Viewed' list. The central 'Featured SWEEPSTAKES & PROMOTIONS' section includes a 'Your Chance to WIN!' graphic and a '\$50,000 Picture Your Retirement Sweeps' offer. On the right, there is a 'NETFLIX' promotion for the series 'ORANGE IS THE NEW BLACK' with a 'WATCH NOW' button.

# XPRIZE Foundation

- The XPRIZE Foundation features technological competitions with large prize purses: [www.xprize.org](http://www.xprize.org)



The screenshot shows the XPRIZE Foundation website homepage. At the top, there is a navigation bar with the XPRIZE logo and links for PRIZES, NEWS, EDUCATION, ABOUT, BENEFACTORS, and DONATE. Below the navigation bar is a large banner for the "BECOME AN OCEAN AMBASSADOR" campaign, featuring a jellyfish and the text "Join us today and help turn the tide on ocean health." Below the banner is the slogan "MAKING THE IMPOSSIBLE POSSIBLE" and a paragraph explaining XPRIZE's mission: "XPRIZE is the global leader in the creation of incentivized prize competitions. Our mission is to bring about radical breakthrough for the benefit of humanity, thereby inspiring the formation of new industries and the revitalization of markets." Below this are five icons representing different areas: ENERGY AND ENVIRONMENT, EXPLORATION, GLOBAL DEVELOPMENT, LEARNING, and LIFE SCIENCES. At the bottom, there are three columns: "TOP STORIES" with a featured article about a Mars mission, "FACEBOOK" with a post about a Mars mission, and "TWITTER" with a tweet about a Mars mission.

# Legal Issues

- While prize offerings have become more widespread and commonplace on the Internet and social media, the laws governing these promotions have not eased in their restrictions.
- Federal law and all state laws prohibit lotteries (except for state-run lotteries). A lottery has the following elements:
  - *The award of a prize*
  - *Results determined by chance*
  - *Consideration (monetary and possible non-monetary consideration) to enter*
- There are also state laws governing contests – prizes awarded based on skill not chance where objective criteria reviewed by qualified judges control.

# Laws That Apply to Prize Promotions

- Federal Law
  - The FTC Act
  - The Deceptive Mail Prevention and Enforcement Act, 39 U.S.C. Section 3001
- State laws exist governing chance and/or skill promotions.
- Beyond the state laws governing sweepstake/lotteries/raffles/prize promotions, the general rules of accuracy and disclosure in advertising apply.
  - The FTC Blogger and Endorsement Guides may apply if you are offering a prize or incentives to encourage social media postings.
  - *Cole Hahn \$1,000 Shopping Spree Sweepstakes found deficient* because no disclosure that pinnings sweepstakes driven.



- **Note: Countries outside the U.S. have even different requirements.**

# Sweepstakes or Illegal Lottery?

- Touchstone — avoid conducting a lottery by avoiding all three elements.
- Three elements for lottery
  - Chance
  - Consideration
  - Prize



# What Is Consideration?

- Monetary consideration – pay to play
  - Donation
  - Purchase of product
- Non-monetary consideration
  - Completion of lengthy questionnaire
  - Traveling to a location
  - Review content for lengthy time
  - Disclosure of proprietary information

# Eliminating Consideration

- Provide an alternate means of entry
  - Cannot give those entering by fundraising or a donation any advantage
  - Conspicuously disclose the availability of the alternative means of entry
  - All entries must be treated equally with “equal dignity”

# Beware of Post Consideration

- Post consideration is present if consumers must pay monies to claim prize.
- While the FTC has said, post consideration does not create an illegal lottery, some states have specific notification statutes to address this issue and some flatly prohibit.
- Best advice: Avoid post consideration.

# What is chance?

- Chance exists if the odds of winning depend on the number of participants and number of prizes, not any judged criteria.
- If you create a promotion where winner picked on the basis of skill -- chance is eliminated.
  - *If winner selected through vague criteria, chance may remain*
  - *If public picks winner by online voting, chance will remain predominant element*

# What Constitutes Skill?

- Often defined in state statute and regulations
- Skill contests specifically identify
  - criteria on which entry will be judged and weight applied to each criteria
  - use judges who have the expertise to evaluate entries
  - require an actual skill to enter
- Rules should define the skill and the judges, so that criteria are clear to entrants and the requirements for an illegal lottery avoided.

## *Bona Fide Skill?*

- A newspaper contest requiring participants to forecast the results of football games, held an illegal lottery [*Seattle Times Co. v. Tielsch*, 495 P.2d 1366 (1972)]
- Jingle contest where standards were not clear and judging was not performed by a panel of experts, a game of chance [*Lucky Calendar v. Cohen*, 12 AD 2d 107 (1956)]

# Skill Needed to Eliminate Chance

- The skill standard must be known to the participants and govern the result.
- Questions must not be too hard or too easy.
- Ties must be broken by skill, not random drawing.
- Judges must be qualified and use objective criteria to choose winner.

# Special Rules for Skill Contests

- Federal: The Deceptive Mail Prevention and Enforcement Act, 39 U.S.C. Section 3001, sets forth requirements for skill contests that use the mails.
- State: A number of states have special requirements.

California, for example, has specific disclosure rules for skill contests,

[http://www.dca.ca.gov/publications/legal\\_guides/u-3.shtml](http://www.dca.ca.gov/publications/legal_guides/u-3.shtml).



# Special Rules to Consider

- Bonding and/or registration for sweepstakes where prizes total more than \$5,000 (FL, NY)
- Intellectual skill contests that require purchase (donation) must be registered (*e.g.*, AZ)
- Award of all prizes (*e.g.*, AR, CA, FL, TENN)
- Record retention (*e.g.*, CA, FL, RI)
- Advertisements for contest or sweepstakes must have link to Official Rules

# Official Rules Regardless of Sweepstakes or Contest

- View rules as the contract with entrants
- Touchstone
  - Avoid ambiguities
  - Attempt to anticipate issues
    - If a trip is the prize, cover issues that may arise from traveling
    - If car is the prize, require entrants to be of driving age and to have insurance

# Topics to Address in Official Rules

Address the following topics for virtually all sweepstakes

- Statement that no purchase or payment is necessary
- Entry instructions
- Limit on number of entries, if any
- Odds of winning
- Prize description, including suggested retail price
- Eligibility — age, legal residency, and affiliation
- Duration of contest: start and ending date
- Right to amend, modify or terminate
- How winner will be chosen

## Additional Topics to Address in Official Rules

- Releases/limitation on liability
- Responsibility for taxes on prizes and collection of sufficient information to report depending on prize value
- Availability of winner list
- Release of publicity rights
- Return/non-return of entries
- Intellectual property ownership/license
- Any limitations on challenges

# Additional Issues: Internet Promotions

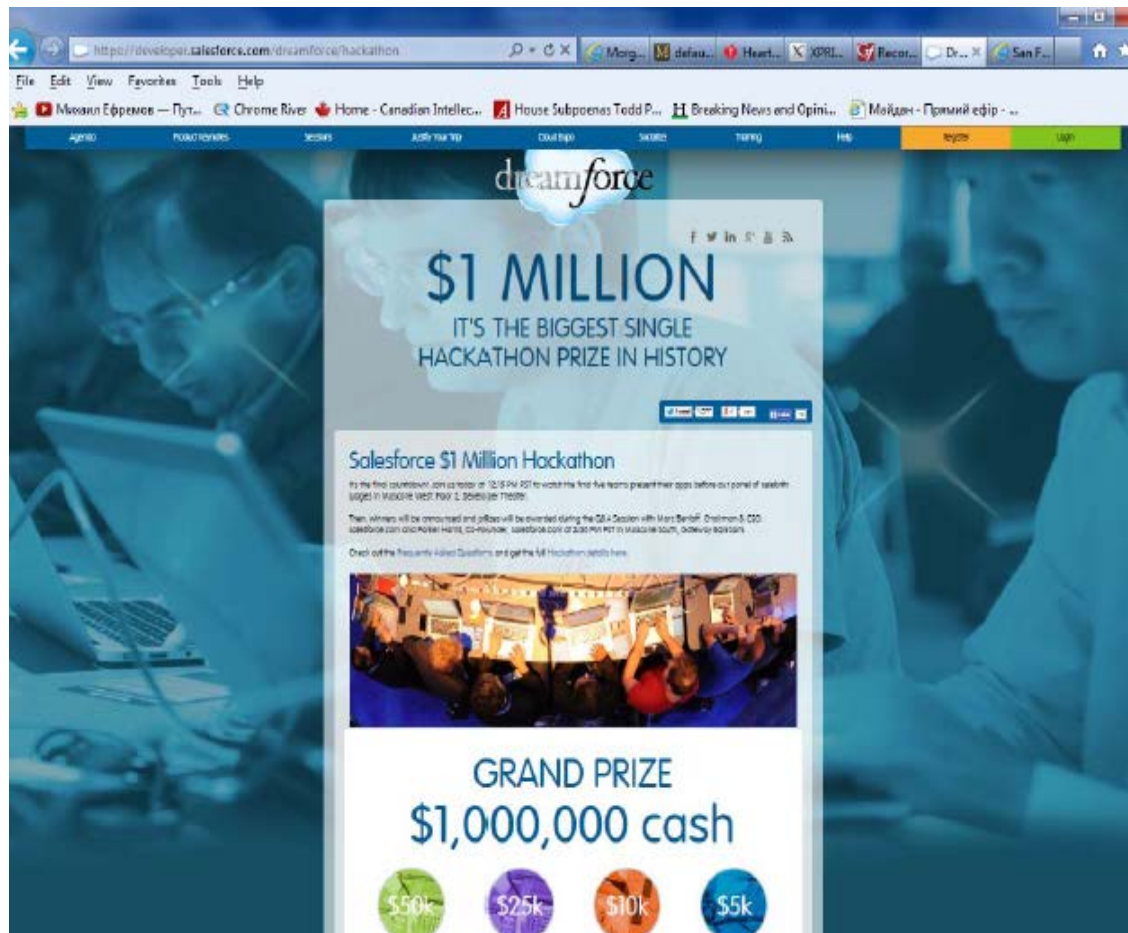
- Fraud clause (virus, other system malfunction)
- Faulty transmission
- Entry made by holder of email account
- Time zone that controls entry deadline
- Age restriction/compliance with COPPA
- Privacy policy
- Geographic limitations
- Disclaimer of association with social media used

# Yet Other Issues

- Trademark issues
  - If prizes offered emanate from third party, do not leave misleading impression that company who manufactures/sells prize is associated with promotion
  - If using an app or social media, need to address the requirements for any disclaimer that the app or social media entity will want.
- Copyright issues
- Proprietary Information issues
- False advertising
  - “You are a winner”
  - “Specially selected”
  - Use of the word “free”

# Hazards of Competitions

- The Salesforce \$1 Million Hackathon Contest



The image shows a screenshot of a web browser displaying the Salesforce \$1 Million Hackathon contest page. The browser's address bar shows the URL <http://developer.salesforce.com/dreamforce/hackathon>. The page features the Dreamforce logo at the top, followed by the headline "\$1 MILLION IT'S THE BIGGEST SINGLE HACKATHON PRIZE IN HISTORY". Below this, the text reads "Salesforce \$1 Million Hackathon" and provides details about the contest, including the deadline and the prize structure. A photograph of a group of people celebrating at a hackathon is shown. At the bottom, the "GRAND PRIZE \$1,000,000 cash" is highlighted, along with four prize tiers: \$50k, \$25k, \$10k, and \$5k.

**\$1 MILLION**  
IT'S THE BIGGEST SINGLE  
HACKATHON PRIZE IN HISTORY

**Salesforce \$1 Million Hackathon**

It's the final countdown: join us today at 12:00 PM PST to watch the live teams present their apps before our panel of judges in MAJORIE WELLS HALL, 2, 3000 JEFFERSON PIKE

Team winners will be announced and prizes will be awarded during the Q&A Session with Mark Benoit, Chairman, \$1,000,000. [salesforce.com/contest/2014/08/20/12:00PM/PST-in-Majorie-Wells-Hall-3000-Jefferson-Pike](#)

Check out the Frequently Asked Questions and get the full Hackathon details [here](#).

**GRAND PRIZE**  
**\$1,000,000 cash**

\$50k \$25k \$10k \$5k

# Hazards of Competitions

- Salesforce contest offering a million dollar prize designed to promote developers' design of Salesforce apps.
- After Salesforce announced a winner, other contestants alleged favoritism, cheating and shady judging.
- In response, Salesforce announced a second winner.
- Contestants continued to allege favoritism, cheating and shady judging.



# Hazards of Competitions

- “IRONMAIN fined 2.8M for illegal lottery”  
<http://westhawaii.com/news/local-news/ironman-fined-28m-illegal-lottery>



# The Enforcers

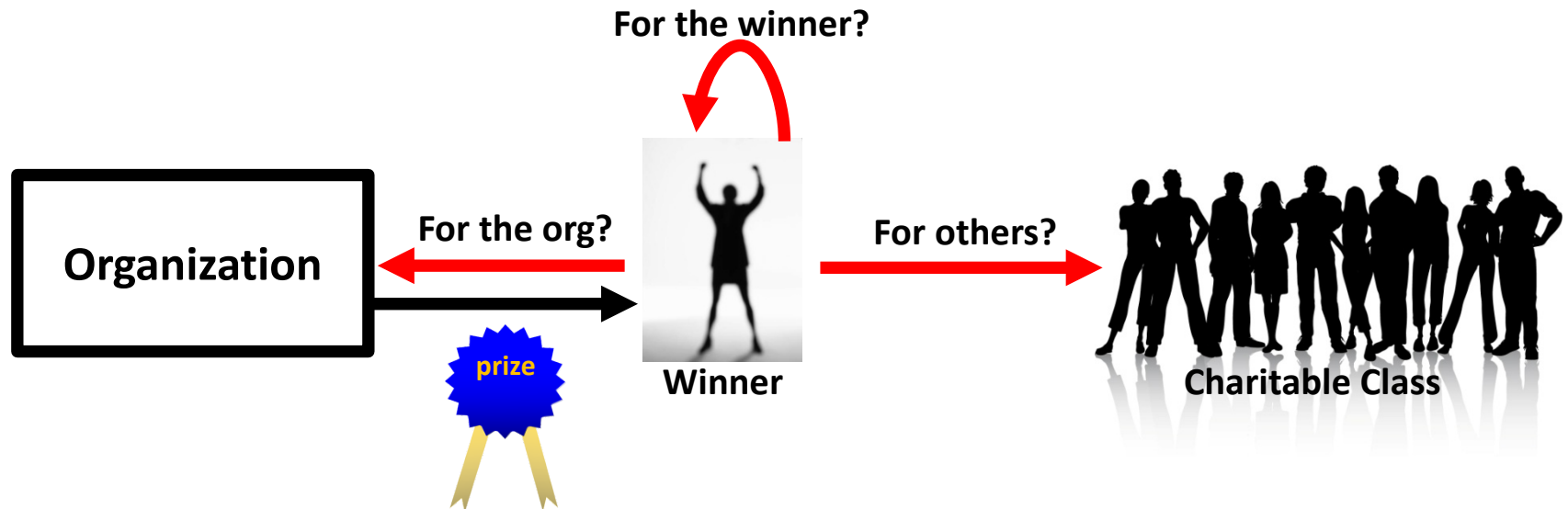
- Federal Government
  - Federal Trade Commission
  - United States Postal Commission
- State and Local Governments (criminal and civil penalties may apply)
  - State Attorney General
  - District Attorney
  - City Attorney
- Individuals through civil litigation

# Beware of Relying on Contests Offered by Others as Your Model

- May be relying on the mistakes of others if you simply copy someone else's rules
- Consider your own unique circumstances – logic is not always controlling
- Vet your unique promotion through legal
- Adhere to the Official Rules in carrying out

# Parsing the Tax Issues

- Who benefits from the contest?
- What do the competitors have to do to win?
- What does the winner do with the prize?



# Tax Issues for the Organization:

## What Kind of Payment Is It?

- Does the organization receive anything in return?
  - No
    - Benefits the contestants/winner
    - Benefits the general public/third party
  - Yes
    - Payment for services
    - Purchase of goods/intellectual property

# Tax Issues for the Organization:

## Is it Charitable?

- What does the winner do with the prize?
- Is the competition intrinsically charitable due to the nature of the competition?
- Do the competitors form a charitable class?
- Does the competition involve private benefit?
  - Who are the direct and indirect beneficiaries of the prize?
  - Can disqualified persons compete and win?

# Tax Issues for the Recipient:

## Is it Taxable Income?

- Section 61 (income inclusion)
- Section 102 (gift exclusion)
- Section 74(b) (prize or award exclusion)
- Section 117 (scholarship exclusion)

# Tax Issues for the Organization:

## Special Rules for Private Foundations

- Is it a taxable expenditure?
  - Payments to individuals
  - Payments for scholarships or fellowships
  - Payments for prizes and awards
  - Payments for specific purposes:
    - to produce a report,
    - to achieve a “specific objective,”
    - to improve or enhance the grantee’s literary, artistic, musical, scientific, teaching or similar capacity, skill, or talent.



# Tax Issues for the Organization:

## Foreign Tax Withholding

- Is the prize U.S. source income?
  - Treas. Reg. § 1.863-1(d)(3): targeted grant? Or achievement award?
- Is the winner a U.S. person?
  - What if the winner is a nonresident alien? What's the winner's visa status? How many days has the winner spent in the US?
  - What if the winner is a foreign entity? Is it a foreign nonprofit? Is the payment effectively connected income?
  - What if the winner uses the prize money to pay sub-contractors who performed services outside the U.S.?
- Special tax treaty rules
  - “Other income” article
  - Forms 8233, W-8BEN

# Tax Issues for the Organization:

## Information Reporting

- Is it a payment for services?
  - Request payee's taxpayer identification number on Form W-9
  - Report grants to IRS on Form 1099-MISC box 3
- Is it a scholarship?
  - Notice 87-31 (scholarships, fellowships, grants and financial aid paid to U.S. citizens and resident aliens are not required to be reported to the IRS by the payors)