

Creative Fundraising Ideas from a Tax Perspective

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As we look around these days, creative fundraising ideas abound. From crowd funding to commercial co-ventures to social impact investing, the list goes on. Ultimately, as nonprofit organizations strategize about future ways to secure funds, management should keep its eyes on at least four areas of tax compliance:

1. Preservation of your tax-exempt status
2. Unrelated business income taxes (UBIT)
3. State charitable solicitation registrations
4. State and local tax issues (sales and use taxes, property taxes, etc.)

Issues in any of these areas could cause an unexpected rain (or hailstorm!) on your charitable parade.

Let's take a look at three contemporary and creative fundraising strategies and weigh some of the potential tax-compliance pros and cons for each.

Fundraising Co-Ventures with Restaurants

Let's say SOS Charity, an exempt organization, sets up an "SOS Charity Night" with participating restaurants across the region, state, or entire United States. SOS Charity promotes the event by sending flyers that offer 20% off pancakes on a given day with a portion of the proceeds going to support the organization's programs.

Is the revenue from SOS Charity Night subject to UBIT?

Although the corporate sponsorship regulations under Treasury Regulation 1.513-4 would suggest that the wording on the flyers would constitute advertising and, thus, the proceeds be subject to UBIT, the revenue might be excluded from UBIT based on the "not regularly carried on" exemption if the SOS Charity Night was only conducted once per year. The IRS actually covered this in a 2014 webcast with the following Q&A:

QUESTION: If an organization sends out an email telling recipients to go eat at an unrelated, taxable-entity fast food restaurant, get a discount, and have a portion of the proceeds go to the exempt organization, is this UBI? The emails do appear to be advertisements due to language in the ad.

IRS ANSWER: This would depend on the specific facts and circumstances of the case. However, if the business activity (the sale of food) is conducted by the restaurant rather than the exempt organization, the business activity (and the income resulting from it) would likely not be imputed to the exempt organization.

Organizations should also be aware that such co-ventures may result in the restaurant being considered a fundraiser for the organization with respect to various state laws.

Farm-to-Table Restaurant Operations

In a recent Private Letter Ruling (PLR, #201702041), the IRS denied tax-exempt status under Internal Revenue Code section 501(c)(3) for an organization that was set up to help educate the public about domestic violence and to assist victims of domestic violence. As an endeavor to raise funds, the new organization included in their

application for exempt status a plan to operate two farm-to-table restaurants. The plan included purchasing all goods, produce, etc. from local vendors and serving only locally grown ingredients. They would hire disadvantaged individuals as “volunteers” to staff these restaurants. Customers would receive tax-deductible receipts for the money they spent on the healthy, freshly prepared meals at the two dining establishments. The organization would also provide information about domestic violence issues at the restaurants via PowerPoint presentations on large-screen TVs. After the initial denial of exempt status, the organization added several new programs. One was described as follows:

“You teach youth the aspects of growing, producing, and maintaining sustainable food systems, and participants can explore career possibilities in various aspects of food preparation. Eligible participants can also become employees at your fundraising locations/resource centers. The produce grown under this program is provided to the public for donations for meals at your fundraising locations/resource centers”

The IRS determined that the organization did not qualify as a charitable organization because the operation of the two restaurants was 1) devoted to non-exempt purposes, 2) more than an insubstantial part of the organization’s activities, and 3) an unrelated activity that did not in further the organization’s charitable and educational activities. The IRS noted, as it has on many occasions, that engaging in a trade or business to raise funds for charitable programs is not an exempt activity “merely because the profits will be used” for the programs.

In this PLR, the IRS stated that the organization’s plan to compensate the “volunteer” workers at the restaurants was a determining factor:

“Additionally, compensating individuals, whom you described as volunteers, for the work they perform preparing and serving meals is not considered a charitable activity.”

One exception to the unrelated business income rule is if substantially all (85%) of the activity is carried on by volunteers. To qualify for this exception, however, the volunteers cannot be compensated in any way.

There might be a few alternatives that could have resulted in a different outcome. For this organization, perhaps they could have conducted these farm-to-table dinners as occasional fundraising activities rather than a primary, ongoing activity of the organization. This should have avoided treatment as an unrelated business activity, because they would not have been regularly carried on. As another example, it would appear that an institution could establish a program or curriculum that aligns with its exempt purpose. Maybe the restaurants could be operated by victims of domestic violence to help them return to the work force. If correctly developed and documented, a program of this nature could be excluded from unrelated business income.

Crowdfunding

This type of venture (in many cases, the better word might be “adventure”) has become a popular fundraising method for all types of organizations. Generally, the crowdfunding model involves three groups: 1) the initiator of the idea or project to be funded, 2) people or groups that support or fund the idea or project, and 3) a platform or intermediary organization that brings the initiators and the funders together.

Recent examples of successful crowdfunding ventures include the ice bucket challenge and text-to-donate phone campaigns. Many crowdfunding ventures are staged to raise funds for specific individuals. Not-for-profit organizations should take care to document that this type of activity is within their stated exempt purpose and that they have measures in place to ensure that funds are going to assist needy individuals in a manner that does not run afoul of the IRS’ private benefit rules.

From IRS Publication 3833, “Disaster Relief Providing Assistance Through Charitable Organizations,” (page 11) we see some commentary on the term, *needy*:

"Individuals do not have to be totally destitute to be financially needy; they may merely lack the resources to obtain basic necessities. Under established rules, charitable funds cannot be distributed to individuals merely because they are victims of a disaster. Therefore, an organization's decision about how its funds will be distributed must be based on an objective evaluation of the victims' needs at the time the grant is made. The scope of the assessment required to support the need for assistance may vary depending upon the circumstances."

In other communications, the IRS has indicated that those who are needy and distressed are somehow "lacking the basic necessities of life, involving physical, mental or emotional wellbeing as a result of poverty or temporary distress."

The questions and issues abound in these types of ventures. Are these contributions deductible for tax purposes? Are donors receiving proper receipts for tax purposes? Might state laws deem intermediary platforms or agents to be professional fundraisers that are required to register with multiple states? Might the crowdfunding initiator organization be required to register with multiples states for charitable solicitations?

Conclusion

Today's nonprofits are using many contemporary, creative, and exciting fundraising (<https://www.aicpa.org/interestareas/notforprofit/resources/taxcompliance/specialeventstaxcomplianceissues.html>) methods. Certainly, the three examples herein are just the tip of the iceberg in this arena. Be diligent. Plan for these types of events and ventures carefully and deploy them strategically. Also, make sure that your organization gets competent legal and tax advice.

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