Fundraising

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FUNDRAISING

A. Charitable Solicitation

Charitable solicitation is regulated by state law and many states require organizations that solicit for charitable purposes to register and file periodic reports with the state charity regulator. Individuals who are paid (and are not employees of a charity) to solicit on behalf of or advise a charity in connection with a charitable solicitation may also be subject to registration requirements.

What is a Solicitation?

A solicitation is a request for a contribution for charitable purposes. A solicitation occurs whether or not a contribution is actually made. A solicitation also includes any advertising that represents that the purchase or use of goods, services, entertainment or any other thing of value will benefit a charitable organization.

Solicitations can be made in person or in writing (including electronic media) and can be made to an individual or to a broader audience.

Who makes a solicitation?

Solicitations can be made by volunteers or employees of an organization. Solicitations by these individuals do not generally trigger additional registration or reporting by the organization.

An organization may also hire agents to solicit on behalf of the organization or advise the organization regarding a charitable solicitation. Engaging the services of a third party to assist the organization with these activities could trigger additional registration and reporting by both the organization as well as the third party.

State Registration/Reporting

Many states and the District of Columbia regulate charitable solicitations. Regulation generally requires an initial registration and annual reporting thereafter. Penalties for violating registration requirements are generally civil and generally include a requirement that the charity register to solicit contributions but may also include forfeiture of funds raised and payment of fines.

Because definitions vary from state-to-state, it is important that an organization review its fundraising activities to determine whether registration/reporting in a particular state is required. Many states require registration before the organization conducts fundraising activity in the state. And, thresholds for registration requirements vary from state-to-state as well.

An area of specific concern is fundraising on the internet. Most of the state statutes were drafted before the internet when national fundraising campaigns were much more expensive (i.e., charities that could afford national campaigns could afford to register in all the states). The internet changed this. Now it costs only a few hundred dollars to create a website and open a Pay Pal account to accept online contributions.

Of particular concern is the thresholds states set for requiring registration and reporting of charitable solicitation activity. The thresholds are generally not limited to funds raised in a particular state. Therefore, an organization could be required to register in a state because it exceeds the stated threshold for total revenues from all sources, but only receives minimal support from that particular state. The only state that addressed this issue is New York, which only requires registration and reporting if an organization receives more than $25,000 from New York sources.

When considering electronic charitable solicitation, note that it is important to distinguish website solicitations from e-mail solicitations as e-mail is considered the equivalent of a mail or fax solicitation.

Once registered, the organization may also be required to file annual reports. Many states tie these annual filing requirements to the organization’s annual IRS filing, but there are some states that have different filing deadlines. Organizations are urged to carefully review filing requirements to avoid jeopardizing the organization’s ability to solicit contributions in a particular state.

The Charleston Principles were drafted by the National Association of State Charity Officials (NASCO) and were finalized in March 2001. It is important to recognize that the Principles are not law; they were designed to help states develop their own regulatory approach to charitable solicitations on the Internet.

The Principles provide the following standards:

- Registration required when courts can assert personal jurisdiction.

- Recommended adoption of baseline standards for requiring out-of-state charities to register. For example, if non-Internet activities are sufficient to require registration, then Internet activities are irrelevant.

- Registration is required when a charity solicits contributions via an interactive website AND (a) specifically targets residents of particular state, OR receives contributions from a state on a repeated and ongoing basis or substantial basis through its website.

- Registration is also required when a charity solicits contributions through a non-interactive site that specifically invites further offline activity or other communications that promote the website AND (a) specifically targets residents of a particular state, OR (b) receives contributions from a state on a repeated and ongoing basis or substantial basis through its website

B. Donor Restricted Funds

When an organization receives a donation or payment, the organization may generally use such revenue to fund activities that further the organization's stated purposes. However, assets received by an organization may be considered restricted based on the language included in the solicitation materials or explicitly by the donor.

Two (2) types of donor restrictions predominate. Under the first, the gift instrument (which includes solicitation materials) limits use of the gift for specific purposes (e.g., to fund cardiac care and prevention). This type of limitation is sometimes referred to as a "use" restriction.

Gifts may also be restricted as to the amount of income or principal that can be spent, commonly referred to as an "endowment" restriction. Sometimes, both types of restrictions are found in the same gift.

Use Restrictions

In order to find that a gift is restricted in use for a specific purpose, the restriction must be clearly expressed by the donor. Absent direction by the donor, the gift is deemed to be an absolute gift to the charity to be used for the charitable purposes prescribed by its charter.

The organization is under a legal obligation to apply assets received subject to donor restrictions in accordance with those restrictions, but is allowed reasonable and proper related administrative expenses. Thus, charitable gifts or bequests received subject to a use restriction must be used in accordance with that restriction. To do otherwise is a breach of fiduciary duty of the organization's governing body. In this regard, it is important to establish that a particular fund is indeed use-restricted. It is not uncommon for donors to use precatory language ("I would ask that the assets be considered for use as part of the program established in my parents' name") in their gifts. Such recommendations are not legally binding on the organization, but provide a context in which expenditure decisions should be made.

The internal accounting for use-restricted gifts becomes very important in order to assure that unrestricted assets are not used in order to meet obligations that can also be served by use-restricted funds. An organization should consider a policy under which the most restricted assets are expended first, so as to assure that use restrictions are satisfied as the dollars are spent. If the internal accounting systems of the organization are not sufficiently robust to assure this practice, then some attention should be paid to getting them in compliance.

There have been questions raised as to whether the income or gains related to a use restricted gift are legally considered to be bound by the same use restriction as applied to the original funding amount. The question is a difficult one and organizations need to look to state law to determine whether restrictions apply to the income or gains. The historic practice of many organizations is to subject any investment income or gains allocable to donor-restricted funds to the same use restriction as the original gift. Note that the same concern does not arise for use-restricted assets that are also subject to an endowment restriction, as the assumption in this case is that the fund in its entirety is subject to both types of restrictions.

Endowment Restrictions

A second category of donor-restrictions includes those instruments that designate the fund as "endowment" or prohibit the fund from being wholly expended on a current basis. Normally an endowment restriction requires that the principal be maintained intact and only income spent. Funds conveyed by these instruments are often referred to as "pure endowment" funds. It is important to distinguish such funds from those that, having been given to the institution unrestricted, are later designated by action of the board to be used as endowment for investment and expenditure purposes, namely "quasi-endowment funds."

Absent express language by the donor, or clear response by the donor to a solicitation so stating, an endowment restriction is not assumed. This is generally helpful to the recipient charity, which benefits from the flexibility of investing and expending a fund as endowment where appropriate. Importantly, organizations should review closely any donor solicitation materials to assure clarity on this point.

Investment of endowment assets is a key part of managing these types of gifts. Organizations should look to state law for the standards and requirements that govern the investment and management of investment assets. State law will also provide guidance regarding the process by which an organization should appropriate funds for expenditure from endowment assets.

C. Gift Receipting Requirements

Charitable organizations must provide certain information to donors, because the failure to do so may result in the denial of deductions claimed by donors and the imposition of penalties on the charity.

No federal income tax deduction is allowed for any charitable contribution of $250 or more unless the donor has a contemporaneous written substantiation from the charity.[1] In cases where the charity provided goods or services to the donor in exchange for making the contribution, this contemporaneous written acknowledgment must include a good faith estimate of the value of such goods or services. Taxpayers may no longer rely solely on a canceled check to substantiate a cash contribution of $250 or more.

The substantiation must be “contemporaneous.” That is, it must be obtained by the donor no later than the date the donor actually files a return for the tax year in which the contribution was made. If the return is filed after the due date or extended due date, then the substantiation must have been obtained by the due date or extended due date.

The responsibility for obtaining this substantiation lies with the donor, who must receive it from the charity. The charity is not required to report this information to the IRS on behalf of donors. A charity that knowingly provides false written substantiation to a donor may be subject to the penalties for aiding and abetting an understatement of tax liability.

[1] Donors may also request receipts for cash contributions under $250 as donors are required to maintain a bank record or a written communication from the charity indicating the amount of the contribution, the date the contribution was made and the name of the charity. This requirement applies to *all* cash contributions (even those under $250).

While there is no prescribed format for a written substantiation, the following will comply with the requirements of the law:

> Thank you for your gift of [set forth dollar amount or describe property]. Your generous contribution will help us greatly in meeting our goals. Please note that you must retain a copy of this gift receipt for federal income tax purposes and that no goods or services were furnished in consideration of your kind gift.

Additionally, a charity must provide a written disclosure statement to donors who make a payment, often described as a "*quid pro quo* contribution," in excess of $75. This requirement is separate from the written substantiation required for deductibility purposes discussed above, although the same written acknowledgment may satisfy both requirements. An example of a *quid pro quo* contribution is where the donor gives a charity $100 in consideration for a luncheon ticket valued at $40. In this example, $60 would be deductible. Because the donor's payment (the *quid pro quo* contribution) exceeds $75, the disclosure statement must be furnished, even though the deductible amount does not exceed $75.

The charity must furnish the disclosure statement in connection with either the solicitation or the receipt of the *quid pro quo* contribution. If the *quid pro quo* disclosure statement is furnished in connection with a particular solicitation, it is not necessary for the charity to provide another statement when the resulting contribution is actually received. An example of such a disclosure might be as follows:

> Tickets for the event are $100 each, $900 for a table of ten. We estimate that the value of the benefits received by each ticket holder totals $50. Please consult your tax advisor regarding the tax-deductibility of a portion of your payment. Note that you must retain a copy of this gift receipt for federal income tax purposes

Note that the value of benefits received by the donor is the fair market value, even if some of the goods or services provided are donated for the event. The disclosure must be in writing and must be made in a manner that is reasonably likely to come to the attention of the donor. For example, a disclosure made in small print within a larger document might not meet this requirement.

A penalty is imposed on charities that do not meet the disclosure requirements. For failure to make the required disclosure in connection with a *quid pro quo* contribution of more than $75, there is a penalty of $10 per contribution, not to exceed $5,000 per fundraising event or mailing. The charity may avoid the penalty only if it can demonstrate that the failure was due to a reasonable cause.

Recordkeeping for Fundraising Events

Charities raise money in a variety of different ways. It is important to account for these funds correctly for many reasons, including:

- accurate financial information is required to complete the annual IRS Form 990 filing; and
- correct gift substantiation depends upon a proper understanding of how payment amounts are characterized.

Below are a few examples of fundraising events and the reporting an organization should follow for them. Additional guidance is available in IRS Publication 1771, *Charitable Contributions — Substantiation and Disclosure Requirements*, which is available at http://www.irs.gov/pub/irs-pdf/p1771.pdf. Essentially, payments received as part of a fundraising event fall into one of the following categories: revenue in exchange for goods or services (a *quid pro quo*), a charitable contribution with no expectation for a return benefit or a combination.

Dinners, golf tournaments, and other events. Payments from participants must be separated into two categories. The value of the goods and services the donor receives (i.e., the estimated value of what the purchaser would have to pay in the open market) is an exchange transaction for the charity. Only the difference between the payment received by the charity and the *quid pro quo* received by the donor is considered a charitable contribution, and is eligible for a federal income tax deduction.

> EXAMPLE: A supporter pays the organization $1,000 for a table at a fundraising dinner. Organization estimates that the fair market value of the dinner is $400. Vendors, who support the event, underwrite $100 of the cost and the organization pays the remaining $300 cost of the dinner per table from the proceeds of the event. The *quid pro quo* value of the exchange is $400 (cost of the dinner). The remaining $600 is considered a charitable

contribution/public support, even though the net income to the organization is $700. The table purchaser should receive a gift receipt for $600.

Raffles. No portion of a payment for a chance in a raffle is a charitable contribution, even if the purchaser does not win a prize. The full amount of the payment is recorded as revenue from a fundraising event, but is not considered a charitable contribution (i.e., no federal income tax deduction). You should also be aware that certain federal withholding requirements apply to prizes awarded as part of a raffle.

> EXAMPLE: The organization receives a trip voucher from a local travel company, valued at $2,500. The organization provides a gift receipt to the travel company for the full amount of the voucher and records it as a charitable contribution/public support. It then raffles off the voucher. Each raffle ticket costs $100 and all proceeds from the sale of raffle tickets are considered revenue. However, gift receipts are not required because the revenue is not considered charitable contributions/public support. The net income to the affiliate depends upon the number of tickets sold.
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> **Note: Many states limit (or prohibit) the ability of charities to conduct raffles or other games of chance. Check with legal counsel before conducting one.**

Auctions. Like raffles, the bidders at an auction are motivated by a purchase, so it is unlikely that their payments will constitute charitable contributions. It is possible that for some items, where the fair market value is easily ascertained, that portion of the payment in excess of the market value is considered a charitable contribution.

> EXAMPLE: Same result as above, except that the purchaser may be eligible for a charitable contribution deduction if the amount paid exceeds the fair market value of the item. In such case, the difference is considered a charitable contribution/public support, with the remainder being revenue. An example might be a case of wine, for which the retail price is easily ascertained. A bidder paying in excess of that price makes a charitable contribution for the difference.

Quid Pro Quo Exceptions

Though the acknowledgment usually needs to describe goods or services provided by an organization in exchange for a contribution of $75 or more, there are exceptions.

The “token exception” applies to insubstantial goods or services provided by the organization and do not need to be described or valued in the gift receipt provided to the donor. Goods are considered insubstantial if

- the fair market value of the benefit received does not exceed the lesser of two percent of the payment or $106; or
- the payment is at least $53, the only items provided have the organization’s name or logo on them and the cost of these items is within the limit for “low-cost articles,” which is $10.60.

Another exception, the membership benefits exception, applies to annual membership benefits, which are also considered to be insubstantial if provided in exchange for an annual payment of $75 or less and consist of annual recurring rights or privileges, such as:

- free or discounted admissions to the charitable organization’s facilities or events;
- discounts on purchases from the organization’s gift shop;
- free or discounted parking; and
- free or discounted admission to member-only events sponsored by an organization, where a per-person cost (not including overhead) is within the “low-cost articles” limits.

Lastly, the intangible religious benefits exception applies if a religious organization provides only “intangible religious benefits” to a contributor, in which case, the acknowledgment does not need to describe the value of those benefits. Instead, it need only state that the organization provided intangible religious benefits to the contributor.