

FUNDRAISING ISSUES FOR NONPROFIT ORGANIZATIONS

PUBLIC COUNSEL | COMMUNITY DEVELOPMENT PROJECT | FUNDRAISING ALERT

GENERAL FUNDRAISING CONSIDERATIONS

Charities that are recognized as tax-exempt under Section 501(c)(3) of the Internal Revenue Code are generally not required to pay income tax. However, income from certain activities, as explained below, may still be taxable under federal or local law. Additionally, numerous registration and reporting requirements under federal and local law exist in connection with fundraising activities. The following highlights just a few of those taxes and reporting requirements.

Tax on Unrelated Business Activities

Charitable organizations may be required to pay tax (UBIT) on income derived from a regularly carried on trade or business if the activity is not substantially related to the organization's exempt purpose (an "unrelated business activity"). This general framework for taxation of income from unrelated business activities contains some exceptions, including, for instance, if in operation of the unrelated activity the charitable organization: 1) utilizes a volunteer workforce; 2) sells donated merchandise; or 3) conducts bingo or similar activities.

Certain fundraising activities may be considered unrelated business activities if they are regularly carried on (for example, weekly or online sales or auctions) and no exception to the UBIT rules applies. Two cautions exist with respect to unrelated business activities and fundraising. The first relates to the scope of the activities, and the second relates to potential tax liability. First, to ensure that it maintains its tax-exemption, an organization should not dedicate a substantial part of its time or resources to "unrelated" activities. Second, unless an exception applies, the income from such unrelated activities will be subject to UBIT.

Keep in mind that income-generating activities that are structured to further one or more of a charity's exempt purposes will not be subject to UBIT because they do not fall within the definition of "unrelated business activities." For example, a charity's operation of a retail grocery store as part of a therapeutic and training program to help disadvantaged youth, when the store is almost fully staffed by the youth, is not likely to constitute an unrelated business activity because the store is operated in a manner that furthers one of the charity's exempt purposes by assisting the youth.

Additional information concerning unrelated business activity and its exceptions can be found in IRS Publication 598, Tax on Unrelated Business Income of Exempt Organizations, available at www.irs.gov/pub/irs-pdf/p598.pdf.

Sales and Use Tax

Sales and use tax applies to the sale or use of tangible personal property in California. Charitable organizations may be subject to either tax depending on the nature of a particular fundraising activity. Organizations must obtain a seller's permit if they are engaged in business in California and intend to sell or lease tangible personal property that would ordinarily be subject to sales tax if sold at retail, unless certain limited exceptions apply to the particular sales activity.

For additional information, please see California State Board of Equalization Publication 18, Tax Tips for Nonprofit Organizations, available at www.boe.ca.gov/pdf/pub18.pdf, and Publication 73, Your California Seller's Permit, available at www.boe.ca.gov/pdf/pub73.pdf.

Substantiation of Charitable Contributions

Donors and charities must comply with a number of different substantiation requirements in connection with the donation of goods and services. Generally, charities are required to provide written disclosures to a donor who makes a contribution in excess of \$75 if the donor receives goods or services in exchange for that contribution. For donations of any amount, a donor will need either an acknowledgement from the charity or a bank record such as a cancelled check or credit card statement, in order to claim the deduction. Additionally, a donor is responsible for obtaining a written acknowledgement for any single contribution of \$250 or more in order to claim the donation as a deduction.

For additional information, please see IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements, available at www.irs.gov/pub/irs-pdf/p1771.pdf, and IRS Publication 526, Charitable Contributions, available at www.irs.gov/pub/irs-pdf/p526.pdf.

Notice of Intention and Information Card

In the City of Los Angeles, a charity must file a Notice of Intention with the Los Angeles Police Commission Charitable Services Section at least 15 days prior to the start of any fundraising campaign or special event that involves solicitation for charitable purposes. The charity is then issued an Information Card that must be provided to all potential donors. Detailed information about this requirement can be found on the Los Angeles Police Commission website,

www.lapdonline.org/police_commission/content_basi_c_view/9147.

Many cities and counties have enacted similar ordinances regulating charitable solicitations. You should be aware of the requirements for all cities or counties in which you are conducting fundraising. A list of city and county offices with information on local solicitation ordinances can be obtained at

www.ceb.com/info/NonprofitsAppendixC.asp.

GAMING ACTIVITIES

Although Article IV, Section 19 of the California Constitution prohibits many forms of gambling in California, nonprofit organizations meeting certain eligibility requirements may conduct bingo, raffles, or “poker nights” as fundraisers, if these games are conducted according to detailed rules after appropriate registration. These exceptions to the prohibition on gambling are summarized below.

Charity Poker Night Fundraisers

Eligible organizations that have been in existence for at least three years may register with the California Attorney General's Bureau of Gambling Control to conduct one “poker night” fundraiser each year, in which participants may play controlled games such as poker or Pai Gow. (Eligible organizations with multiple chapters may hold one such fundraiser per chapter per year.) Such an event must be no more than five hours in duration.

Winners' prizes at these events must be donated, and cash prizes may not be awarded. No individual prize awarded may exceed a cash value of \$500, and the total value of prizes awarded may not exceed a cash value of \$5000. Persons under the age of 21 may not participate. At least 90 percent of revenues generated at these events must go directly to the nonprofit organization, and no more than 10 percent of gross receipts may be paid as compensation to the entity or persons conducting the fundraiser, excluding a facility rental fee.

Organizations holding these fundraisers must maintain event records, and be willing to provide an itemized report to the Bureau of Gambling Control upon request, of gross receipts, costs incurred, recipients of net profits, number of fundraiser participants, and prizes awarded. All suppliers of equipment used in playing the controlled games must register with the Bureau of Gambling Control as well.

For more detailed information about the requirements for conducting charity poker night fundraisers, visit the California Attorney General's Bureau of Gambling Control website,

<http://ag.ca.gov/gambling/charitable.php>.

Bingo

The California Penal Code defines bingo as a game of chance in which prizes are awarded on the basis of designated numbers or symbols on a card that conforms to the numbers or symbols selected at random. Tax-exempt charitable organizations generally may conduct games of bingo for fundraising purposes in California, as long as the city or county in which the bingo is to occur has implemented an authorizing ordinance and the bingo games are operated consistent with that local ordinance and with the California Penal Code.

In the City of Los Angeles, charitable organizations may legally conduct bingo games if they obtain a license from the Los Angeles Police Commission Charitable Services Section. The application fee to obtain the license is \$50, of which \$25 may be refunded if the license application is denied. An additional fee applies when the total amount paid out in bingo prizes in a month is in excess of \$2,000.

There are many additional rules regarding the conduct of the bingo game under the California Penal Code. For example, generally bingo may only be conducted between the hours of 12:00 noon and 12:00 midnight, and bingo may be conducted by one organization no more than 3 days per week and must be open to the public. Alcohol may not be served in the room in which bingo is being played, and persons under the age of 18 are not permitted to operate or play bingo. Prizes for bingo are limited to \$250 per game of bingo, and no more than 40 games may occur during any one bingo session. Funds from bingo games must be counted jointly by at least two members of the charity, deposited into a special bingo bank account and not commingled with other funds. Likewise, disbursements from the special account must be signed by two authorized officers of the charity and used only for charitable purposes. Certain additional rules apply to senior citizens' organizations (groups whose members are at least 50 years of age) that, among other things, exempt these groups from payment of the application fee if bingo is for recreational purposes.

For a complete listing of the rules related to bingo in the City of Los Angeles, see the Los Angeles Police Commission Charitable Services Section website,

www.lapdonline.org/police_commission/content_basi_c_view/9147.

The proceeds of bingo will not likely subject an organization to UBIT because the IRS has created a special exception to the UBIT rules for proceeds derived from certain bingo games. For more details, see Section 513(f) of the Internal Revenue Code and IRS Publication 598, Tax on Unrelated Business Income of Exempt Organizations, available at www.irs.gov/pub/irs-pdf/p598.pdf.

Raffles

A raffle is a type of lottery in which prizes are awarded to people who pay for a chance to win. Only “eligible organizations” (nonprofit tax-exempt organizations that have been registered in California for at least one year) may legally conduct raffles in California. An organization that intends to conduct a raffle must first submit a raffle registration form, Form CT-NRP-1, and a filing fee with the California Attorney General’s Registry of Charitable Trusts, at least 60 days before the scheduled date of the raffle. The registration period for conducting raffles is September 1 through August 31 annually. The organization must receive written confirmation of registration before conducting any raffle activities, including the selling of raffle tickets.

Additionally, the organization must file a disclosure report, Form CT-NRP-2, for all raffles conducted during the reporting year. The disclosure report is due on or before October 1. Precise record-keeping is required as reports that include estimates of proceeds and expenses will not be accepted for filing. If a raffle is a part of a larger fundraising event, the organization has an obligation to keep the accounting of the raffle proceeds and expenses separate from the larger event.

California law also prescribes rules for the operation of raffles. Each ticket must be sold with a detachable coupon or stub that is marked with a unique and matching identifier. Winners of the prizes must be determined by draw, and the raffle must be conducted under the supervision of a natural person age 18 or older. Additionally, at least 90 percent of the gross receipts from raffle ticket sales must be used by the organization to benefit or support charitable or beneficial purposes in California. Groups are prohibited from awarding raffle prizes by use of a gaming machine, apparatus, or device such as a slot machine. A raffle cannot be advertised, operated, or conducted over the internet. However, the organization conducting the raffle may place an announcement of a raffle on its website.

A raffle is exempt from the registration requirement if 1) it is part of a scheme that does not require any participant to pay for a chance to win, 2) the tickets are offered on the same terms as those for which a donation is given, and 3) there is a general and indiscriminate distributing of tickets. In either case, if a charitable organization regularly conducts raffles, the raffle may constitute an unrelated business activity and the proceeds may be subject to UBIT.

For more information on raffle restrictions, eligible organizations, and registration requirements, please refer to the California Attorney General’s website,

<http://oag.ca.gov/charities/raffles>

Auctions and Other Sales of Goods

There is no specific prohibition in California or federal tax law on the ability of a charity to hold an auction for fundraising purposes. An auction or silent auction does not constitute a game, but is rather a sale of goods by the organization. Typically, both regular and silent auctions allow participants to bid on any item offered for sale, and the winning bidder will purchase the auctioned item for the bid price. Purchasers of

items at a charity auction may claim a charitable contribution deduction for the excess of the purchase price paid for an item over its fair market value. However, the purchaser must be able to show that he knew the value of the item was less than the purchase price. For example, if a charity provides a catalog with a good faith estimate of items available for bidding and the purchaser has no reason to doubt the accuracy of the published estimate, the purchaser may generally take a charitable contribution deduction equal to the excess of the purchase price over the published value.

Donors who provide goods for charities to sell, whether at an auction or otherwise, may take a charitable contribution deduction in connection with that donation, but the deduction will be limited to the donor's tax basis (acquisition cost) in the contributed property. Donors are not permitted to claim a fair market value charitable deduction for a donation of appreciated property that is donated for sale rather than for use by the charity. IRS Publication 561, *Determining the Value of Donated Property*, available at www.irs.gov/pub/irs-pdf/p561.pdf, contains information on determining the fair market value of donated property.

Charitable organizations may be subject to UBIT on the proceeds derived from such sales if they are regularly carried on, unless an exception (e.g., utilizing a volunteer workforce or selling donated merchandise) applies. Organizations should review IRS Publication 598 to assess whether any UBIT exceptions apply. A charitable organization may also be subject to sales tax for conducting sales of goods, and should review the California State Board of Equalization website, www.boe.ca.gov, and BOE Publication 18, to determine if it is subject to such tax.