Joseph Redouté
Pink Roses in a Vase
Dated 1838
Watercolor & Gouache over Graphite on Vellum
Courtesy of National Gallery of Art
Gift of Dian Woodner

Fundraising
Legal Issues for Charitable Organizations

~ Michael J. Wilson

While a charitable organization's mission is the fundamental reason for its existence, there can be no mission without money. Fundraising is always critical to any charitable organization's success—even to its survival. However, fundraising without complying with Florida law can have disastrous consequences, as several principals with a charitable organization learned last year when they were charged by the Florida Attorney General with violating both the Florida Charitable Solicitations Act (FCSA) and Florida's Gambling Act, which govern raffles conducted by charitable organizations.

There are many methods and approaches to fundraising, and different ones work for different charitable organizations. This article does not describe the methods. Instead, it covers basic legal issues that impact fundraising and charitable organizations, including some legal issues often overlooked but which can attract the attention of the Florida Attorney General.

Florida Charitable Solicitations Act

Charitable organizations seeking to raise funds must comply with the FCSA. One of the key requirements of the FCSA is that, with certain exceptions, anyone who solicits donations from Floridians must register with the Florida Department of Agriculture and Consumer Affairs (the DACA) and renew his or her registration statements annually. Certain charitable organizations are exempt from the FCSA, including bona fide religious organizations, educational institutions, and charitable organizations that limit the solicitation of contributions to their members. Organizations with less than $25,000 in total revenue during a fiscal year are also exempt, providing that volunteers, members, or officers, none of whom are compensated, perform their fundraising activities.

Charitable organizations must generally register with the DACA prior to engaging in solicitation activities in Florida. This requirement is frequently overlooked by many new charitable organizations. Those that have not yet obtained their tax exemption determination letter from the Internal Revenue Service (IRS), a process that typically takes at least several months, can still proceed with registering with DACA, but they must supply a copy of the determination letter with their renewal.

Charitable organizations subject to the FCSA must also file an annual financial statement with the DACA for the immediately preceding fiscal year or provide certain federal tax forms. The annual financial statement must include, among other information, a (i) balance sheet; (ii) statement of support, revenue and expenses, and change in the fund balance; and (iii) statement of functional expenses, including program service costs, management and general costs, and fundraising costs. Additional reporting is required if an organization spends less than 25 percent of its total annual functional expenses on program service costs.

Under recent changes to the FCSA, charitable organizations must adopt a conflict of interest transaction policy, and each of the charitable organization's officers, directors, and trustees must annually certify that he or she complies with the policy. The annual certification must be submitted to the DACA with the charitable organization's annual registration statement. Further, the charitable organization must provide details to DACA on any economic or business transaction between the organization and any of its officers, directors, or trustees (including any immediate family members or related entities of any of the foregoing).

A requirement of the FCSA frequently violated is the requirement that a statement be included in each and every printed solicitation, written confirmation, receipt, and reminder of a contribution. That statement, reprinted below, must be conspicuously displayed in all capital letters:

A COPY OF THE OFFICIAL REGISTRATION AND FINANCIAL INFORMATION MAY BE OBTAINED FROM THE DIVISION OF CONSUMER SERVICES BY CALLING TOLL-FREE WITHIN THE STATE. REGISTRATION DOES NOT IMPLY ENDORSEMENT, APPROVAL, OR RECOMMENDATION BY THE STATE.

The statement must also include a toll-free number for the DACA and, as added by the amendment, the website for the DACA, which can obtain the charitable organization's registration statement. If a charitable organization solicits donations online, then the foregoing statement must be conspicuously displayed on the organization's website. The website must also provide the mailing address where contributions are to be sent, provide the telephone number to call to process contributions, or provide for online processing of contributions.

How to Conduct a Raffle That Complies with Florida Law

Many charitable organizations fail to comply with Florida law governing raffles. Florida law prohibits raffles with certain, limited exceptions. For a charitable organization to lawfully conduct a raffle, it must meet all of the following eight requirements:

1. The charitable organization must have a current exemption letter from the IRS under certain specified Internal Revenue Code sections, including Code section 501(c)(3).

2. The charitable organization cannot require payment in any form for the raffle tickets; however, a minimum donation may be suggested. In my experience, many raffles run by charitable organizations fail this requirement.

3. All advertisements, notices, tickets, or entry blanks for the raffle must contain the following information: (a) rules governing the conduct and operation of the raffle; (b) full name of the organization and its principal place of business; (c) source of funds used to award cash prizes or to purchase prizes; (d) date, hour, and place where the winner will be chosen (unless tickets are not offered to the public more than three days prior to the raffle drawing); (e) prizes to be awarded; and (f) a statement that no purchase or contribution is necessary. This is another requirement that charitable organizations often fail to meet.

4. The winner of the raffle cannot be predetermined.

5. The raffle cannot be conditioned on a minimum number of tickets being distributed or a minimum number of contributions.

6. There can be no discrimination between entrants who gave contributions (or suggested donations) and those who did not.

7. The winner of the raffle must be promptly notified.

8. The offered prize or prizes must be awarded. An organization cannot fail to award prizes under any circumstances.

It's worth noting that a charitable organization may limit the number of tickets distributed to any one entrant.

Besides Florida issues, raffles require charitable organizations to comply with certain IRS reporting and tax withholding requirements. The charitable organization must generally obtain certain information from the raffle winner on IRS Form 5754, and the charitable organization must report raffle information annually on IRS Forms W-2G and 1096. An issue that catches many charitable organizations unaware is that if the prize is something other than cash, such as a car, then the charitable organization is generally required to collect from the raffle winner cash equal to 25 percent of the fair market value of the prize and submit it to the IRS on behalf of the raffle winner. Failure to comply with these rules can cause the charitable organization to be liable for penalties and tax.

Joint Ventures

Charitable organizations sometimes seek to monetize their assets and increase their cash flow by entering into a joint venture with a for-profit business. These joint ventures involve several complex governance, economic, and tax issues.

Governance and economic issues that the charitable organization must consider include defining the scope and purpose of the joint venture, how decisions will be made and disputes settled, who will have authority to bind the joint venture, how costs and profits will be allocated among the parties to the joint venture, what will be the term of the joint venture, and what will happen upon the termination or split-up of the joint venture (i.e., how do the parties exit the joint venture). Another issue is whether the joint venture will seek to raise capital from outside sources and, if so, how that will be handled.

The form of the joint venture must be determined. Options include a corporation, partnership, or limited liability company. Often, this determination will be made based on tax considerations. There are many tax issues to consider, but they general fall into one of two buckets. The first bucket relates to whether participation in the joint venture will jeopardize the tax-exempt status of the charitable organization; the second bucket relates to whether income generated by the joint venture will be unrelated business taxable income (UBTI) to the tax-exempt organization. Let's look at each separately and consider ways to limit or avoid them.

Will the joint venture jeopardize the tax-exempt status of the charitable organization?

When analyzing whether participation in the joint venture will jeopardize the tax-exempt status of a charitable organization, the primary issue to consider is whether the joint venture will create a private benefit or private inurement. This occurs where an individual or for-profit entity receives benefits from the charitable organization that are disproportionate to the person's or entity's contributions to the charitable organization.

A common way that private inurement arises in a joint venture is where the IRS determines that the charitable organization's contributions to the joint venture are not commensurate with the ownership interest or "economic deal" that the charitable organization receives from the joint venture. For example, there can be private inurement in a 50/50 joint venture where the IRS determines that the contributions of the charitable organization to the joint venture are worth more than the contributions of the for-profit party. Having such private inurement or private benefit can cause a charitable organization to lose its tax-exempt status. Using independent consultants to value the contributions of the parties to the joint venture can help limit the risk of private benefit or private inurement. The structure of the joint venture can also help to limit the risk: whether the charitable organization will have ultimate control over the joint venture (such as majority voting rights or the ability to appoint a majority of the board of the joint venture). Another factor in limiting risk is ensuring that the joint venture agreement mandates that the joint venture will be operated in a manner consistent with the tax-exempt purposes of the charitable organization.

Will income generated by the joint venture be unrelated business taxable income (UBTI) to the tax-exempt organization?

Regarding the second bucket of tax issues, UBTI is income derived from a trade or business regularly carried on and that is not substantially related to the performance of tax-exempt functions. UBTI is taxable to a charitable organization in much the same way as a for-profit corporation's income is taxable. In a joint venture structured as a partnership or a limited liability company taxed as a partnership, income generated by the joint venture is often UBTI to the charitable organization. Having too much UBTI can also jeopardize the tax-exempt status of the charitable organization. If the venture will generate large amounts of UBTI, the charitable organization should consider inserting a for-profit "blocker corporation" between the charitable organization and the joint venture. While this added layer of entity structure will not reduce the taxation of UBTI, it will generally cleanse the income of its UBTI status, because the charitable organization will receive the income as dividends, which are not UBTI, from the blocker corporation.

Private Foundations

Private foundations, unlike public charities, are subject to an additional set of tax rules that can affect their fundraising. Private foundations are nonprofit organizations that are not public charities because they are funded primarily by a single individual, entity, or family. Because there is less public involvement or oversight with private foundations, there are several tax rules (including the so-called "self dealing rules") that impose restrictions on the private foundation. These rules include the self dealing rules that impose excise taxes on the individuals involved in a private foundation's transaction with insiders ("disqualified persons"), which do not apply to public charities. These excise taxes, which can be as high as 200 percent of the amount involved in the transaction, can be imposed on the disqualified persons and the foundation's managers. Disqualified persons include directors, substantial contributors, and family members of directors. Transactions subject to the excise taxes include the sale or lease of property; the lending of money; and furnishing goods, services, or facilities between a disqualified person and the foundation. What catches many people unaware is that under the self-dealing rules, it is immaterial whether a self-dealing transaction resulted in a benefit (such as a sale to the foundation of property for less than its fair market value) or a detriment to the private foundation. For example, the sale by a disqualified person to a private foundation for $1,000 of an asset worth $100,000 would still be a self-dealing transaction subject to excise taxes. To avoid excise tax, the disqualified person should instead just donate the $100,000 asset to the private foundation.

Another complex arrangement is one in which a private foundation seeks to participate in co-investment arrangements with disqualified persons to improve its investment performance, diversify its portfolios, take advantage of economies of scale, or participate in investment funds that the private foundation otherwise could not access. There is scant precedential guidance from the IRS on these arrangements, but they must be analyzed carefully to try and minimize (as much as possible) the risk of being subject to the self-dealing rules and other issues. Because of the significant risk that such arrangements could cause substantial penalties, private foundations should carefully consider whether to request their own private ruling from the IRS to determine whether a proposed co-investment arrangement will pass muster.

Not All Gifts Are Equal: Why You Should Have a Gift Acceptance Policy

While it's always wonderful to receive a gift, there are certain gifts that a charitable organization may not want. Of course cash is always welcome, but some gifts, like time-shares or a landlocked vacant lot in another state in a bankrupt residential development, may be more expense and hassle than they are worth. Some gifts may have the potential of exposing the charitable organization to liability, such as real estate with environmental contamination issues or interests in a closely held corporation, partnership, or limited liability company.

A gift acceptance policy is critical to ensure that donors, board members, and the development team are all on the same page for what gifts a charitable organization will accept, won't accept, and will only accept under certain circumstances. A well-done gift acceptance policy will serve as a guide to the development team as they solicit donations. The development team also won't have to waste time analyzing whether to accept a certain odd gift every time it is offered—they can refer instead to the gift acceptance policy.

Charitable organizations should review their gift acceptance policies annually and update them when appropriate to make sure the policies for non-cash and deferred gifts (such as bequests) make sense for the charitable organization. This process can also ensure that the development team is focusing on the donors and gifts that make the most sense for their charitable organization.

Mike is a Williams Parker shareholder.

He practices tax, corporate, and business law, handling sophisticated tax planning and tax controversy matters and advising clients on their most significant business transactions. He is an active member of many civic and legal organizations' boards. Mike earned his J.D. and M.Acc. from the University of Florida and he is certified by the Florida Bar as an expert in tax.