Title: Fundraising for a Nonprofit Organization Can't Turn into Fundraising for Your Own Benefit: News from the Tax Court

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Date: December 2, 2013

The Lane Report: December 2013

A recent decision by the U.S. Tax Court could make it more difficult for some nonprofit organizations to maintain exemption from income tax.

For context, the Internal Revenue Code exempts from tax the income of various types of entities, with perhaps the most prominent such type being "501(c)(3) organizations," so named for the paragraph of the Code which defines them. This category includes most organizations that would be considered charities, including organizations which are organized and operated exclusively for charitable, religious, literary, scientific, or educational purposes, or for testing for public safety, for the prevention of cruelty to children or animals, or for fostering national or international amateur sports competition (but only if the organization does not provide athletic facilities or equipment). To qualify as tax exempt under Section 501(c)(3), the organization must not participate or intervene in any campaign for or against any candidate for public office. It must not have carrying on propaganda or otherwise attempting to influence legislation as a substantial part of its activities. And no part of the organization's net earnings may inure to the benefit of any private shareholder or individual. The latter requirement is considered both to "private inurement," in which benefits are conferred upon insiders of the organization (such as managers and officers), and to restrict "private benefit," in which benefits are conferred upon outsiders (third parties).

Both the "private inurement" and "private benefit" restrictions were at issue in the Tax Court case, *Capital Gymnastics Booster Club v. Commissioner*. The Capital Gymnastics Booster Club was a nonprofit organization founded for the purpose of "fostering national and international sports competition, within the meaning of Section 501(c)(3). The athletes affiliated with the booster club were gymnasts from age 6 through 18, all of whom trained at the Capital Gymnastics National Training Center – a private, for-profit facility. The gymnasts' families paid monthly tuition directly to the Training Center and also incurred other expenses paid to third parties such as national dues, the cost of specialized equipment, and the expenses of travel to gymnastics meets. But the cost of the competitions themselves was borne by the Booster Club.

Membership in the Booster Club was mandatory for the parents of athletes who trained at the Training Center. Parents were required to pay $40 per year to help cover the Booster Club's operating expenses, plus an assessment between $600 and $1,400 per year to pay for their child's competition costs, including entry fees for gymnastics meets and travel costs for the coaches. Parents could pay the

competition costs in cash, but they had an alternative option to participate in fundraising for the Booster Club instead. If a family engaged in fundraising, the family would receive "points" from the Booster Club in proportion to the fundraising profit that they generated. Each point that a family earned would be used to offset their child's assessment by $10. Parents who did not participate in fundraising (a little over half of the families) did not receive any benefit from the other parents' fundraising activities.

The IRS revoked the Booster Club's tax exemption on the grounds that its income inured to the benefit of private individuals and that the Club was operated for a substantial private purpose. The Booster Club responded by filing a petition in Tax Court to reverse that decision and have its tax exemption reinstated.

The Tax Court stated that the Booster Club had the burden to overcome the IRS's determination that, because of the way that it credited fundraising points, part of the Booster Club's net earnings inured to the benefit of private individuals – the parent-members – and that it operated in that substantial respect for the benefit of designated private individuals (the children of fundraising families), not for the benefit of the public.

The Tax Court determined that the Booster Club allowed substantial private inurement to the parent-members who participated in fundraising, because those parents received relief from the economic burden of their assessments. This provided an impermissible substantial private benefit to *those parents'* children – not to the child-athletes in the program overall. The Booster Club enabled parent-members to raise funds for the benefit of themselves and their children, but under the name and tax exemption of the Booster Club. This fundraising did not benefit all the child-athletes in its programs, but only those whose parents did the fundraising. Furthermore, the fundraising was the Booster Club's primary function – it was not considered an incidental part of the Booster Club's activities.

Even though the athletes affiliated with the Booster Club are considered to be a charitable class, the Booster Club did not show that the parent-members who received fundraising "points" were actually poor, disadvantaged, or otherwise members of a charitable class. When an organization benefits members without regard to their being in a charitable class, it fails to further a purpose worthy of having the organization receive tax-exempt status. Although the Booster Club engaged in administrative activities which facilitated the athletes' and teams' ability to participate in competition, that was not its primary activity. The Booster Club could not show that it was operated *exclusively* for charitable purposes, and hence the Tax Court sustained the IRS's determination that the organization was not entitled to tax exemption under Section 501(c)(3).

Professor Richard Wood of Capital University Law School has suggested that this decision may have consequences beyond the world of sports booster clubs: "501(c)(3) organizations that compensate those who assist with fundraising activities by reducing fees or other payments may risk losing their tax

exempt status. Schools that provide tuition relief for parents who assist with fundraising may be particularly vulnerable. Additionally, those who work as fundraisers in exchange for reduced tuition or fees will be required to report taxable income."

However, the principles expressed in this Tax Court decision are not new. In fact, the IRS had published a document in 1993 titled "Athletic Booster Clubs: Are They Exempt?" which described a hypothetical gymnastics booster club referred to as "Club A." Club A carried on a fundraising program which was described as follows: "Each gymnast who expects to receive a benefit from funds raised by A is required to earn a specific number of points through the efforts of his/her parents. The actual points requirement is determined each year in proportion to the funds distributed to each gymnast. The parent-members of gymnasts receiving the most benefits are required to earn the most points. Those who have not earned their mandatory points will be ineligible for any distribution of funds to offset team costs the following year. Simply stated: *If you don't help raise money, you won't share in the distribution of raised funds*." (Emphasis in original.) The IRS stated that Club A would not qualify as tax-exempt because its activities would result in the inurement of income to its parent-members.

By contrast, another hypothetical gymnastics booster club described in the same document, "Club B," operated as follows: "B's funding is derived from corporate sponsorships and ads sold for placement in the meet sheets. B also runs concession stands at the meets. Several times a year, B sponsors other fund-raising activities such as silent auctions, car washes, and the like. B charges no dues and maintains no point system by which parents can earn credits towards the payment of entry fees or other fees and expenses. B's by-laws and membership agreements strongly urge parent-members to participate in the various fund-raising activities for the benefit of all gymnasts on the competitive teams. Such participation is, however, not required. B supports all team gymnasts to the full extent of its resources regardless of whether their parents are members or contributors." The IRS stated that Club B would qualify as tax-exempt because it "conducts its activities to benefit the entire class of competitive athletes without regard to parent participation."

Complying with the statutes and regulations pertaining to tax exemption can be complex. The Law Offices of Marc J. Lane has experience in helping nonprofit organizations become organized, secure tax exemption, and maintain tax exemption through all stages of their existence. If you or a nonprofit organization with which you are associated would like to learn about our services for nonprofit tax-exempt entities, please contact Marc J. Lane in confidence via email at mlane@MarcJLane.com or via telephone at (312) 372-1040/ (800) 372-1040.

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