Tax Court Rules on Common Fundraising Practice

A Virginia booster club was faulted for giving credit to families based on the amount they raise.

by Ashley Gaddis

A U.S. Tax Court ruling calls into question the practice of having fundraising benefits pass through to individual families or students.

The ruling involved a gymnastics booster club in Virginia. At issue was the club's practice of crediting individual families with points toward their athlete's annual fees and assessments based on the amount of money the families raised through fundraising activities. This practice allowed families to essentially "work off" their own club bill—which ranged from $600 to $1400 per athlete—by selling wrapping paper, cookie dough, or other items. Families that did not fundraise had to pay their full share, preventing them from "freeloading" on the others. The Internal Revenue Service revoked the club's nonprofit tax exemption in 2008. A federal judge upheld the decision in August 2013, ruling that the booster club's activities were not charitable.

The ruling does not affect parent groups that hold fundraisers to purchase new school equipment or pay for academic programming that will benefit a large number of children. But groups and schools that offer families or students credit for raising money should consult with their attorneys about the ruling's implications. The following types of organizations, in particular, may want to make sure they comply with all tax laws and regulations:

1. Private schools that offer fundraising tuition credits
2. Groups that sell scrip
3. Booster clubs

Fundraising Credits Are Not Charitable

In the case, Capital Gymnastics Booster Club, Inc. versus Commission of Internal Revenue (http://www.ustaxcourt.gov/InOpHistoric/CapGymMemo.Gustafson.TCM.WPD.pdf), the booster club argued that its tax-exempt status should be restored because its charitable mission was to foster amateur sports competition—in its case, the sport of gymnastics—and that its fundraising activities supported that mission. But the court ruled that the club's fundraising practices benefited only certain athletes and families—or club insiders—which violates rules governing tax-exempt organizations. The judge also found that the club's primary activity was the fundraising itself, which is not a charitable mission.

Pennsylvania attorney and nonprofit law expert Donald Kramer, editor of a national nonprofit law newsletter, noted that the judge did not rule that the club's fundraising practices were wrong or illegal. In fact, the judge wrote that the club's point system may well be a rational and wholesome way to raise money to benefit young athletes. However, he also wrote that the point system does not advance a tax-exempt purpose. To receive a 501(c)(3) federal tax exemption, an organization must exist to benefit a public good, not individual people.

Other Issues in the Case

Several factors can affect a nonprofit group's tax status, which is why schools and parent groups should consult their own attorneys to see if the Capital Gymnastics ruling has an impact on their fundraising or other operations. Kramer pointed out that the booster club had several policies and practices that proved to be problematic in the eyes of the tax court:

1. Membership in the booster club was mandatory for all families with athletes at an affiliated gymnastics training center.
2. The fundraising activities were the primary function of the organization.
3. The fundraising benefited individual organization "insiders," which is also known as private inurement.
4. The fundraising did not equally benefit all the athletes in the club.
5. The club did not use any of the fundraising proceeds to provide scholarships or financial assistance to athletes based on their economic status or ability to pay.

"It's a combination of all these practices that make them impermissible under the Internal Revenue Code Section 501(c)(3)," Kramer says.

IRS Rules on Scrip

One common type of fundraising that often benefits individual families as well as schools is scrip, a program in which schools, churches, and other nonprofit organizations buy gift cards to grocery stores, gas stations, home improvement chains, and other popular retailers at a reduced cost and then sell them to parents at face value. In 2009, the IRS ruled that the difference in price is a rebate that the purchaser of the scrip—typically a family—can keep, give to the school, or apply to their own child's tuition.

Schools can create simple agreements with families that detail the percentage of each rebate that will cover administrative fees, the percentage that will go to the school's general fund, and the percentage that the family can receive back or apply to its tuition account, says Dan Springer, president of the Great Lakes Scrip Center, a private broker of scrip fundraising programs.

"It is important to clearly define that this is the family's money and that they have the option to receive the rebate back," Springer says. "It is not the organization's money, so the organization can't be guilty of private benefit."

Springer said he has not been advised that the Capital Gymnastics decision affects the previous IRS ruling on scrip programs, but he emphasized that he is not an attorney or tax accountant. He encouraged schools and parent groups that participate in scrip fundraising to consult their own attorneys and accountants for guidance in managing their scrip programs.

Staying Safe

Booster clubs or parent groups that want to credit individuals for their fundraising efforts—also known as "cooperative" fundraising—can consider organizing as for-profit entities. A downside to this, however, is that for-profit groups cannot solicit tax-deductible contributions from businesses or donors.

Groups that want to retain their nonprofit status should keep the following three things in mind when they fundraise:

1. Make sure the fundraising benefits all students in the school, on the team, or in the club.
2. Make membership in the group voluntary and don't penalize students whose families don't participate in fundraising activities.
3. Encourage families to make voluntary "fair share" donations that help cover the cost of running the charitable activities.

"The important lesson of this case is that the whole operation of the booster club was for the benefit of individual families," Kramer says. "The more voluntary the organization and the more you spread the benefits, the safer you are."

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