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## A Legal Tutorial for Fundraisers

Almost all nonprofit organizations rely on fundraising as a significant source of their revenue. And while creative fundraising strategies are to be encouraged, it's important to remember that nonprofits are subject to numerous rules that govern fundraising practices!<sup>1</sup>

As a rule, all nonprofit organizations are subject to the laws and regulations of the state in which the organization operates (and possibly other states as well, as discussed below.) However, charitable organizations – also known as 501(c)(3) organizations – are subject to federal laws and regulations governing tax-exempt entities, as well. Don't know the difference between a nonprofit organization and a 501(c)(3)? Here's a quick primer:

When an organization wishes to be classified as “nonprofit”, it must register with a state – usually the state in which it operates. Every state has different classifications for nonprofit organizations. For instance, New York and some other states have a type of business classified as a “Not-For-Profit Corporation.” Other states have corporations that are classified as “Non Stock Corporations.” What all of these corporations have in common is that they do not have any owner, and the business of the organization is run by a board of directors.

Once an organization formally registers as a nonprofit company with the state, the organization can request federal tax-exempt status with the Internal Revenue Service. If granted tax-exempt status by the IRS, an organization will not have to pay federal taxes on its income (provided that income is related to the organization's “charitable mission”), and donations made to the organization generally will be tax deductible for the donor.

So, all 501(c)(3) organizations are nonprofits. But not all nonprofits are 501(c)(3)s!

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<sup>1</sup> Although this article provides an overview of the legal issues involved in nonprofit fundraising, it does not constitute legal advice. I encourage you to seek the advice of a qualified U.S. attorney, who can ensure your compliance with all U.S. tax requirements and procedures, based on your specific circumstances.

Determining what agency in a particular state regulates nonprofits can be a little tricky, as the agency varies from state to state. (For example, in New York, charities are regulated through the New York Attorney General's office; in New Jersey, charities are regulated through the New Jersey Division of Consumer Affairs.) Fortunately, the National Association of State Charity Officials has compiled a list of the agencies in each state that regulate charities and other nonprofits. That list can be accessed through that group's website at <http://www.nasconet.org/documents/u-s-charity-offices/>.

While it would be impossible to discuss every IRS and state rule governing fundraising in this publication, below are a few of the common mistakes that arts (and other nonprofit) organizations make when soliciting and accepting charitable donations.

- **Soliciting donations in a state without registering there:** Almost every state requires an organization to register if it will solicit donations within that state. The definition of "solicit" here usually is pretty broad, and includes any type of fundraising effort directed at residents of a particular state. This includes holding a fundraising activity in a particular state; directing written or verbal solicitation communications to people located in that state; advertising or publicity directed at residents of a particular state.

Here's an example: a small nonprofit theater produces several shows a year in New York City. They solicit donations in the five boroughs only. The theater company is required to register with the New York Attorney General's office, which permits the company to solicit donations throughout New York State. After several seasons, the theater company does well, and decides to expand its solicitation efforts throughout the Tri-State area. The company must register both in New Jersey and Connecticut, so that it legally may solicit donations in those states as well.

- **Hiring a fundraiser who will receive a "cut" of the funds raised:** While this type of arrangement is not illegal in itself, it does create a number of potential legal pitfalls. Because charitable donations cannot be used for "private inurement" (legal jargon meaning the money is going into someone's pocket instead of toward the nonprofit's charitable mission), certain limitations must be in place on this type of arrangement to keep it legal. First, the commission or percentage received by the fundraiser must be "reasonable," as must the fundraiser's overall compensation. ("Reasonable" here means that the fundraiser actually provides services, and that the total compensation is commensurate with the time spent rendering services.)

Here's another example: an orchestra hires a professional fundraiser to solicit donations for the orchestra. The fundraiser agrees to spend 10 hours soliciting donations, and as compensation for his services, the fundraiser will take a 20% commission on all funds raised. Miraculously, the fundraiser raises five million dollars for the orchestra! However, the one million dollar compensation that the fundraiser receives is probably not reasonable for his 10 hours of work. On the other hand, if the agreed arrangement provides that the fundraiser will spend a specific number of hours on particular fundraising tasks, AND there is a cap on what the fundraiser can earn for the project, AND that cap is not an unreasonable fee for the services rendered, then this is an acceptable arrangement. The bottom line is that the total compensation to the fundraiser

must be reasonable in relation to the amount of time the fundraiser spends soliciting donations!

One last note on outside fundraisers: Many states regulate “professional fundraisers” and “fundraising counsel.” If your organization decides to hire outside fundraising assistance, be sure to check out the guidelines in your state (and any state in which you’ll be soliciting donations) to ensure you’ll be in compliance!

- **Improper documentation of charitable contributions:** The Internal Revenue Service (and many states) require that many charitable contributions be documented. A 501(c)(3) organization must following the following rules for acknowledging gifts:

- All monetary gifts (cash, checks, etc.) of \$250 or more must be acknowledged in writing and “contemporaneously”. This does not mean that you must send out an acknowledgement minutes after a contribution is received! In this context, “contemporaneously” means only that a donor must receive the written acknowledgement no later than the date the donor timely files his or her tax return for the year the contribution was made.

Example: Joe Smith gives the ABC Dance Company, a 501(c)(3) organization, a \$500 donation on June 1, 2013. ABC’s acknowledgment to Mr. Smith must be sent to him before he files his 2013 tax, or April 15, 2014, whichever is earlier.

- All in-kind contributions (i.e., non-monetary) valued at \$250 or more are subject to the same rule, plus the acknowledgement must accurately describe the item(s) being donated, and the acknowledgement also must state either that no goods or services were provided by the organization, or, describe the goods and/or services that were provided and give a good faith estimate of their value. (See IRS Publication 561, can be downloaded from the IRS website at [www.irs.gov](http://www.irs.gov).)
- One exception to the in-kind rule is donation of services. Donations of services are not tax deductible!
- These written acknowledgments need not be lengthy or involved! Here are two acceptable examples:

*“Thank you for your cash contribution of \$300 that (organization’s name) received on December 12, 2012. No goods or services were provided in exchange for your contribution.”*

*“Thank you for your cash contribution of \$350 that (organization’s name) received on March 6, 2013. In exchange for your contribution, we gave you a cookbook with an estimated fair market value of \$60.”*

- All donations of property valued in excess of \$5,000 require the receiving the donor to complete Form 8283. Before the donor submits the form to the IRS, the receiving organization must complete Part IV of Form 8283 (acknowledging receipt of the donated property.)

Finally, the IRS kindly has prepared several publications to guide charitable organizations in their fundraising practices. These publications include:

- Publication 1771, *Charitable Contributions – Substantiation and Disclosure Requirements*
- Publication 3079, *Gaming Publication for Tax-Exempt Organizations* (recommended reading if your organization is planning a bingo or casino night!)
- Publication 4301, *A Charity's Guide to Vehicle Donations*

Each of these publications is available for download at the IRS's website at [www.irs.gov](http://www.irs.gov).