



IRS Highlights Private Benefit Concerns in Use of Fundraising Accounts

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Youth activity organizations or booster clubs that are 501(c)(3) public charities provide a multitude of opportunities for today's youth, including theater, dance, sports clubs and scouting. These organizations know all too well that fundraising is vital to their ability to carry out their exempt purpose. But, could the way in which an organization allocates its fundraising proceeds be endangering its tax-exempt status?

IRS rules for charities state all of an organization's proceeds must be used for the tax-exempt purposes of the organization. In many youth activities, a common requirement of membership is for children or parents to participate in fundraising to help offset the cost of membership, including dues, equipment, uniforms or travel costs. An organization can use raised funds to reduce or eliminate these costs. An organization could also use its funds to provide assistance to individual members in cases of financial hardship.

However, when the distribution method of the fundraising proceeds is the creation of an "account," whereby, the money an individual member raises during a fundraising event is reserved for that member alone or when records are kept showing how much each parent or student contributed to the fundraising efforts, these records are considered individual fundraising accounts (IFAs) and potentially cross the line by providing more than just an insubstantial accrual of private benefit to an individual. The IRS has stated IFAs may disqualify an organization from tax-exemption as a public charity. Treasury regulations state, "An organization is not organized or operated exclusively for one or more of the purposes specified ... unless it serves a public rather than a private interest." Thus, when an organization credits specific fundraising accounts, it is operating for the benefit of private interests, such as the designated individuals.

Private benefit is at the forefront of the IRS' radar. A June 2011 directive to IRS field agents issued by Lois Lerner, the IRS director of exempt organizations, stated "if a booster club confers benefits on a participant in return for his/her fundraising activities, such as crediting amounts raised by a participant toward that participant's dues requirement, or by crediting amounts raised against the cost of a trip, the booster club is providing a private benefit to that participant. Consequently, such practices could result in the organization failing to be described in § 501(c)(3)." The IRS has also rejected recent applications for tax-exemption of youth athletic organizations on this same premise.

Because of the complexity of the private benefit rules, there is no bright line determination of when private benefit has been provided. However, an important consideration for your organization is if you are earmarking funds for the benefit of a specific member or to a specific member's required fundraising account, this practice may be jeopardizing the organization's tax-exempt status.

If you have questions regarding your organization's fundraising practices, please contact your Eide Bailly representative.

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