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NONPROFIT LEGAL NEWS
December 13, 2022

This article presents general guidelines for Ohio nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Tax Compliance for Fundraising Events

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Fundraising events such as galas, dinners, and golf tournaments can provide benefits to charitable organizations including increasing awareness of its charitable mission, raising additional funds and creating favorable publicity. Over the past two years, charitable organizations shifted their annual fundraising events to virtual attendance and are now transitioning back to in-person events. Unfortunately, fundraising events, whether in-person or virtual, can also cause unintended headaches if tax compliance issues are overlooked.

The success of a charitable organization's fundraising event is dependent on the coordination and communications between the charitable organization's fundraising, marketing and accounting departments. All three of these areas are critical to ensure adequate records are completed, maintained and that the IRS and State rules and regulations are followed.

Each fundraising event has distinct tax reporting requirements. Let's walk through a variety of fundraising events and their respective tax reporting requirements.

Gala or Dinner Events

A charity that hosts a gala or dinner event charges a fee to attend the event. The fee is generally consisting of two parts – the fair market value (FMV) of the dinner as well as any entertainment and a charitable contribution, which is the amount of the fee that exceeds the fair market value of the dinner and entertainment.

For example, if the gala ticket price is $150 and the fair market value of the dinner the attendee received was $50 and the entertainment was $30, the amount of the charitable contribution is $70 ($150 ticket less $50 dinner and less $30 entertainment). Generally, the charity includes this information in their marketing materials promoting the event.

At the conclusion of the event, the charity will send an acknowledgement to the participant thanking the individual for attending the event and informing them of the price of the ticket ($150), the benefits the participant received for attending the event ($80), and the amount of their charitable contribution ($70). This information is also disclosed on the charity's form 990.

For all tickets $75 and over, the charity must provide the donor an acknowledgement regarding the tax-deductible portion of the donation. However, this practice is perceived as beneficial to donors, so the charity may choose to provide this information for lower ticket.

How can a charity determine the fair market value of a dinner and/or entertainment?

The key word to remember is reasonable. Is it reasonable to think a steak dinner with a salad, potato, vegetable and dessert would cost $10 if purchased at a restaurant? NO. The charity must provide the donor with a good faith estimate of the goods or services the donor received.

The charity could obtain a menu or price list from a restaurant in their area that would provide a similar dining experience. If the caterer provided a discount, they could ask the caterer their typical price – the charity can factor in cost or the value of venue etc., in determining the fair value of what the donor received in return.

Best practices are to have the charity's development, marketing and accounting areas working together in planning and running its charity's gala to gather and disseminate this information to your potential donors.

Charity Auctions

Charities often decide to a have a silent and a voice auction at the gala dinner event. The charity solicits and receives non-cash items for the auction. Acknowledgements or receipts should always be provided to the donor for donations including non-cash or in-kind contribution. It is the responsibility of the donor (NOT the charity) to determine the value of a non-cash contribution for purposes of their income tax returns. DO NOT provide the donor a value for their donated item.

The charity's acknowledgement should include the charity's name/address, employer identification number, a description of the item donated, and the date of the donation. The acknowledgment should NOT include the item's value. The acknowledgement should also include one of these statements:

- No good or services were provided in return of the contribution OR
- A description of the item and good faith estimate of the value of any goods and services provided in return for the contribution (NOT the item's value)

After the non-cash item is received, the charity internally places a value on the item. The description of the auction item in the auction catalog should include a good faith estimate of the fair market value. Generally, items purchased at an auction are not tax-deductible. The charity should include language notifying attendees that only amounts paid in excess of the fair market value may be deductible as a charitable contribution. For example:

The excess amount above an item's fair market value that a winning bidder pays to receive the item typically is tax-deductible.

Determining the value of the items for the auction can be a tough job, and it's often difficult to know where to start. The charity may use any reasonable method to estimate the fair market value as long as the charity applies the method in good faith.

If the donated item is commercially available, the charity can use the purchase price of the item as its value. If the item is not commercially available, the charity may determine the fair market value by using comparable goods or services.

Goods or services may be similar or comparable even if they do not have the unique qualities of the goods or services being valued. The IRS has provided the following examples:

Example 1. A charity provides a one-hour tennis lesson with a tennis professional for the first $500 payment it receives. The tennis professional provides one-hour lessons on a commercial basis for $100. A good faith estimate of the lesson's FMV is $100.

Example 2. For a payment of $50,000, a museum allows a donor to hold a private event in one of its rooms. A good faith estimate of the FMV of the right to hold the event in the museum can be made by using the cost of renting a hotel ballroom with a capacity, amenities, and atmosphere comparable to the museum room, even though the hotel ballroom lacks the unique art displayed in the museum room. If the hotel ballroom rents for $2,500, a good faith estimate of the FMV of the right to hold the event in the museum is $2,500.

Example 3. For a payment of $1,000, a charity provides an evening tour of a museum conducted by a well-known artist. The artist does not provide tours on a commercial basis. Tours of the museum normally are free to the public. A good faith estimate of the FMV of the evening museum tour is $0 even though the artist conducts it.

It is important to have your marketing, development and accounting areas working together to develop, plan and execute your charity's auction. Working together to:

- Solicit non-cash donations
- Acknowledging the receipt of the donation
- Develop your auction catalogs for participants including a good faith estimates as to the items' value
- Acknowledging and thanking the auction winner for their winning bid and informing the winner of the value of the benefits they received in receiving the item and the amount (if any) that would be considered a tax-deductible contribution

Raffle

In addition, the charity has also decided to hold a raffle at the gala. Raffles have long been a popular fundraiser for nonprofits. They're easy to produce, affordable for participants, and reliable revenue generators.

However, care must be taken to ensure the raffle is conducted in accordance with all applicable state laws and regulations. The charity must comply with the federal income tax requirements. In addition, the purchase of a lottery ticket is NOT a tax-deductible contribution to the charity.

A raffle is considered a form of a lottery. It's a game of chance and, as such, the laws that govern raffles are administered by state and county governments. The laws that govern raffles vary greatly from state to state (and county to county in some states) making it difficult to provide the exact regulations for your area. Please check the state and local rules and regulations in the location of the raffle and the location(s) you are selling raffle tickets.

Winnings must be reported when the amount is $600 or more and at least 300 times the amount of the winner's wager (the raffle ticket price). You can take the net amount of the winnings less the wager when determining if the $600 threshold is met.

For example, the charity sells $2 tickets, and your winner receives $1,000. Because the winnings ($998) are more than $600 and more than 300 times the amount of the $2 wager, the charity must report the winnings to the IRS.

Form W-2G, "Certain Gambling Winnings," must be filed with the IRS and provided to the winner to show reportable winnings along with the related income tax withheld. The winner should provide the charity with his or her name, address and Social Security number to include on the filing.

If the charity reports using a paper form, the charity must file copy "A" with the IRS by February 28 following the calendar year of the payment. If the charity files electronically, the charity has until March 31. The winner must receive copies "B" and "C" of Form W-2G by January 31.

Income tax must be withheld from the winnings and remitted to the IRS if the proceeds (the difference between the amount of the winnings and the amount of the wager) are more than $5,000. If the winnings are in the form of a noncash payment (for example, an automobile or artwork), the proceeds are the difference between the fair market value of the item won and the wager amount. When the value of a noncash prize isn't obvious, it's wise to obtain a valuation before the drawing.

The charity must withhold 24% in tax from the winnings in 2022. Note that the 24% rate applies to the total amount of the proceeds from the wager, not just the amount that exceeds $5,000. Say the charity holds a raffle with $1 tickets. The winner wins $6,000. But, because the proceeds ($5,999) exceed $5,000, you must withhold $1,439.76 ($5,999 × 24%).

The charity may need to do "backup" withholding on raffle prizes

The charity might be required to withhold 24% of raffle prizes for federal income tax backup withholding. Specifically, backup withholding applies when:

- The winner doesn't furnish a correct Social Security number,
- The regular income tax hasn't been withheld, and
- The winnings are at least $600 and at least 300 times the wager.

For example, the charity holds a raffle, selling tickets for $2 apiece. One of the participants wins $1,200 but refuses to provide the charity with his/her Social Security number. The charity will pay this winner $912.48 ($1,200 less $287.52, or 24% of $1,198), rather than the entire amount of winnings, since the charity must remit the $287.52 to the IRS. If the charity mistakenly pays out the entire amount to the winner, without any withholding, the charity still owes the IRS the backup withholding amount of $287.52.

For a noncash prize with a fair market value of more than $5,000 after deducting the wager, the charity has two options:

1. The winner reimburses the charity the amount of withholding tax the charity must pay to the IRS or
2. The charity pays the withholding tax on behalf of the winner, calculated at 31.58% of the FMV less the wager. If you pay the withholding tax, you should report the "grossed up" amount of the prize (FMV of the prize plus the amount of withholding taxes paid on behalf of the winner) in box 1 of Form W-2G and the withholding tax in box 2.

Taxes withheld from raffle winnings are nonpayroll withheld taxes and must be reported on Form 945, "Annual Return of Withheld Federal Income Tax." The amounts you report must include the total amount of tax withheld that you reported on all the Forms W-2G filed for the year. There are different deposit requirements, depending on whether total taxes withheld annually are under or over $2,500.

Raffles can pay off but if the charity wants to come out a true winner, it will need to satisfy the tax and filing requirements.

Other Considerations

There a few other considerations a charity should be aware of before holding its fundraising event. These considerations are explained briefly below but are complicated and may require assistance from the charity's tax advisor or legal counsel.

Compliance with State Charitable Solicitation Laws

Charities engaging in fundraising and solicitation of donations are subject to state solicitation laws. Generally, the states require registration as a condition to charitable solicitation within their jurisdictions. Registration entails submitting a registration fee and documents showing a statement of charitable purposes, how the charity intends to solicit in the state, as well as organizational documents such as its articles of incorporation, bylaws, and an IRS determination letter.

The charity should make sure they understand the state solicitation laws before soliciting contributions to avoid these costly penalties and negative publicity.

Sales Tax

The sales tax requirements for charitable organizations can be confusing. When the charity is putting on a fundraiser, raffle, or auction, the last thing on anyone's mind is whether sales tax applies.

In many states, a charity can be exempt from paying sales tax when purchasing items. The exemption applies to purchases only and not when the charity is selling items. Charitable auctions are sales and the charity's sales tax exemption does not apply. Many states have exceptions to the requirement of charities collecting and remitting sales tax. Having a knowledgeable tax advisor will be beneficial.

Unrelated Business Income

Charities are required to pay income tax on unrelated business income (UBI). UBI is defined as income from a trade or business, regularly carried on, that isn't substantially related to the organization's exempt purpose. Holding a charity auction could be considered a trade or business. The IRS considers raffles to be a form of gaming, which is a trade or business. If you routinely hold charity auctions and/or raffles, it's possible these activities could be considered "regularly carried on." Generally, fundraising events are not likely to be considered substantially related to your exempt purpose. Utilizing the net proceeds in furtherance of your charitable mission does NOT in of itself cause the unrelated income to be considered substantially related.

One exception is where the activity that is considered a trade or business is conducted with "substantially all" volunteer labor. The term "substantially all" hasn't been formally defined, but the IRS's "unofficial guideline" is that 85% or more of the labor is performed by volunteers. A volunteer is a person who is not receiving any compensation. If the charity is relying on this exemption, make sure it maintains records to demonstrate the level of volunteer support.

Conclusion

When organizing a fundraising event, it is important to utilize the talents of the charity's marketing, development and accounting areas. Many charities are not at a size where they have three separate and distinct areas. If that's the situation, be sure to focus on these three disciplines while planning, developing, and hosting your fundraising event.

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