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## **Advanced Issues in Fundraising**

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## Advanced Issues in Fundraising

Charities are pursuing various fundraising opportunities in the constant search for sustainable, unrestricted revenue. Individuals are driving many fundraising initiatives, whether as soliciting their peers, donating at the register, or purchasing products associated with a charitable purpose. Charitable organizations are also contemplating various impact investing structures to diversify revenue streams.

Current marketing trends demonstrate that aligning a charitable cause with the sale of goods and services will continue to increase. In the 2015 Cone Communications/Ebiquity Global CSR Study, 63% of survey respondents bought a product associated with a cause in the past twelve months. More significantly than simply purchasing goods related to a charitable cause, the same survey found that 90% of global consumers are likely to switch brands to one associated with a good cause, given similar price and quality.<sup>1</sup>

Cause-marketing or cause-related marketing is a general term that denotes the association between a marketing scheme supporting a commercial endeavor that relates to or supports a charitable purpose. According to the Cause Marketing Forum, the origin of the term “cause-related marketing” is attributed to American Express and its 1983 Statue of Liberty Restoration project. However, records of cause marketing programs date back to at least 1976, with Marriott and the March of Dimes.<sup>2</sup>

As charitable fundraising and marketing programs have evolved, so have the legal and tax requirements applicable to both the tax exempt organization and the for-profit marketer. This paper will discuss the regulatory schemes relating to consumer-driven fundraising, cause-related marketing and impact investments, including federal taxation and federal and state statutes and various structures.

### I. Regulatory Schemes

#### A. Federal

As tax-exempt organizations, charities are subject to scrutiny based on their privileged position. The Internal Revenue Service and the Federal Trade Commission both serve a role in ensuring the integrity of the charitable sector.

##### 1. Unrelated Business Income

Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”)<sup>3</sup> provides for exemption for charitable organizations from federal income tax. However, a tax is imposed on these organizations that derive net income from activities that do not further their exempt purposes.<sup>4</sup> Section

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<sup>1</sup> 2015 Cone Communications/Ebiquity Global CSR Study, page 10 and 21, available at <http://www.conecomm.com/research-blog/2015-cone-communications-ebiquity-global-csr-study>.

<sup>2</sup> The Cause Marketing Forum, “Background and Basics,” available at [http://www.causemarketingforum.com/site/c.bkLUKcOTLkK4E/b.6443937/k.41E3/Background\\_and\\_Basics.htm](http://www.causemarketingforum.com/site/c.bkLUKcOTLkK4E/b.6443937/k.41E3/Background_and_Basics.htm).

<sup>3</sup> All section references in this Article refer to the Code, unless otherwise indicated.

<sup>4</sup> Section 511(a)(1).

513 defines an “unrelated trade or business” as any trade or business, the conduct of which is not substantially related to the exercise by such organization of its charitable, educational, or other purpose constituting the basis for its exemption.<sup>5</sup> The Code defines unrelated business taxable income (“UBI”) as income from an unrelated trade or business that is regularly carried on.<sup>6</sup> An organization pays income tax, called unrelated business income tax or “UBIT” on its net UBI at either the corporate tax rates or the trust tax rates, depending on the form of organization of the entity.<sup>7</sup> Its origin was to prevent tax-exempt organizations from competing unfairly with businesses that pay tax on earnings.<sup>8</sup>

UBIT serves to equalize the economics of a transaction, regardless of whether the activity is conducted by a nonprofit or for-profit. The tax removes the competitive advantage of the increased margin available if income tax is not a cost of doing business, thereby leveling the playing field and reducing the opportunity for such “unfair competition.” UBIT is applicable to most forms of tax-exempt organizations.<sup>9</sup> Both private foundations and public charities are subject to UBIT, as well as state colleges and universities.

With respect to fundraising activities, the tax-exempt organization will need to determine whether its activities fall within the definition of UBI (or are excluded by one of the exceptions or modifications). The following outlines the elements of what is considered UBI and explains how the fundraising activities of the charity may implicate the UBI rules.<sup>10</sup>

a. UBI - Is there a trade or business?

Section 513(c) states that “the term ‘trade or business’ includes any activity which is carried on for the production of income from the sale of goods or the performance of services.” The Treasury Regulations provide that the definition of a trade or business for purposes of Section 513 has the same meaning it has in Section 162 (which concerns the requirements of the business expense deduction) and “generally includes any activity carried on for the production of income from the sale of goods or performance of services.”<sup>11</sup> As a result, “trade or business” is broadly construed, encompassing most activities.

Section 513(c) specifies that merely because an activity does not result in profit does not mean that it will not constitute an unrelated trade or business. However, courts have held that the presence of a

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<sup>5</sup> Section 513(a).

<sup>6</sup> Section 512(a)(1).

<sup>7</sup> Section 511.

<sup>8</sup> *U.S. v. American Bar Endowment*, 477 U.S. 105 (1986). *See also* *C. F. Mueller Co. v. Comm’r*, 190 F.2d 120 (3<sup>rd</sup> Cir. 1951).

<sup>9</sup> Sections 511(a)(2)(A) and 511(b)(2); Treas. Reg. §1.511-2(a)(3)(iii).

<sup>10</sup> Section 512(b)(6) now requires organizations operating one or more unrelated trades or businesses to compute UBIT separately for each trade or business.

<sup>11</sup> Treas. Reg. §1.513-1(b).

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