

nonprofit Navigator

Fundraising Has Never Been So Easy, Right? Some of the Risks and Legal Obligations of Web-Based Fundraising

Nonprofits increasingly are taking advantage of the Internet to raise funds. Fundraising on the web has become popular largely because it provides a relatively inexpensive way to reach a wider section of the public than traditional marketing methods. This article, the first in a two-part series, describes some legal obligations associated with accepting credit card donations online, raising funds through third-party sites, and recruiting corporate sponsors, and discusses some of the risks that nonprofits should keep in mind when conducting these activities. Next month's article will focus on affinity shopping agreements and online raffles and auctions.

These articles do not present a comprehensive discussion of all the requirements or issues raised by fundraising on the Internet, so organizations engaging in the activities described in this series or other web-based fundraising activities should consult an experienced attorney for further guidance.

Credit Card Donation Pages

Some nonprofits are drawn to soliciting donations via credit card online as an inexpensive and efficient way to raise funds. To accept payment via credit card, a nonprofit organization (or business) must obtain a "merchant

services" account from a bank or third-party service provider. Since most merchant account agreements are designed to cover in-person activities, not online transactions, nonprofits seeking to establish a merchant account should make sure that the agreement with the bank or third-party provider contemplates Internet activities.

Nonprofits that solicit donations using the Internet instead of telephones or print materials may not be relieved from state registration obligations.

Many nonprofits employ third-party providers rather than going through the complicated and expensive process of obtaining their own merchant account and establishing a fully automated, secure web site that can process credit card transactions automatically. While this seems easier, going to a third-party provider can inadvertently get a nonprofit into legal difficulties.

Most merchant account agreements have provisions prohibiting a practice known as "factoring" — that is, an agent that is not

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Nonprofit Navigator is published monthly by the Washington, D.C. law firm of Harmon, Curran, Spielberg & Eisenberg, LLP. Subscription rates are \$115 for one year and \$198 for two years for subscriptions sent within the United States. Special rates are available on request for multiple subscriptions sent to the same address and for outside the U.S. All rates subject to change without notice. Subscription requests and address changes may be addressed to:

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Election Connection

FEC Sets Threshold for Mandatory Electronic Filing

Following up on legislation passed last September, the Federal Election Commission has proposed rules that would set at \$50,000 the threshold for filing FEC reports electronically. Under the proposed rule, candidates and their authorized committees, party committees, non-connected committees, the separate

proposed rules, voluntary electronic filing would still be an option for political committees that do not exceed the \$50,000 threshold.

There are several advantages to filing electronically:

- filers get instant confirmation of submission;
- validation features of e-filing software look for missing information prior to filing;
- the potential for errors or delays in third party delivery is reduced;
- amendments are easier to make; and
- aggregate and summary information is calculated automatically by the software.

Reports filed electronically are displayed on the FEC web page in their entirety, including contributor names and addresses (as they are on paper filings).

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PACs with \$50,000 in annual contributions or expenditures would have to file electronically.

segregated funds of corporations and labor organizations, and other persons required to file would be required to file electronically when either their total contributions or total expenditures within a calendar year exceed the \$50,000 threshold.

The FEC has had a voluntary electronic filing system in place since 1996. Under the

If You Don't Pay, You Can Win Free Sweepstakes Entry No Bar to Deductibility of Contributions

Raffles and sweepstakes have long been a popular feature of charitable fundraising campaigns. The drawback was that the IRS generally does not allow sweepstakes or raffle participants to claim a tax deduction for the entry fees, as the participant was deemed to be paying for the chance to win a valuable prize rather than making a charitable donation.

In a recent letter ruling, the Service explained an exception to this general rule, allowing charitable deductions for contributions made in concert with a sweepstakes program, so long as the sweepstakes did not require a contribution to enter.

Tearing a page from the Easter Seals model, in which an initial fundraising solicitation contains a gift to foster goodwill, a university incorporated a sweepstakes program into its fundraising drive. The school mailed sweepstakes tickets to the public free of charge and promoted the sweepstakes on its television and radio stations. The mailing, in large bold type, indicated that a contribution was not necessary to participate, but asked participants to consider making a donation to the university. The mailing also prominently noted that making a contribution would not increase a participant's chance of winning. The university could not distinguish sweep-

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FEC Crashes the Party

The National Republican Senatorial Committee (NRSC) recently settled an FEC complaint based on a series of soft money contributions it made to nonprofit organizations for GOTV drives. It agreed to pay a \$20,000 FEC penalty and transfer approximately \$88,000 dollars from its federal (hard money) account to its non-federal (soft money) account.

You can't pay others to do what you are not allowed to do.

The complaint addressed \$840,000 in contributions that the NRSC made to the National Right to Life Committee, the American Defense Foundation and Coalitions for America from 1992 through 1994. All of these contributions were made with soft money. The short answer, says the FEC, is that you can't use soft money to pay other people to do something that, if done by you, would have to be paid for by hard money. The FEC concluded that because the NRSC knew the organizations would use the funds to do GOTV designed to assist state and federal Republican candidates, it should have paid for some of the activity with hard money in accordance with the standard formula governing the allocation of hard and soft money for GOTV expenses. The FEC's General Counsel's report notes that even the NRSC did not dispute that if it had conducted the GOTV activity on its own, it would have had to pay at least in part with hard money.

Perhaps at least as interesting to nonprofit organizations is that the FEC decided not to proceed against any of the nonprofits that received the NRSC money. Originally the FEC pursued this case based on a theory of improper coordination. Under that theory,

the GOTV expenditures made by the nonprofits, if coordinated with the NRSC, would have been illegal corporate contributions and the nonprofit groups could have faced significant penalties.

In light of recent rulings narrowing the concept of "coordination," the FEC's General Counsel conceded that coordination must involve specific knowledge of another party's plans. Because in this case the NRSC had only general knowledge that the groups were going to conduct GOTV rather than specific knowledge of the planned activities, the FEC abandoned its coordination theory [NN, 9/99, p.2 and 11/99, p.4]. This is a positive sign for those nonprofits that struggle to determine how much contact they may have with candidates and parties before they irreparably taint activities such as independent expenditures and issue advocacy that are supposed to be conducted independently.

Free Sweepstake Entry, cont.

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stakes entries with contributions from those without one.

The rule of thumb is that organizers must make it very clear that it is possible to both enter and win the sweepstakes without contributing a dime. If so, participants who do contribute will be able to deduct the contribution from their income, even if they win.

Charities planning to incorporate a sweepstakes into their fundraising programs should also keep in mind that Congress recently enacted new postal legislation, applying to both commercial and nonprofit organizers, which governs sweepstakes promotion. [NN 4/00, p.4]

Fundraising Focus

The Other Shoe

IRS Addresses New "Split-Dollar" Arrangement Legislation

The IRS has established procedures for compliance with recent legislation sharply restricting so-called "split-dollar" insurance transactions used by some taxpayers and charities to shield assets from taxation.

These arrangements were a sweet deal for donors. In a typical form, Jane would "donate" money to the local university and take the applicable deduction, with the "understanding" that the university would assist the Jane Family Trust (or some other intermediary) in paying the premiums on her cash-value life insurance policy. Both the university and the Trust would be listed as beneficiaries of the life insurance policy, but an agreement would give the Trust most of the policyholder rights, especially cash surrender value and death benefit.

These arrangements were heavily marketed and came under increasing fire from the Service, which viewed the exchange of a donation for assistance in paying premiums on a life insurance policy as abusive. In response, last December, Congress prohibited charitable deductions for transfers associated with payment of insurance premiums, destroying

the tax benefits of these arrangements. The legislation also imposed excise taxes on charities making premium payments in the amount equal to the premium paid.

Charities paying insurance premiums after February 9, 1999 must file form 4720 and pay the excise tax by June 24, 2000.

Charities left holding the split-dollar bag, namely those liable for the excise taxes resulting from insurance premiums paid after February 9, 1999, must file form 4720 and pay the tax; those not on calendar tax years must do so by June 24, 2000; those whose tax years end after January 1, 2000 must file and pay five months and 15 days after the end of their tax years. Forms 990, 990-PF, 5227 and will be changed to require reporting and accounting of split dollar arrangements. Next year, the IRS will introduce the new form 8870 to report and collect personal benefit contract excise taxes.

Mandatory Electronic Filing, cont.

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Several software options are available for the e-filing. The cheapest is the FEC's FECFile 3 software, which can be downloaded at no cost at <http://www.fec.gov/software.html>. The current FEC software package is missing a few forms, including Form 5, which is used by persons other than political committees for reporting independent expenditures, and Form 7, used for reporting corporate and labor organization communica-

tions to the restricted class. However, the FEC has indicated that it will update its software soon. The FEC plans to conduct FECFile 3 classes in August and September.

E-filing software can also be purchased at <http://products.aristotle.org/> and <http://www.gnossos.com/>. The files generated by the programs offered on these pages have been tested by the FEC and were found to produce properly formatted filings.

Wisconsin AG Gives Up On Cause Marketing Regulations

What began with a bang is on the verge of ending with a whimper. Last year, the Attorneys General of 16 states along with the District of Columbia Corporation Counsel caused a splash when they released a preliminary joint report, *What's in a Nonprofit's Name*, sharply criticizing the practice of so-called cause-related marketing, a \$500 million source of funds for the nonprofit community. The practice is commonly embodied in the form of the nonprofit's seal of approval on a for-profit entity's goods or services. [NN 6/99 p. 3]

The report had produced a set of guidelines, largely aimed at disclosing relationships between the for-profit and nonprofit entities, and cracking down on deceptive practices and qualitative comparisons (e.g., ads suggesting that the nonprofit has tested a given product and found it superior to others, or misstating the effects that purchases of the product will have on a sponsor's charitable contribution to the nonprofit).

Wisconsin Attorney General Jim Doyle had led the charge against the practice, but now, in a memo circulated to the other attorneys general, he has decided that "the best course of action is to permit the nonprofit community the time to voluntarily conform its practices in the interests of full and fair disclosure to consumers." Distancing himself from the report, he expressed a preference to monitor cause-related marketing in his state, rather than "authoring an advisory opinion which some will construe as a statement on what those practices should be nationwide."

The fallout of Doyle's decision is not yet clear, either for state regulation of cause-related marketing or for the report itself. The nonprofit community is generally pleased with his decision as the report had been widely criticized for its lack of attention to trademark law and what constituted an unrelated business.

Web Fundraising, cont.

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authorized as a service reseller using its own merchant account to offer credit card services to others. Organizations that accept credit card donations through third-party providers should be sure that the provider is authorized by a credit card company as a service reseller. In one state, credit card factoring has been made a criminal act, and in other states it may be prosecuted under various fraud statutes.

Third-Party Sites

The security problems and expenses associated with establishing the capability to accept credit card donations online have also led many nonprofits to turn to web-based

charitable "portal" sites, such as *giveforchange.com* and *givenation.com*, that are specifically established for facilitating online donations. Because these sites provide fundraising assistance, operators of these web sites may find themselves subject to state regulations and registration requirements for professional solicitors.

Most states (and even some municipalities) regulate nonprofits' solicitation of funds. Typically, organizations must register with the relevant state office, file various information disclosures, and pay annual filing fees before soliciting contributions in the jurisdiction. It is unclear how the current registration laws

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Web Fundraising, cont.

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will apply in the Internet age. Will states (or even municipalities), for example, have the right to require registration when someone from their jurisdiction makes a credit card donation online to an organization which operates in another state? Such an application of the law could effectively stop smaller organizations from using the Internet for fundraising due to the high cost of registering in every state. At a minimum, organizations and fundraisers that conduct online fundraising should make sure to meet registration requirements at least in those states where they maintain a physical presence.

To avoid the burden of state registration requirements on professional solicitors, fundraisers often try to cast themselves as mere service providers. Nonprofits employing these fundraising services should either require the provider to register or ask for indemnification for any penalties the organization incurs for employing an unregistered professional solicitor.

In addition, before deciding on a particular way to accept online donations, nonprofits should get information on the prospective operator's financial status, its other clients, and what fees are charged. It may be worthwhile to contact other charities using the service to see what expenses they have had and how much money they have raised online.

Corporate Sponsorships

Nonprofits may also solicit corporate support of their web pages. Corporate sponsorship is often acknowledged through display of a corporate logo, notation of the sponsor's web address and/or 800 number, a moving banner, or a link to the sponsor's web site.

Because of the lack of IRS guidance for distinguishing between acknowledgments and advertising online, there is no consensus about how to characterize such links. Should the income be considered taxable advertising

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Nonprofits participating in online fundraising activities that require a service provider contract should:

- Make sure the contract is not exclusive so that you can participate in other sites or do fundraising on your own Web site;
- Be able to terminate the contract for any reason with a reasonable notice period;
- Avoid automatic renewals for long periods;
- Include in the contract a provision that the operator will give you itemized, detailed statements of donations made, donor names/e-mail addresses, and any expenses that operator deducts;
- Make sure you have a right to receive and use data on donors for your own fundraising efforts;
- Make sure that the operator maintains current charitable solicitation registrations and bonding requirements in all applicable states;
- Make sure your organization is also registered to solicit funds;
- Make sure contract clearly specifies the operator's take from the contributions (minimum fees, percentages, etc.);
- Specify when the charity is to receive the donations or when they will be transferred to its bank account;
- Make sure all donor receipts comply with IRS requirements;
- Make sure the service provider will indemnify you for any costs associated with the violation of contract provisions; and
- Make sure that the service provider agrees to protect the confidentiality of donor information.

Web Fundraising, cont.

Continued from previous page

revenue when, for example, the link transfers users to the sponsor's e-commerce site? Or are these links properly considered passive, non-taxable acknowledgments since the web site visitors must take an affirmative action to reach the donor's web site?

Although it is not clear whether electronic acknowledgments alone satisfy substantiation and disclosure requirements, the IRS has not ruled it out.

Unofficial IRS documents suggest that a simple link to a sponsor's home page will retain the passive character associated with corporate sponsorships, while a moving banner — a graphic advertisement usually containing a moving image — or a link to an e-commerce site is more likely to be considered to be advertising. This position is consistent with regulations proposed last March by the IRS [NN, 4/00, p.1], which stated that acknowledgments may include a sponsor's location, telephone number, or Internet address.

Substantiating Internet Contributions

In general, individuals claiming deductions for charitable contributions of \$250 or more must obtain contemporaneous (meaning no later than the time of filing the return claiming the deduction) written substantiation from the charity. There is no prescribed format for the written acknowledgment, and some web sites that solicit donations provide acknowledgments via e-mail.

Does such electronic acknowledgment, alone, satisfy the substantiation requirements? There is no certain answer, yet. Some IRS officials have suggested electronic receipts be given serial numbers to prevent fraud, a requirement not imposed on paper receipts.

However, they have not ruled out e-mail receipts to meet the substantiation requirements.

Non-Charitable Contributions

Federal tax law requires many organizations that are ineligible to receive tax deductible charitable contributions to disclose the non-deductibility of contributions during fundraising solicitations. Covered organizations raising funds on the web should be sure to include a statement such as, "Contributions or gifts to [name of organization] are not tax deductible," on the same page as the request for funds. The print should be easily visible against the background and not in smaller type.

While the exact calculation of penalties for failing to comply with these requirements on a web site is not clear, the risk of penalties is up to \$10,000 a year.

A fundraising solicitation by a nonprofit subject to the non-deductibility disclosure requirements likely would be in compliance if it:

1. Includes a statement similar to the following: "Contributions or gifts to [name of organization] are not tax deductible";
2. Is in at least the same type size as the primary message, and is readily visible against the background of the page;
3. Appears on the same page as, and in close proximity to, the actual request for funds (viewer must be able to view the statement without following a link); and
4. Is either the first sentence in a paragraph or itself constitutes a paragraph.

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Getting to Know Harmon, Curran, Spielberg & Eisenberg, LLP

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For almost 20 years, Diane has represented citizen groups, state and local governments, and individuals in a wide range of environmental cases relating to nuclear facility safety, radioactive and chemical waste disposal, National Environmental Policy Act compliance, and environmental justice. A nationally recognized expert in the field of nuclear safety law, she was instrumental in the shutdown of the unsafe Yankee Rowe nuclear power plant in Massachusetts, the closing of the severely contaminated Sequoyah Fuels uranium processing factory in Oklahoma, and the defeat of an application to build a uranium enrichment plant in a rural African-American community in Louisiana. Her current cases include a challenge to a proposed uranium mine in a rural Navajo community; litigation on behalf of the State of Utah against a large spent-fuel storage facility; and opposition to the significant expansion of spent-fuel pool storage capacity at the Harris nuclear plant in North Carolina.
