The Legality of School Booster Clubs Engaging in Cooperative Fundraising Activities: A White Paper to Help Determine if Your Fundraising Activities are Legal

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Some parent school support groups, often called booster clubs, provide "credit" to volunteers who participate in fundraising activities. Parents and students often feel that people won't volunteer to raise funds for the group unless credit is given to those who actually help. In addition, it is understood that some students cannot afford to participate in band trips, state and national athletic competitions and the like unless fundraising opportunities are available.

The IRS calls fundraising activities in which individuals receive credit for funds raised ***cooperative fundraising***. When records are kept showing how much each parent/student contributed to the fundraising effort, these records are called *individual fundraising accounts (IFAs).* The IRS has said that that cooperative fundraising and IFAs may disqualify a school booster club from tax-exemption as a public charity under section 501(c)(3) of the Internal Revenue Code. This white paper will explore what the IRS has written about cooperative fundraising and IFA's and provide a methodology for analyzing when cooperative fundraising is likely to disqualify a group as a public charity.

Public charity status of school booster clubs

To qualify as a public charity under section 501(c)(3) of the Internal Revenue Code, an organization must be operated for a ***public*** purpose. Most parent groups that support school activities – such as athletic, music and academic booster clubs and PTOs – qualify as public charities because they support education or promote amateur athletics, both of which are listed in the Internal Revenue Code as public charitable purposes. Booster clubs may not, however, be primarily operated to help individual members pay the costs of having their children participate in an extracurricular activity.

There are several ways an organization can be disqualified from public charity status. One activity that is completely prohibited under IRS rules for 501(c)(3) public charities is ***private inurement***. Private inurement occurs if the people who control the organization – including the officers and directors – called "insiders" in IRS language – receive direct financial benefit from their relationship to the organization. This rule differentiates how nonprofit charities operate from how for-profit companies operate. Charities must operate for a public purpose and not provide direct financial benefit to the officers and directors. For-profit companies, however, are set-up to earn income and distribute that income to the owners.

As a result, if a booster club holds a number of fundraisers and then divides the funds raised between the people who raised the money , the IRS would likely find that the booster club is engaging in illegal private inurement activity.

Another way an organization can be disqualified from public charity status is if undertakes too much ***private benefit*** activity. A private benefit activity is any activity that benefits private individuals rather than the broad public purpose of the organization. Private benefit is similar to private inurement but can be found if any individual benefits. Private inurement is found only when the "insiders" benefit. The existence of ANY private inurement will disqualify an organization from public charity status, while a limited amount -- or ***insubstantial amount*** in IRS language -- of private benefit activity is tolerated.

The reason an insubstantial amount of private benefit activity is allowed is because, in practice, the federal law that states that to qualify under section 501(c)(3) organizations must be organized and ***exclusively*** for recognized tax-exempt purposes, is interpreted to mean ***primarily*** engage in tax-exempt activities. As a result, limited amounts of non-

exempt activities, including unrelated business activities and cooperative fundraising activities, will not disqualify an organization from public charity status.

Key IRS writing on booster clubs

The key IRS writing regarding school booster clubs and their fundraising activities is the 1993 article, ***Athletic Booster Clubs: Are They Exempt?*** accessible at http://www.irs.gov/pub/irs-tege/eotopica93.pdf. Although the title references athletic booster clubs, the IRS states that "the principles discussed...are...applicable to many other types of parent-controlled booster clubs." In this article the IRS describes two hypothetical booster clubs, Club A and Club B, and concludes that Club A does not qualify for tax-exemption while Club B does qualify.

The IRS found the following activities of Club A significant in why the booster club did not qualify as a public charity:

- All parents were required to members of the club and pay initial and annual dues;
- All parents and gymnasts were required to participate in fundraising activities or pay fees in order to participate (the "work and pay or don't pay rule");
- A point system was used to credit members for the amount of funds they each raised;
- The booster club was related to a for-profit gym; and,
- The gym owners had voting rights on the booster club's board of directors.

The key factors in finding that Booster Club B was different than Club A and therefore qualified for tax-exemption were:

- Parents were strongly encouraged but not required to be members of the club;
- All selected competition team athletes were allowed to participate regardless of parent participation in fundraising; and,
- The private gym owners did not serve as voting members of the board of directors.

The IRS also notes in the article that activities of parent support groups related to public schools are less suspect for private inurement and private benefit activities because (a) "Participants in the programs are selected on the objective and nondiscriminatory criteria set by the schools", and (b) the "element of public control removes much of the discretion evident in...private booster clubs".

A methodology for analyzing when cooperative fundraising is likely to disqualify a group as a public charity

The flow chart in Appendix A provides a methodology for when cooperative fundraising activities are likely to disqualify an organization from 501(c)(3) public charity status. Examples A and B below show how to use the methodology.

Example A: public school band booster organization

A band booster club raises funds to help the band purchase new instruments, attend music competitions, and take the band on tour. The band booster club sponsors a variety of fundraisers including a fall festival, a winter auction, and a spring citrus sale. Funds are given to the band based on an annual budget. Depending on the amount of funds raised, an equal amount of the cost for each student to go on the band tour is paid by the boosters. Students must pay the remaining cost of the band tour. Students who cannot afford to pay their share are encouraged to participate in the spring citrus sale. Seventy-five percent (75%) of the proceeds raised by each student in the spring citrus sale are credited against their costs for the band tour. The remaining 25% of the citrus sale proceeds go to the general band booster fund and are generally used to provide scholarships for students who could not otherwise go on the band trip. It is understood by students that the citrus sale proceeds may not be withdrawn or otherwise controlled by the students. If the students don't go on the band trip, the citrus proceeds go back into the general band fund.

The citrus sale is a type of cooperative fundraising activity. So, the answer to the first question on the flow chart, "Does your booster club engage in cooperative fundraising?" is "yes". The band booster club also answers "yes" to the next question, "Is cooperative fundraising an insubstantial amount of overall activities"? The band has a variety of fundraising activities, most of which do not involve IFAs. In addition, some, but not all, of the proceeds from the cooperative fundraising activity are accounted for in an IFA. The band booster also answers "yes" to the next questions, "Does your booster club support a public school". As a result, the band booster club determines that its limited cooperative fundraising activities are likely not an issue with respect to the booster club's qualification as a 501(c)(3) public charity.

Example B: A booster club related to a for-profit gymnastics school

The gymnastics school parent group sponsors a variety of activities including sponsoring local competitions, operating concessions, selling ads for programs, and operating car washes. All parents of students at the gymnastics school are automatically members of the booster club. Booster club members are recognized with "credit" in an individual fundraising account for the number of hours they spend working fundraising events throughout the year. If parents don't earn enough credit they must pay required fees to pay for their child's competition uniform, competition entry fees, and other fees. If a parent does not either work enough hours and earn enough credits, or pay the shortfall in cash, their child may not participate in the competitions or on the gymnastics team.

Using the flow chart, the answer to question one for the gymnastics booster club is "yes", the club engages in cooperative fundraising. The answer to question two is "no", the cooperative fundraising is not an insubstantial part of the gymnastic booster club's overall activities. Credit may be earned with respect to hours spent on any of the fundraising activities of the booster club. The next question then is, "Are students sleeted to participate on an objective, non-discriminatory basis." The gymnasts are selected for the competition team based on skill so the answer is "yes". This leads to the question, "Do you have a work-and-pay or no play" policy. The answer is yes – if the parents don't earn enough credits or pay the shortfall in cash their child may not participate on the competition team. As a result, the cooperative fundraising activities of the gymnastics booster club are likely to disqualify it from public charity status under section 501(c)(3).

A critique of the IRS writings on cooperative fundraising

In addition to concern that the nearly twenty-year-old IRS article cited in this paper appears to be the most relevant writing, the IRS reasoning in the article raises a few questions. The IRS compares Booster Club A that it describes as not qualifying for public charity in the article as being similar to a parent group that started a bus transportation service to take their children to a private 501(c)(3) school. Rev. Rul. 69-175, 1969-1 C.B. 149. In this frequently cited revenue ruling, the IRS found that the parent support group was not tax-exempt because it operated to "provide a cooperative service for [the parents]...to fulfill their individual responsibility of transporting their children to school. Thus,....serves a private rather than a public interest".

The bus transportation group, however, appears to be significantly different than the description of Booster Club A and the different than the operation of most school booster clubs. The bus transportation group engaged in only one activity, transporting students from home to school. The organization did not engage in any activity described as being educational or charitable under the Internal Revenue Code. The bus service did not, for example, support the school by transporting sports teams, band, choir or other competition teams to events. This differs significantly from typical parent-school support groups that provide services and financial resources to support legitimate tax-exempt activities of public or private tax-exempt schools.

The IRS article also looks to a 1991 General Counsel Memorandum (GCM) 39862 as presenting the "latest and clearest discussion of this inurement proscription". GCM 38962, and many other similar IRS rulings on private inurement, involve joint ventures between hospitals and their medical staff. Any similarity between these types of medical joint ventures and the usual cooperative fundraising activities of parent school support groups is hard to find.

Three key conclusions

The following key conclusions are made based on a review of the federal law and the limited IRS writings regarding cooperative fundraising and IFAs:

1. The IRS has found that engaging in cooperative fundraising activities using of individual fundraising accounts (IFAs) may disqualify an organization for federal tax-exempt status under section 501(c)(3);
2. Cooperative fundraising activities **are not strictly prohibited** under federal law and IRS rules, and the IRS' analysis and arguments are not convincing;. however,
3. If booster clubs engage in cooperative fundraising activities it is recommended that such activities make up only **an insubstantial amount** of the booster clubs overall activities.

APPENDIX A: A methodology for analyzing when cooperative fundraising is likely to disqualify a group as a public charity

DEFINITIONS:

Cooperative fundraising – fundraising activity in which participants are given "credit" for funds raised

Work-and-pay-or-don't-play – policy under which parents must earn fundraising credits and/or pay shortages to enable their child to participate in activities

Tax-exempt/public purpose – purpose recognized the IRS as benefiting a segment of the public; and that does not primarily benefit a private interest, such as paying fees/costs that are parent's responsibility for their child.