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CHARGING FEES FOR PROGRAM SERVICES

As nonprofit organizations seek to diversify revenue streams, many are considering whether to charge for the goods and services they provide. Program service fees can constitute a significant additional revenue source for many nonprofits, particularly when reliance on charitable giving has become an ever-increasing challenge.

In general, it is permissible for tax-exempt, nonprofit organizations to engage in activities that generate revenues. Charging a fee for program services or goods is quite common. For example, an organization may charge a fee for participants to attend a workshop, charge tuition for an after-school program, or charge for the purchase of books or materials. However, before charging fees, nonprofit managers should work with an attorney to carefully consider the legal and financial implications of revenue-generating activity.

IRS Regulations Governing Nonprofit Fee Generation

Tax exempt organizations are permitted to charge fees for their services. The question is whether or not the **activity** generating the revenue is “**substantially related**” to the organization’s exempt purposes (which means the **activity itself** “**contributes importantly**” towards achieving the mission of the organization (because the **activity itself** is “**directly in furtherance**” of the organization’s objectives). If the **activity itself** is **not** “substantially related” the revenue will be treated as “unrelated business income” and (if, after offsetting the expenses incurred in generating such revenue, there is a net surplus) may require the organization to pay Unrelated Business Income Tax (UBIT). Note that just because the organization uses the revenues generated to help achieve its mission is **not** sufficient to make an activity “**substantially related**”.¹

Not fully covered in this legal alert are the various issues involved when a tax-exempt organization generates significant “unrelated business income” by deciding to engage in or continuing revenue-generating activities that are not related to its exempt purposes, i.e., non-program services (including sales to persons not within the charitable class the organization is authorized to serve). Please consult Lawyers Alliance or other legal counsel for more guidance.

¹ For more information (including some helpful examples) on whether certain revenue may result in UBIT and how much “unrelated business income” is permissible without jeopardizing an organization’s tax-exempt status, see IRS Publication 598 “Tax on Unrelated Business Income of Exempt Organizations,” available at www.irs.gov/pub/irs-pdf/p598.pdf or contact Lawyers Alliance.

Sliding Scale Fees

A sliding scale is a fee structure that bases the amount charged for program services or goods on a particular participant's ability to pay. Absent any restrictions in your organization's funding contracts, using a sliding scale is permissible. To ensure proper accountability and fairness, the organization should develop a policy that sets forth eligibility standards, including what documentation is acceptable to prove a participant meets such standards. If the requested documentation contains personally identifying information such as social security numbers, the organization will have to develop a procedure for protecting this information. The sliding scale policy should be reviewed frequently and available upon inquiry so as to avoid any claims of favoritism or unequal application of the sliding scale.

Voluntary Donations to Participate

If your organization wishes to keep program services free of charge, you may consider asking for a "suggested" or "voluntary" donation to help the organization cover the costs of the program. This may incentivize participants to give to the program even if it is difficult financially to do so. Be careful to ensure that the donation is truly voluntary and the services are available even if the participant does not make a contribution. Whether a "suggested donation" fee structure is appropriate depends largely on the nature of the program and the population the organization serves. Remember that any donations made to the organization are subject to the IRS rules on deductibility and documentation of contributions. If a donor receives services in exchange for a charitable contribution, there may be a limit on how much of that contribution is tax deductible. Organizations must provide a written disclosure to donors who give more than \$75, partly as a contribution and partly for goods and services provided by the organization.²

Other Considerations

Your organization should review its funding contracts and award letters, including public and private funding agreements, to ensure none prohibit charging a fee.

Moreover, it may not be clear whether your organization's activities are related to or further its exempt purposes. Classifying activities as program-related or not can often be a challenge. Consult Lawyers Alliance or legal counsel if you have questions about the classification of your organization's fee-generating activities.

Lastly, organizations should be aware that the IRS may refuse recognition of, or even revoke, an organization's tax-exempt status when its financial support is entirely earned-income-based. This may occur regardless of whether or not the revenues derive from activities substantially related to the organization's exempt purposes. In the absence of a varied and broad fundraising program by such organizations, the IRS may raise questions regarding "undue commerciality" and whether charging fees for program services "significantly detracts from the organization's ability to achieve its stated charitable purpose." While this is an issue for relatively few

² For more information on these rules, see IRS Publication 526 "Charitable Contributions," available at <http://www.irs.gov/pub/irs-pdf/p526.pdf> and IRS Publication 1771, "Charitable Contributions: Substantiation and Disclosure Requirements," available at <https://www.irs.gov/pub/irs-pdf/p1771.pdf>.

organizations, Boards of Directors should be aware that budgets based entirely or substantially on fee-for-service income have the potential to adversely affect an organization's tax-exempt status.

This alert is meant to provide general information only, not legal advice. Please contact Staff Attorneys Neil Stevenson at nstevenson@lawyersalliance.org or Noah Sapse at nsapse@lawyersalliance.org, or visit our website www.lawyersalliance.org for further information.

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