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**Program Preservation, Evolution, and Financial Change: Finances and Fundraising
Charging Fees for Program Services**

As nonprofit organizations deal with a turbulent economy, they may 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 organizations to engage in activities that generate revenue. Charging a fee for program services or goods is one of the most common ways that nonprofits do this. 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 the activity generating the revenue is “**substantially related**” to the organization’s exempt purposes, i.e., whether 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** to the exempt purposes, the revenue will be treated as “**unrelated business income**” and (if there is a net surplus after offsetting the expenses incurred in generating such revenue) may require the organization to pay “Unrelated Business Income Tax” (UBIT). Note that simply using the revenues generated to help achieve an organization’s mission is **not** sufficient to make an activity substantially related to the exempt purposes.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 to engage in 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).²

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.

² For more information on this subject, see here:

[Basics of the Federal Unrelated Business Income Tax on Nonprofits Legal Alert.pdf \(lawyersalliance.org\)](http://www.lawyersalliance.org/lawyersalliance.org)

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, the organization will also have to develop a procedure for protecting this information. The sliding scale fee policy should be reviewed frequently and be 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. For example, 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. Note also that organizations must provide a written disclosure to donors who give more than \$75.³ So if an organization is offering an exercise class that would cost \$25 at the going market rate, and a participant gives the organization \$100 to participate, the organization would provide a written disclosure to the participant that the value of their donation was \$75 (the payment above the market rate).

Other Considerations

Your organization should review its funding contracts and award letters, including public and private funding agreements, to ensure that they do not prohibit charging fees for services.

Classifying activities as program-related or not can often be a challenge. It also may not be clear whether your organization's activities are related to or in furtherance of its exempt purposes. Consult Lawyers Alliance or other 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 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 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.

³ 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>.

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