Coronavirus and Nonprofits: Cancellation of Fundraising Events and Membership Dues May Convert to Tax-Deductible Donations

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In the wake of the coronavirus (COVID-19) pandemic, charitable organizations around the world have been forced to cancel or postpone their fundraising events. In addition, many charitable organizations have been advised to close their facilities and perform their operations virtually, if possible. As a result, nonprofits that collect membership dues, tuition, or fees can render limited or even no services in exchange. Unquestionably, these activities represent a substantial source of revenue; as such, nonprofit organizations are highly reliant on fundraising events and membership dues to fulfill their tax-exempt mission.

Nonprofits may question how to handle the return or retainment of such payments and whether these payments can, in fact, be considered an individual's tax-deductible donation. In reckoning with these questions, one should understand that a charitable contribution is a gift—and just like any gift, it is an irrevocable transfer of a donor's entire interest in the donated cash or property. Typically, since the donor's entire interest in the donated property is transferred, it is not possible for the donor to recover the donated property; however, in certain circumstances, such as during this pandemic, there may be exceptions to the general rule.

In today's rapidly changing digital age, organizations can instantly communicate with and broadcast information to the public. The emergence of e-commerce has created electronic payment systems like online credit card payments and electronic checks. On a daily basis, nonprofit organizations are announcing on the internet the cancellation of fundraising events and their guidelines for ticket refunds. Often, guests should not expect an automatic refund but instead will need to follow certain directions, as set forth by the nonprofit, to request a refund or elect to designate the payment as a charitable donation.

Traditionally, the only form a refund took was as a paper check; if that refund check were lost, destroyed, misplaced, or otherwise left uncashed, the unclaimed refund would constitute abandoned property and be subject to escheatment laws under the respective state jurisdiction. Now, any concerns about disseminating information to the public at large and issuing refunds through alternative methods have been essentially eliminated.

Contributions and Gifts under IRC Section *170*

Under IRC section 170, in order for a charitable contribution to be deductible as a payment to or for the use of a qualified charitable organization, it must be a gift. A “qualified charitable organization” is a nonprofit organization that qualifies for tax-exempt status according to the U.S. Treasury.

Qualified charitable organizations are generally exempt under IRC section 501(c)(3) and include those operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to animals or children, or for the development of amateur sports. In addition, nonprofit veterans' organizations, fraternal lodge groups, cemetery and burial companies, and volunteer fire companies can also qualify. Federal, state, and local governments can also be considered qualified charitable organizations if the money donated to them is earmarked for charitable causes.

In order for a gift to exist, there must be, among other requirements, a payment of money or transfer of property without adequate consideration—in other words, the transfer must be gratuitous in nature. As was well-articulated in *Petti v. Comm'r of Internal Revenue*, for a charitable contribution to be deductible, "the transfer must be a gift which is completed, made voluntarily…with donative intent…and without consideration or benefit (other than *mere satisfaction*) to the donor." If, however, a payment is made to a charity by a donor partly as a contribution and partly for goods or services provided to the donor by the charity, referred to as a “quid pro quo contribution,” all or part of the payment will not be a gift, and a deduction in whole or in part will not be allowed.

Quid Pro Quo Contributions

When a taxpayer receives or expects to receive a benefit in exchange for a charitable contribution, the benefit is a quid pro quo if the fair market value is equal to the benefit received; as such, the contribution is not deductible under IRC section 170(a). If the quid pro quo is worth less than the amount of the taxpayer's transfer, the transfer is deductible to the extent that the amount of the contribution exceeds the fair market value of the benefit received, as long as the excess amount was transferred with the requisite donative intent. The burden is on the donor to establish that the amount paid is not the purchase price of the item, privilege, or benefit received—and that part of the payment does in fact qualify as a gift.

Quid pro quo contributions are common in the context of fundraising events because they’re designed to solicit payments intended to be, in part, the purchase of admission or participation in an event. In these situations, the cost of tickets to a charitable event is eligible for a contribution deduction to the extent that the purchase price exceeds the fair market value of admission and/or other privileges associated with the event. In *United States v. American Bar Endowment*, the U.S. Supreme Court set the standard known as the excess value test, stating that “a payment of money generally cannot constitute a charitable contribution if the contributor *expects* a substantial benefit in return.”

Another example of a quid pro contribution arises in connection with the deductibility of membership dues and fees paid to charitable organizations. Nonprofits like museums and philharmonic organizations frequently offer memberships for an amount that is disproportionate to the benefits received. Whether the payments are charitable contributions, in whole or in part, is a question of fact and depends on such factors as the nature and extent of the benefits or privileges conferred upon members. If any reasonably commensurate return privileges or facilities are made available in exchange for a membership payment, the payment is not a charitable contribution.

In general, a charity is only required to return donations when the gift is conditional and the condition fails, although there may be many other instances in which it could be appropriate to return the funds to the donor, such as when a project is abandoned or overfunded or when there was no general charitable intent. While no definitive guidance exists on how a nonprofit should respond to returning contributions when an event has been canceled—or now that membership privileges and benefits have ceased amid the COVID-19 pandemic—the circumstances in each case should be compared with guidelines to determine how the nonprofit should proceed.

Viewing this in the reverse, clear guidance does exist in the event that an individual is unable to attend an event. In these situations, the unused ticket qualifies as a charitable contribution only if it is returned to the organization, as illustrated in Revenue Ruling 74-348 (1974-2 CB 80, 1/1/1974). Revenue Ruling 67-246 (1967-2 C.B. 104) states that the test of deductibility of payments to charitable organizations in connection with admission to certain fund raising activities for charity is not whether the *right* to admission is exercised but whether the taxpayer *accepted or rejected* that right. The mere fact that a ticket is not used does not entitle the taxpayer to any greater right to a deduction than if the taxpayer did use it.

Considerations and Recommendations

Nonprofit organizations should have practices in place when engaging in fundraising activities. This includes determining in advance of solicitation the amount properly attributable to the purchase of admissions or other privileges and the amount solicited as a gift. The respective amounts should be stated at the time of the solicitation and can be indicated on the ticket, receipt, or other evidence issued in connection with the payment. Examples of these requirements are provided in Revenue Ruling 67-246. In making such a determination, the full fair market value of the admission and other benefits or privileges must be taken into account.

Amid the COVID-19 pandemic, as nonprofit organizations face closures and cancelations of public fundraising events, they should consider several important points and guidelines, discussed below.

Nonprofit organizations should establish and adopt a written refund policy and display it on the printed material connected with its fundraising events. The policy should typically not allow for refunds of donations; however, if there are certain special circumstances, those should be clearly specified. For example, the policy may state that all deposits will be refunded in full if a workshop is cancelled due to low enrollment, instructor scheduling conflicts, or causes beyond the nonprofit's control. Furthermore, the policy should specify the procedure for requesting refunds and the specific time limit during which refunds will be granted.

Nonprofit organizations should communicate new arrangements and details to its guests and donors when fundraising events have been postponed instead of cancelled. The message dispatched should state whether refunds will be granted or applied to the rescheduled event.

Nonprofit organizations should notify participants, ideally via a formal public announcement on their website, of a cancelled fundraising event and as a way to offer a refund and set forth the refund conditions. An organization may offer different refund options, such as refunding the fair market value of admission and privileges associated with the event only or refunding the full amount.

Nonprofit organizations facing closure should also contact their members and provide membership options. Some of the common options that may be offered are—

- asking members for their continued support by maintaining regular dues during the closure (this option would continue to afford members with nondeductible treatment),

- convert the membership into a tax-deductible charitable donation during the period of closure (the member should explicitly opt in to this option and a tax deduction receipt should be issued to the member), or

- close or freeze its membership until a later date (the member should explicitly opt out from membership).

Membership renewal dates should be clearly disclosed. Most importantly, the donor or member should follow the procedures established by the nonprofit organization in requesting a refund or canceling a membership by unequivocally indicating its intent—ideally in a standard written inquiry, whereby the response is documented. A lack of response within a certain designated timeframe would imply the donor/member has relinquished their right to a refund or modification to their membership privileges.

Nonprofit organizations are required to comply with the substantiation and disclosure requirements for charitable contributions and, most commonly, issue written acknowledgements to donors no later than Jan. 31 of the year following the donation. For cash charitable contributions of $250 or more, the Treasury Regulations require the donor to secure a "contemporaneous written acknowledgment" from the donee. This substantiation requirement must take place as of the earlier of—

- the date the taxpayer files its tax return, or

- the due date (including extensions) for filing the tax return.

Nonprofit organizations should consider the impact of issuing refunds (or other modifications) and whether it may need to issue revised acknowledgement letters. Most certainly, modifications to the good faith estimate of the value of goods or services that an organization provided in return for the contribution may be necessary. This may be most prevalent in situations where a charitable acknowledgement letter was already issued for fundraising proceeds collected in 2019 that are now being refunded in 2020.

A taxpayer who itemized receiving the full tax benefit of a charitable donation in one year and who receives a refund of that donation in another year is required to include in gross income the amount previously deducted. This basic concept, better known as double-dipping, states that a taxpayer cannot procure a double benefit, a deduction in one year and nontaxable treatment in a subsequent year.

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