



Board Talking Points: Charging Fees for Program Services

As nonprofits seek to generate revenue to preserve programs, many are considering new fundraising strategies, including whether to charge for the goods and services they provide. Program service fees can constitute an additional revenue source for many nonprofits, particularly in times where reliance on charitable giving has become an ever increasing challenge. Diversified funding streams can be vital to an organization's success and financial health. Below are frequently asked questions about charging for nonprofit services.

Questions:

- 1. Are tax-exempt organizations allowed to charge a fee for service?**
- 2. Can we use a sliding scale to charge for program services?**
- 3. Can we keep services free of charge, but ask for a "suggested" donation?**
- 4. Are there other limitations for nonprofits to consider when contemplating charging fees for services?**

Answers:

- 1. Are tax-exempt organizations allowed to charge a fee for service?**

Yes, generally, 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. The question is whether the revenue from the fee-for-service activity is tax-exempt, or whether the activity generating the fee subjects to the organization to taxation, as Unrelated Business Income Tax (UBIT). In order to avoid UBIT, the fee-generating activity must be related to, or further, your organization's exempt purpose.

The IRS has stated that an activity is unrelated to an organization's exempt purpose if there is no connection to the exercise or performance of charitable, educational, or other purpose or functions constituting the basis for an organization's tax exemption. Internal Revenue Code, §513(a). The need to raise funds or using the profits from an unrelated activity to fund your organization's programs does not qualify as furthering exempt purposes.

For more information on whether an activity is taxable as UBIT and how much UBIT 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.

- 2. Can we use a sliding scale to charge for program services?**

Yes, absent any restrictions in your organization's funding contracts, using a sliding scale is permissible. A sliding scale is a fee structure that bases the amount of fee charged for program services

or goods on a particular participant's ability to pay. To ensure proper accountability and fairness, the Board 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 then 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.

3. Can we keep services free of charge but ask for a voluntary donation to participate?

Yes, if your organization wishes to keep program services free of charge, it may instead ask 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 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, as well as 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. For more information on these rules, see IRS Publication 526 "Charitable Contributions", available at www.irs.gov/pub/irs-pdf/p526.pdf and Publication 1771, "Charitable Contributions: Substantiation and Disclosure Requirements," available at www.irs.gov/pub/irs-pdf/p1771.pdf.

4. Are there other limitations for nonprofits to consider when contemplating charging fees for services?

Your organization should review your funding contracts and award letters, including public and private funding agreements to ensure that charging a fee for services is permissible and not prohibited or limited by an agreement.

Moreover, it may not be clear whether your organization's activities are related to, or further, your exempt purposes. Classifying program activities 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 deny recognition of tax-exemption to an organization on the grounds that the financial support of the organization is entirely fee-based, whether or not the activities from which the fees derive relate to the organization's exempt purpose. The IRS has often used the absence of a varied and broad fundraising program as a basis to deny tax-exemption. When an organization is entirely or substantially dependent on fee-for-service revenue, the IRS may raise questions of "undue commerciality" and inquire whether charging fees for program services "significantly detracts from the organization's charitable purpose." While this would be an issue for relatively few organizations, Boards should be aware that revenues based entirely or substantially on fee-for-service income have the potential to affect an organization's exempt classification.

This alert is meant to provide general information only, not legal advice. Please contact Lindsey Jones, Staff Attorney, at (212) 219-1800 ext.228, ljones@lawyersalliance.org or visit our website www.lawyersalliance.org for further information.