Crowdfunding and Your Nonprofit: Legal Traps and Tips

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What is Crowdfunding Anyway?
Crowdfunding Definition

Essentially the practice of raising money for a cause or undertaking by reaching out to a large number of people as potential donors through social media, online platforms, or in-person events.
Online Crowdfunding Platforms

Some Benefits of Online Crowdfunding:

• Has the potential to reach a much broader audience
• Can help to build relationships and attract and inspire new supporters
• Platforms generally provide easy-to-use interfaces that eliminate the need to build a new website
• Platforms often employ gamifications techniques and social media integration

• BUT - many online crowdfunding platforms charge a fee, either per contribution or as a percentage of the amount raised – typically 5-15%
Crowdfunding Industry

- $34B estimated to have been raised by crowdfunding campaigns in 2015 – $2.8B in donation crowdfunding
- Currently 191 U.S.-based crowdfunding platforms
- World Bank study projected crowdfunding would be a more than $90B industry by 2025
- Average crowdfunding donation online is $88.22
How is Crowdfunding Being Used?

By Nonprofits:

• To fundraise, attract new donors, and/or grow mission awareness
• Setting up a page on a crowdfunding platform or creating their own

By Individuals:

• New venture/project fundraising
• Directly soliciting charitable funds for personal purposes
• Fundraising on behalf of a favorite nonprofit
State Charitable Solicitation Registration
Registration Requirements

Majority of States Require Charitable Solicitation Registration

• Registration generally with the Attorney General
• If soliciting or holding charitable funds in that state
• Prior to solicitation of funds
Online Fundraising

When to Register?

- Charleston Principles
  - Specifically targeting residents
  - Receive substantial contributions from residents
  - Receive repeated contributions from residents

The Unified Registration Statement

- A multistate filing process
Crowdfunding Platform Registration Requirements
DoPlatforms Have to Register?

Majority of States Also Require Charitable Fundraisers to Register

- Professional Fundraisers
- Fundraising Counsel
- Commercial Co-Venturers

- Crowdfunding platform sites may need to register, particularly if holding charitable funds directly and/or providing additional fundraising services
  - But most have taken the position that they don’t meet these definitions
Why Does This Matter for Nonprofits?

Requirements When Working with Registered Fundraisers

- Written contract with specific terms
- Sign off on annual reports
- Consistent reporting by nonprofit and platform

- Expect to see increased state regulation of crowdfunding platforms in the near future
Unauthorized Fundraising
Who Can Fundraise For a Nonprofit?

- Boards and authorized officers may delegate authority to agents, including to fundraise on nonprofit’s behalf
  - Defined scope and appropriate oversight
  - Many states require prior permission from a nonprofit to use its name in connection with a solicitation

- If nonprofit discovers unauthorized fundraising, often advisable to take steps to stop it
  - Protect reputation
  - Control messaging/public image
  - Avoid potential liability exposure
Suggested Practices

• Monitor crowdfunding sites for unauthorized fundraising activity
  • State law often requires nonprofits to exercise control over fundraising activities for their benefit
• Develop a fundraising policy
• Inform supporters how they can best support the organization
Private Benefit Concerns
Public Benefit Requirement

501(c)(3)s must serve a public, rather than private, interest

- May provide benefits to individuals that are incidental, qualitatively and quantitatively, to furthering exempt purposes
- Must serve a sufficiently broad charitable class
  - Crowdfunding campaigns to benefit a specific individual/family unlikely to be broad enough
No Conduit/Pass-Through

501(c)(3)s may not act as mere conduits
- Must exercise discretion and control over contributions received
  - Variance power

Contributions earmarked for specific individuals aren’t deductible charitable contributions
- IRS will collapse transaction and consider it a contribution directly to the individual
- Cannot “lend” tax ID, even for a good cause
Charitable Trust Doctrine
What is the Charitable Trust Doctrine?

• Nonprofits hold assets in trust for use in furtherance of their exempt purposes
• Must honor any restrictions placed on contributions
• Purposes at time of contribution are a restriction on its use and can be evidenced by:
  • Articles of Incorporation
  • Bylaws
  • Oral and written statements and representations to the public
Content of Crowdfunding Campaigns

• Nonprofits also need to ensure they avoid misrepresentation or fraud in connection with solicitations
  • Nature of nonprofit
  • Purpose or beneficiary of solicitation

• 2015 Washington AG enforcement action against crowdfunded project that failed to follow through
Rewards Crowdfunding & Sale of Goods
Rewards Crowdfunding

Offering rewards, gifts, or perks in exchange for donations as an incentive to motivate individuals to support a crowdfunding campaign.
Quid Pro Quo Contributions

501(c)(3)s must provide a written disclosure for any *quid pro quo* contribution

- *Quid pro quo* contribution =
  - Donor contributes more than $75
  - Donor receives goods or services in return

- Written disclosure =
  - Statement that deductible amount of contribution is the difference between the payment and the fair market value of the goods or services received in return
  - Include a good faith estimate of such fair market value
Sale of Goods

If selling goods through a crowdfunding campaign, consider:

- Whether a seller’s permit is required
- Whether sales are subject to sales tax
- May depend on state jurisdiction over sales
Unrelated Business Income

Unrelated business income (UBI) =

1. Trade or business
2. Regularly carried on
3. Not substantially related to furthering the organization’s exempt purposes

UBI Implications

• Unrelated business taxable income subject to the unrelated business income tax (UBIT)
• If too substantial, may jeopardize exemption
Practical Planning Tips
Selecting a Crowdfunding Platform

What to look for:

• Ensure nonprofit will have control over content of campaign page
• Transparency to both the nonprofit and donors regarding any fees to be charged by the platform & the ultimate amount to be received by the nonprofit
• Clear indication of whether a charitable campaign is run by a nonprofit directly or by an individual
• Treatment of donor data
• Vetting practices for charitable campaigns
• Timing of transfers to the nonprofit if not directly contributed
• What happens if a campaign is not fully funded
• Accounting procedures and process for challenging any accounting
Set Realistic Expectations

- Many crowdfunding campaigns do not reach their set goal
- Establish realistic budgeting plans in case the campaign is not as successful as was hoped for
- Crowdfunding as part of a diverse fundraising plan
- Look at:
  - Size of nonprofit’s standard online donations
  - Amounts raised by similar crowdfunding campaigns
  - “Crowd” you can share the campaign with
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