Crowdfunding, Online Payments, and Charitable Fundraising

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What is Crowdfunding?

- “Crowdfunding” is simply raising funds from a large number of funders to support a project, cause, or organization
  - Nonprofits engaged in fundraising from the general public have been “crowdfunding” for centuries!
  - What’s new: A profusion of online crowdfunding platforms
  - Crowdfunding Centre: Today there are over 450 online platforms
Crowdfunding Models

DONATIONS
REWARDS-BASED
CROWDLENDING
CROWDEQUITY
Crowdfunding Models (continued)

- **Donations**
  - Gifts from donors, no (legal) strings attached

- **Rewards-based**
  - A campaign stating that upon achieving a stated goal (e.g. receiving $[x]$ in donations, having [y] number of people sign up for a marathon etc.), a reward will be provided to each participant
  - Creates a contractual obligation to provide the reward once the stated condition(s) have been satisfied
Crowdfunding Models (continued)

- **Crowdlending**
  - Borrowers are matched with lenders on a platform to make or receive unsecured microloans

- **Crowdequity**
  - SEC rules allow a company to raise up to $1M by selling securities through registered crowdfunding portals
    
    - Provide some relief from SEC registration and reporting, or accredited investor requirements applicable to companies conducting larger offerings
Online Crowdfunding Options

- **Donations**
  - Add a “donate” button to your existing site
  - Get listed on a charity directory
  - Use a turnkey donation campaign solution
Online Payments – The Basics

- Online payments require a gateway, payment processor, and payment network
  - An online **gateway** captures payment card information, similar to a point-of-sale device at a store
  - A **payment processor** formats and batches the transaction, and transmits it to a member of the network that the payment card is on.
  - A **payment network** routes transactions between its members, and settles their net positions at the end of each day
Payment Networks – Inside the Black Box

- An open or four-party payments network consists of participating members and a central “switch.”

- Most payment networks only admit banks as members
  - A merchant can only submit transactions through an acquiring bank or its agent
  - A purchaser must have a bank-issued card or account in order to send money to the merchant
Online gateways/processors like PayPal and Stripe provide APIs or hosted white-labelled webpages that allow you to accept payments within your website.

**Pros:**
- Lowest cost option – per transaction fee can be less than half of that charged by turnkey solutions
- Maintain full control over your site and user experience

**Cons:**
- Requires some coding and integration to implement
- Does not drive traffic to your website or campaign
Platforms like Network for Good and Indiegogo provide a complete suite of functionality needed to run a donation campaign, including customizable campaign website, social media integration, reports, and payments acceptance.

**Pros:**

- One-stop shop for all your crowdfunding donation needs
- Integrated social media and data analytics capabilities allow targeted marketing and promotion

**Cons:**

- Highest cost option in terms of fees
- May present a credit or compliance risk depending on their level of involvement in payments acceptance
Donations – The Charity Directory Option

- Online directories like JustGive and Causes provide organized communities or searchable listings that connect individual or businesses with causes and nonprofits
  - **Pros:**
    - Provides access to community members with a common cause or interest
    - May allow greater flexibility to use other services of your choice
  - **Cons:**
    - Search and community functionalities will generate multiple results besides your organization
    - User interface tends to be cluttered
Donations – Key Considerations

- **Cost**
  - Payment processor and platform fees are a mix of fixed per transaction fees, percentage per transaction fees, and monthly or annual fees
    - Build models incorporating your anticipated number of campaigns and participants, transaction amounts and volumes in order to meaningfully compare different options and platforms
  - On some platforms, payment processor fees are passed through separately from platform fees
    - Make sure to read the fine print and not the advertising – or risk paying double what you expected in fees
### Third-Party Risk

- Donations that are processed directly between donors and donees by PayPal or Stripe only settle through entities that are subject to safety and soundness regulation (money transmitters, banks etc.)

- Some platforms accept payments on your behalf into their corporate accounts, and then periodically wire, write checks for, or ACH funds to donees
  
  - Risk of loss through platform bankruptcy, security breach or employee malfeasance
  
  - Risk that platform will be deemed a money transmitter by federal or state regulators and ordered to cease and desist their activities
  
  - Many sites disclaim all liability to you in their terms of use – even for donated funds
Donations – Key Considerations (continued)

- **Campaign Structure: Flexible vs. Fixed**
  - Flexible campaigns are “keep-what-you-make,” even if the fundraising target is not met
  - Fixed campaigns are “all or nothing” where failure to meet the fundraising target results in the refund of all donations and the waiver of all fees
  - If using a turnkey provider, make sure they support the structure that works for you
Donations – Key Considerations (continued)

- **User Experience**
  - Tradeoff between maintaining control of user experience and obtaining additional functionalities through outsourcing
    - If you are using a turnkey solution or a charity directory and the “look and feel” of your campaign site is important to you, look into the degree of customization that the platform supports
    - Make sure the platform’s service and customer support meets your standards – review BBB ratings and conduct test transactions before running a full campaign
Donations – Key Considerations (continued)

- **Marketing**
  - Existing contacts: Which types of contacts and social media does your donor base use? Your platform should support integration of your campaign with these.
  - Prospective contacts: Charity directories can provide you with access to a network of potential donees. They and some turnkey solutions can also provide you with advice on how to effectively target donors.
Some Major Compliance Areas of Concern

- Who is responsible? The crowdfunding platform, or the organization using that platform to raise funds?
- Federal tax compliance
  - Applies to recipient organization, platform, and donor alike
- Fair trade practices laws at both federal and state levels
- State and local law:
  - Charitable solicitation rules
  - State and local sales and use tax
Federal Tax Issues

- Charitable contribution deduction for contributions made through crowdfunding platforms
  - Who is the donee and is responsible for issuing the acknowledgment of each contribution? Factors to consider:
    • Is the crowdfunding platform operated by a charitable organization?
    • Does the crowdfunding platform have any discretion and control over the use of contributed funds, or is the relationship strictly one of agency?
  - What is the amount of the deduction? Does the deduction include the amount retained by the operator of the crowdfunding platform?
Federal Tax Issues

- **501(c)(3) organizations operating crowdfunding platforms**
  - These are issues for both donors and recipient organizations, too!
  - Due diligence for recipient organizations
  - Private inurement or more-than-incidental private benefit
    - May threaten a platform’s 501(c)(3) status or trigger punitive excise taxes against the platform
  - Operated for charitable purposes? Some operators may provide service “like a business” and run afoul of the Commerciality Doctrine
  - Public charity status is essential; it is virtually impossible for a private foundation to run a crowdfunding platform and comply with PF rules
Fair Trade Laws

- Federal law and state laws in all 50 states proscribe business practices that are deceptive or unfair
  - Federal fair trade laws apply to interstate commerce and are enforced by FTC
  - State fair trade laws enforced in most states by the Attorney General

- Both crowdfunding platforms and recipient organizations may be held liable
  - Both civil and criminal penalties apply

- Ensure all communications to public are complete, accurate, and not deceptive, particularly concerning use of funds
State Charitable Solicitation Laws

- Perhaps the biggest minefield in charitable fundraising, whether crowdfunding is involved or not
- Use of crowdfunding platform **does not** insulate a charitable organization from state charitable solicitation laws, and can increase exposure in some respects
- Crowdfunding platform operators are not always informed
- Key players may be classified as any of the following:
  - Professional fundraiser
  - Fundraising counsel
  - Commercial co-venturer
  - Charitable organization
State Charitable Solicitation Laws

- **What states have jurisdiction?**
  - The state where an organization soliciting funds is domiciled
  - Any state where the organization is targeting its fundraising
  - What about Internet solicitation?

- **Charleston Principles**
  - Law in only two states (TN and CO), but represent charity regulators’ most up-to-date thinking, and are helpful elsewhere
  - Jurisdiction applies if organization receives contributions:
    - “on a substantial basis”
    - “on a repeated and ongoing basis”
State Charitable Solicitation Laws

- Registration for Charities
  - Approximately 45 states require registration for any organization soliciting funds for charity, including charities themselves
  - Which states have jurisdiction over my organization’s fundraising?
  - Use of a crowdfunding platform may trigger Charleston Principles analysis
  - Is the crowdfunding platform operator required to register?
  - On the other hand... can the presence of a registered crowdfunding platform operator relieve the recipient organization of registration?
  - Can be a complex, expensive, bureaucratic process
Professional fundraiser ("PFR") status

- A PFR solicits funds for consideration
- PFR status triggers heavy regulation in almost every state
- Some states exclude 501(c)(3) organizations from PFR status
- Are crowdfunding platforms PFRs? The question is unsettled. Who is doing the soliciting?
- Crowdfunding platforms serving nonprofit organizations should be aware of this issue
Commercial co-venturer ("CCV") status

- A CCV is a for-profit business that **represents to the public** that sales of goods or services benefit a charitable purpose.

- Some crowdfunding promotions where goods are sold may trigger CCV requirements.

- Key question of CCV status: **Who is making the representation?**

- CCVs are regulated in 24 states; requirements vary widely, but usually include:
  
  - Written contract between CCV and charitable organization
  
  - Disclosure of amount per unit sold that goes to charity
  
  - Registration (in 10 states)
Questions?
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