An Overview of Scrip Tax Issues

An analysis of Internal Revenue Service Private Letter Ruling #PLR-118535-09 and implications for non-profit organizations:

- Income to the Parent (and possible 1099 reporting needs)
- Inurement or Private Benefit, and
- Unrelated Business Income.

August 13, 2009

Great Lakes Scrip Center®
America's Preferred Scrip Provider™

Three tax questions have been raised with respect to the operation of scrip fundraising programs, with particular reference to those programs that allow parents to be able to allocate some portion of the amounts attributable to their program participation to the tuition accounts of their children. The issues to be addressed are:

- Income to the Parent (and possible 1099 reporting needs),
- Inurement or Private Benefit, and
- Unrelated Business Income.

Several persons have offered varying opinions on all three issues in efforts to interpret the complex tax regulations applicable to §501(c)(3) organizations (sometimes referred to as non-profit organizations or NPOs).

From time to time, questions have also been raised regarding the ability of a participating family to claim a charitable contributions deduction when funds are raised through scrip programs. Conventional wisdom has suggested that families are paying face value and receiving a gift card of similar value in return, and, therefore, no charitable deduction is permitted.

Great Lakes Scrip Center has undertaken the task of requesting guidance from the Internal Revenue Service (IRS) on these issues. In response to this request, the IRS (in July 2009) issued a Private Letter Ruling (currently designated as PLR-118535-09 - copy attached) adding clarity to these issues. This paper summarizes this new guidance as it pertains to tax questions surrounding scrip programs.

Income to the Parents

One persistent and basic question has been whether or not any portion of the funds that are raised through a scrip program and applied to a family's tuition account should be considered taxable income to the parent who purchases the scrip. If any funds applied to the tuition account are considered income to the parent, then the NPO would have reporting responsibilities (Form 1099), and parents would be required to include this income as part of their personal tax return.

It has been our view that scrip fundraising is unique from other forms of fundraising in that the scrip (gift cards) are primarily purchased for personal consumption, used in place of cash, checks, and credit cards in normal everyday household shopping. Retailers offer to sell their gift cards at less than face value in order to encourage families to shop in their stores. This reduction in purchase price from the face value is, in effect, a rebate from the retailer. Previous private letter rulings and other guidance documents from the IRS have clearly indicated that rebates are not considered gross income, but rather a reduction in the amount of the purchase price. Therefore, following similar reasoning, monies generated by families through their purchase of scrip would NOT have to be reported by the organization through the issuance of a Form 1099.

This same conclusion is clearly reached for scrip programs by PLR-118535-09. Conclusion #1 states: "*The portion of the purchase price Taxpayer pays a charity for scrip that taxpayer can either receive back in cash or allow the charity to retain does not constitute gross income under § 61.*"

Charitable Donation Deduction

Once it is clear that the funds raised in a scrip program are rebates and not reportable as gross income to the final purchaser, it is natural to ask about the deductibility of any rebate funds that the purchaser allows the organization to retain. In other words, can a rebate retained by the organization be claimed as a charitable contribution by the person buying the scrip?

In other (non-scrip related) private letter rulings, the IRS has clearly indicated that so long as the person receiving a rebate voluntarily ***chooses*** to donate all or part of the rebate to charity, then such a voluntary donation does indeed qualify for a charitable tax deduction for that amount, subject to all the other regulations associated with charitable contributions. (Emphasis added on the word "chooses" as explained below under "Conclusions")

This deductibility conclusion is clearly supported for scrip programs in PLR-118535-09.

Conclusion #2 states: "*The amount of the rebate that the Taxpayer can receive in cash but instead allows the charity to retain constitutes a charitable contribution at the time Taxpayer could have received the amount in cash, to the extent provided in § 170.*"

Inurement/Private Benefit

The Internal Revenue Code requirements prohibit §501(c)(3) organizations from providing impermissible benefits to individuals. The definition of Inurement or Private Benefit from the IRS web site states: "*A section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization.*"

All §501(c)(3) organizations should scrupulously avoid any Inurement/Private Benefit transactions as the sanction for this kind of activity is loss of §501(c)(3) tax-exempt status. Thanks to the July 2009 private letter ruling directly applicable to scrip programs, the IRS concluded that the scrip rebate is the property of the family that makes the scrip purchase (referred to as the "Taxpayer" in PLR-118535-09). Thus, the rebate is not "part of the net earnings of a section 501 (c)(3) organization." In other words, the §501(c) (3) organization (or NPO) never owns the rebate as an asset (or ever receives it as its own income). Thus, the NPO has no asset or income of its own with respect to that amount that it could transfer to a family or individual and, thereby, risk creating an act of private inurement or private benefit.

Unrelated Business Income (UBI)

The third tax related question concerns whether funds raised for a non-profit organization through the operation of a scrip program are subject to what the tax code defines as Unrelated Business Income (and thus subject to the Unrelated Business Income Tax). The rules and regulations that interpret UBI make clear that an organization can avoid this tax liability by performing the work of running its scrip program "substantially all" by volunteers. Relevant tax rules and regulations define "substantially all" in other guidance as meaning that at least 85 percent of the work of operating the program is performed by individuals without compensation. Understandably, any organization will need to have its employees perform certain administrative tasks such as making deposits and recording transactions. But so long as the bulk of the work (marketing and promoting the program, accepting and processing family orders, receiving back the scrip cards, and distributing them appropriately to participating families) is accomplished by volunteers, such a program is likely to satisfy the 85 percent volunteer labor requirement.

Conclusions

1. PLR-118535-09 clearly indicates that funds generated by participants in an appropriately structured non-profit organization's scrip program are rebates from the purchase of scrip. As rebates, such funds are not considered gross income to the participants (as defined by Internal Revenue Code §61). Therefore, the nonprofit organization is not required to issue a tax form to the participants for such rebates.

2. PLR-118535-09 describes the rebates as "cash back to the Taxpayer". Thus, we conclude that, under an appropriately structured written agreement, the participants in a NPO scrip program can decide to choose how their rebates will be allocated, including the payment for any expenses associated with their participation in activities of the NPO. Examples of such expenses include school tuition, travel fees, sports fees, etc. Note that any rebates used in this matter would NOT qualify for a charitable contribution deduction as discussed below.

3. As defined in PLR-118535-09, scrip rebates (or any portion thereof) that participants choose to donate to their NPO (rather than to receive as cash) are eligible to be claimed as a charitable contribution deduction so long as all the other requirements for charitable contributions under §170 are met, AND the participants have clearly chosen to allow the NPO to retain them. This choice is a necessary component in order to

claim a charitable contribution deduction. It is also critical that the participant not receive any goods or services in return for the donation such as fee or tuition reduction. We believe the same agreement that is used to direct the application of the rebate for participant expenses can also be used to define what percentage of the rebate may be retained by the NPO as a charitable donation from the participant. One notable requirement of §170 is that the NPO must provide donors with an annual report of their contributions to the NPO. In order for participants to qualify for a charitable contribution deduction as defined above, the NPO must provide such an annual report.

4. PLR-118535-09 also recognizes the need for the NPO to retain an administrative fee to cover the expenses (shipping costs, supplies, etc.) associated with running the scrip program.

* * *

A sample agreement is included with this white paper to assist the NPO with defining the important program elements as outlined above.

SAMPLE
2009-Aug-12

[XYZ School]
SCRIP PROGRAM AGREEMENT

[XYZ School] sponsors a scrip program. The scrip you purchase through our program generates cash rebates from the participating retailers. These rebates can be applied to your [tuition] account and/or designated as a donation to the school. In consideration of your participation in the scrip program and our desire to make your tuition as affordable as possible, we agree as follows:

1. We agree to operate this scrip program on your behalf from such retailers and in such quantities as you designate from time to time.

2. As such, we may purchase scrip in advance of your order to be held as inventory at the school. We will only make advance purchases on your behalf in such quantities and types as are consistent with your and other participants' purchase history.

3. To cover our expenses (shipping, supplies, etc.) of operating this program, we will retain [___]% of the rebates received from your scrip purchases as an administration fee.

4. We agree to apply the balance (after administration fee) of your rebates as designated below (please insert desired percentages):

   ____% given to the school as a gift

   ____% credited to the following account(s), allocated among the accounts in accordance with the corresponding percentages:

_____ ___% _____ ___%

_____ ___% _____ ___%

You agree and acknowledge as follows: (i) no employment or partnership arrangement is created as a result of our relationship; (ii) you are the owner of the scrip purchased on your behalf; (iii) you have limited rights to return the scrip we purchase on your behalf, based on the return policy of our scrip supplier; (iv) you shall indemnify us against any loss incurred in connection with there being insufficient funds in your account to cover the checks or ACH debits you issue to pay for your scrip; and (v) we make no representations or warranties of any kind with respect to the scrip purchased on your behalf. This agreement can be terminated by either of us upon 60 day's advance notice to the other.

Please sign and date below to indicate your acknowledgement of this agreement.

Purchaser's Signature: _____

Printed Name: _____

Date: _____

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
Sharon J. Hester, ID No. 50-36622

Refer Reply To:
CC:ITA:B02
PLR-118535-09
Date: JUL 29 2009

LEGEND:

Taxpayer =

Dear Mr.

This responds to your letter dated April 3, 2009, in which you request rulings related to §§ 61 and 170 of the Internal Revenue Code.

RULINGS REQUESTED

The following rulings are requested:

(1) The portion of the purchase price Taxpayer pays a charity for scrip that Taxpayer can either receive back in cash or allow the charity to retain ("rebate") does not constitute gross income under § 61;

(2) The amount of the rebate that Taxpayer elects not to receive in cash and allows a charity to retain is a charitable contribution deductible under § 170.

FACTS

Taxpayer is an individual who purchases scrip from an organization described in § 170(c) ("charity"). The charity purchases the scrip at a discount but sells the scrip at face value to individuals such as Taxpayer. Thus, for scrip with a face value of $100 that the charity purchases at a 10% discount, Taxpayer pays the charity $100, and the charity's cost for the scrip is $90.

As part of Taxpayer's purchase of scrip, the charity gives Taxpayer the option of receiving in cash a portion of the difference between the face value of the scrip and the

charity's cost for the scrip ($X[1]). That is, at the time of purchase, the charity provides Taxpayer two options: (1) Taxpayer may elect to receive $X in cash, or (2) Taxpayer may elect to allow the charity to retain $X.

Taxpayer's proposed transaction:

Taxpayer plans to purchase scrip at face value from the charity. At the time of Taxpayer's purchase, Taxpayer will elect not to receive $X in cash in favor of allowing the charity to retain $X.

LAW AND ANALYSIS

Section 61 provides that gross income means all income from whatever source derived. A rebate received by a buyer from the party to whom the buyer directly or indirectly paid the purchase price for an item is an adjustment in purchase price, not an accession to wealth, and is not includible in the buyer's gross income. See Rev. Rul. 76-96, 1976-1 C.B. 23, as modified by Rev. Rul. 2005-28, 2005-1 C.B. 997.

A deduction for contributions and gifts to or for the use of organizations described in § 170(c) will be allowed to the extent payment of the charitable contribution is made within the taxable year. Sec. 170(a). A charitable contribution must be made voluntarily and with donative intent. U.S. v. American Bar Endowment, 477 U.S. 105 (1986).

Deductions for charitable contributions are limited to a percentage of the taxpayer's contribution base for the taxable year. See § 170(b). No deduction is allowed under § 170(a) unless the donor properly substantiates the contribution as required under §§ 170(f)(8) (relating to contributions of $250 or more) and (f)(17) (relating to all contributions of a cash, check, or other monetary gift, regardless of amount), as applicable.

Ruling request (1)—Rebate from charity:

Taxpayer first asks us to rule that, if a charity gives Taxpayer the option to receive a cash rebate of $X of the purchase price Taxpayer pays the charity for scrip, Taxpayer will not be in receipt of gross income under § 61.

A rebate received from the party to whom the buyer directly or indirectly paid the purchase price for an item is an adjustment to the purchase price paid for the item. It is not an accession to wealth and is not includible in the buyer's gross income. See Rev. Rul. 76-96, 1976-1 C.B. 23, as modified by Rev. Rul. 2005-28, 2005-1 C.B. 997.

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[1] Where the face value of the scrip is $100 and the charity's cost for the scrip is $90, $X is an amount less than $10 (i.e., the difference between the face value and cost of the scrip, with such difference reduced by the charity's additional cost to provide Taxpayer with the option of receiving an amount in cash).

In this case, Taxpayer purchases scrip from the charity and has the option to receive a cash rebate of $X. In lieu of receiving cash, Taxpayer may allow the charity to retain the $X rebate. In either case, this rebate constitutes an adjustment to the purchase price of the scrip and, consequently, is not includible in Taxpayer's gross income.

Ruling request (2)—Contribution of rebate:

Taxpayer also asks us to rule that, if Taxpayer elects to allow the charity to retain the $X Taxpayer could have received in cash, $X will be a charitable contribution under § 170.

Taxpayer in this case may elect to receive a rebate in cash or to allow the charity to retain the rebate. This program, therefore, is distinguishable from the program in American Bar Endowment. The opportunity for Taxpayer to elect whether rebates will be retained by the charity or received in cash by Taxpayer renders the payments in this situation voluntary.

Accordingly, if Taxpayer chooses the option of allowing the charity to retain the $X and complies with all other requirements under § 170, then Taxpayer is treated as making a charitable contribution in the amount of $X in the taxable year Taxpayer otherwise would have received the $X in cash.

CONCLUSIONS

(1) The portion of the purchase price Taxpayer pays a charity for scrip that Taxpayer can either receive back in cash or allow the charity to retain does not constitute gross income under § 61.

(2) The amount of the rebate that Taxpayer can receive in cash but instead allows the charity to retain constitutes a charitable contribution at the time Taxpayer could have received the amount in cash, to the extent provided in § 170.

The charitable contributions that are the subject of this ruling request will be deductible only if all other requirements under § 170 (including substantiation requirements under §§ 170(f)(8) and (f)(17)) are met, subject to the percentage limitations of § 170(b).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In addition, no opinion is expressed or implied on whether any aspect of the transaction or item discussed or referenced in this letter may impact the charity's tax

exempt status under section 501(c)(3) or results in unrelated business income tax under section 511.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

John P. Moriarty
Chief, Branch 1
Office of Chief Counsel
(Income Tax & Accounting)

cc: District Director, Central District