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## **Sponsorships, Advertising, Endorsements and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits**

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## **Presentations**

## Sponsorships, Advertising, Endorsements, and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits

Jeff Tenenbaum  
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June 16, 2011





### What is Unrelated Business Income?

- What is unrelated business income?
- What is excluded from unrelated business income?
- Explanation of specific UBI exceptions
  - Sponsorship income
  - Licensing income
  - Royalty income
- Cause-related marketing



## UBIT Basics

- General Rule  Organization recognized as exempt does not pay income tax on income received by organization
- Exception  If the income received is unrelated business income (UBI or UBTI), subject to taxation. Organization must report and pay tax at corporate rate



*“The term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is **not substantially related** (aside from the need of such organization for income or funds or the use it makes of the profits derived) **to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 ..”***

Internal Revenue Code Section 513



## (1) Trade or Business

- **Profit motive** – but actual profit doesn't matter
- Does the activity resemble those done by taxable **commercial entities**?
  - *C.F. Mueller Co.* case – law school-owned pasta manufacturer
- Does exemption provide an **unfair competitive advantage** in light of activity?



## (2) Regularly Carried On

- Compared to frequency with which commercial activity is carried on by taxable entities
- *National Collegiate Athletic Association v. CIR* – advertising for program booklets for tournament over **three weekends not frequent enough** although advertising sales took place over several months
- Compare to *Veterans of Foreign Wars, Michigan v. CIR* – selling **Christmas cards was unrelated because it was an intermittent business/ seasonal business and the seasonal participation was regularly carried on**



### (3) Not Substantially Related to Exempt Purpose

- Need for income is not enough
- Association context – exempt purpose directed toward the improvement of members' business conditions; activities to **benefit members as a whole** instead of individual businesses
- **Rev. Rul. 81-138** - Chamber of Commerce's lease of building at below market rent to industrial tenant to spur economic development found to be substantially related to exempt purpose



### Is the Income Taxable?

- Unrelated Business Income Tax (UBIT)
  - It is a **trade or business**,
  - It is regularly carried on, and
  - It is **not substantially related** to furthering the exempt purpose of the organization
- Income that is usually UBIT
  - **Advertising income**
  - **Rents received from debt financed property**
  - **Flow through profits from certain controlled entities**
  - **Income received for the performance of services in exchange for tangible goods**



## Is the Income Taxable?

- Income that is generally excluded from UBIT
  - Passive income
    - Passive investment income
    - Donations
  
- Income that is specifically excluded from UBIT
  - Interest income
  - Royalty income
  - Certain research income
  - Conference and Trade Show Revenue
  - Qualified Sponsorship income
  - Certain bingo games
  - Debt management plan services
  - Renting mailing list to another charitable organization

## UBIT Exceptions: Qualified Sponsorship Income

## Corporate Partnerships Maximizing Income

### Qualified Sponsorship Payments

IRC Section 513(i)

- **Safe Harbor** - no arrangement or expectation that the payor will receive a *substantial return benefit (valued at 2% or less of sponsorship payment)*
  - other than the *use or acknowledgment* of the name or logo (or product lines) of the payor's trade or business in connection with the tax-exempt organization's activities
  - Applicable to **broad range of activities**, excluding:
    - » **Tradeshow and convention**
    - » Advertisement or acknowledgment in **regular periodicals** (journals, e-newsletters, etc.)
    - » **Contingent** payments



## Analyzing Benefits

1. Acknowledgment or Advertising?
2. Eligible for Safe Harbor?
3. Determine Value of "Eligible" Benefits





## 1. Acknowledgment or Advertising?

### Acknowledgement

- Use or acknowledgment of the **name or logo** (or product lines) of the sponsor's business, as long as use **is not qualitative or comparative**
  - But slogans which are an **established part of identity are permissible**
- List of sponsor's **location, telephone number, and/or internet address**, including a **hyperlink** from the exempt organization's web site to the sponsor's web site
- **Product displays**, visual depictions, product samples (whether products are sold or are free)

### Advertisement

- **Qualitative or comparative, price information, indications of savings or value, endorsements, inducement to purchase**

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## Illustrations - Acknowledgement

- **Name and Logo on Functional Items:** Use of sponsor's name and logo on advertisements for events (Reg § 1.513-4(f), Ex 1); event programs, cups used at event, helmets and jerseys on players (Ex 4)
- **Naming of Events:** "Coca-Cola Young Scholar's Program" (TAM 9805001)
- **Website Listing:** List of sponsor names on website, including hyperlink to sponsor's site (PLR 200303062)

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## Illustrations - Acknowledgement

- **Product Display:** Displays of automaker sponsor's cars at event (Reg § 1.513-4(f), Ex 11)
- **Established Part of Company's Identity:** "Better Research, Better Health" (Reg § 1.513-4(f), Ex 9)
- **Exclusive Sponsors** – Right to be sole sponsor of an event, or exclusive sponsor among competitors (Reg § 1.513-4(f), Ex 4)



## Illustrations - Advertising

- **Name and Logo on Unrelated Items:** Sponsor name on souvenir flags (purchased by the tax-exempt) bearing sponsor's name, for use by sponsor's employees (Reg § 1.513-4(f), Ex 5)
- **Call to Action:**
  - "For your music needs, give our sponsor a call today" (Reg § 1.513-4(f), Ex 7)
  - "Visit our sponsor today for the finest selection of music CDs and cassette tapes" (Reg § 1.513-4(f), Ex 8)



## Illustrations - Advertising

- **Comparative Language:** “language is used comparing R's product with the products of other manufacturers, or claiming that it is rated best by veterinarians” TAM 9805001
- **Endorsement:** “We endorse sponsor’s drug and suggest you contact your physician for a prescription.” Reg § 1.513-4(f), Ex 12
- **Weblink to Sales Page:** Link from tax-exempt’s sponsor acknowledgment page to sponsor’s sales ad
  - 2000 EO CPE, the IRS stated that “a moving banner is probably more likely to be classified as an advertisement.”



## 2. Eligible for Safe Harbor?

Safe harbor **does not** apply to (**apply regular analysis**):

- **Over 2%** - Sponsorship payments where return value is over 2%
- **Contingent Payments** – Where level of payment depends on attendance, web hits, etc. (not if contingent on event occurring)
- **Exclusive Provider Arrangements** – Right to be exclusive provider of soft drinks (Reg § 1.513-4(f), Ex 6)



## 2. Eligible for Safe Harbor? Cont.

Convention and trade show (exhibit booths, tickets to trade show, acknowledgment at trade show, etc.)

Advertising or acknowledgement in regular periodical

- **Illustration**: A textbook publisher makes a large payment to have its name displayed on the inside cover of a monthly magazine. (Reg § 1.513-4(f), Ex 10)
  - Includes online periodicals
  - Safe Harbor **DOES** apply to periodical associated with a specific event
- **Public Interest Advertising** – “You will not realize (UBIT) when you acknowledge the donations with public interest advertising (where the) advertisements acknowledge the contributing organizations' sponsorship of the N project” consistent with corporate sponsorship rules (PLR 8749085)

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## 3. Determine Value of Eligible Benefits

Valuation Period

- Valuation is applied to each tax year of a multi-year agreement

Valuation Date

- If a **contract** specifies the (good faith and reasonable) “market value,” then the valuation date is the date of the contract
  - Impacts **pay up-front** agreements
  - **Resets** if there is a material change, including renewal or extension
- If **no contract**, then the date that a benefit is provided

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## Illustration

Hix Foundation makes \$5,000 gift to the Good Deeds Foundation (2% = \$100)

- Ex. 1 - \$ 60 Return Benefit - Safe Harbor
  - \$20 educational event tickets
  - \$30 advertising in event program
  - \$10 board dinner
- Ex. 2 - \$150 Return Benefit – No Safe Harbor
  - \$50 licensing rights (not taxed, passive royalty)
  - \$50 educational event tickets (not taxed, related)
  - \$50 advertising in event program (taxed at market rate)



## Essentials for Sponsorship Contracts

- Specify exact form of **acknowledgment**
- Specify **all return benefits**
- Specify **value of taxable benefits**
- Have right to **approve any copy** relating to sponsorship, or using tax-exempt's name/logo
- Specify site to which **hyperlinks** will link



## UBIT Exceptions: Royalty Income



## Specific Exclusions - Royalties

- Passive royalty income is excluded from UBI
- What is a **Royalty**?
  - “Payments received for the right to use intangible property rights and that such definition does not include payments for services” *Sierra Club v. Commissioner*
- Components
  - **Name, mark and mailing list**
  - **Third-Party Product**
    - e.g. affinity card, not medical journal
  - **No active promotion** (or quantify value and pay tax)
    - Announcement letter okay
    - Quality control measures okay



## Royalties – License of Name or Logo

- **General rule:** The less an organization does the more likely income is to be characterized as royalty income
- Evidence of royalty relationship:
  - Payment relates to use of a **valuable right**
  - Organization's activities are generally limited to **those necessary to protect its reputation**
    - Review use of logo for quality and style
    - Limit the use of logo to approved circumstances
- Evidence of other (usually service) relationship:
  - **Personal service** component to relationship (*i.e.*, appearance or endorsement requirement)
  - **Significant activities** or rights such as approval of editorial content and preparing articles in a publication
  - Existence of a **quid pro quo** transaction

## Royalties – License of Name or Logo

- IRS has taken a **strict position** with royalty income
- Dual purpose relationships:
  - If **service component minimum** – likely not an issue
  - If **service component significant**
    - IRS will likely determine that none of the income is royalty income
    - Courts have looked to the entire relationship

## Royalties – License of Name or Logo

- Dual purpose relationships **best practices**:
  - IRS would prefer **two separate agreements**, usually not necessary
  - Clearly identify and **bifurcate the royalty and service payments** in the agreement
  - Be **reasonable**
  - Do not **title** the agreement “Service Agreement”



## Royalties – Mailing List Rental

- Income from rental of mailing list to exempt organization is **excluded for UBIT** under Code
- Rental of mailing list to **taxable** entities is **excluded from UBIT as royalties**
- Courts have looked to whether the agreement requires “**significant**” activities – usually problems are the result of **promotional or endorsement activities**
- Are your organization’s mailing lists marketed to specific organizations or entities or **sorted to meet the particular needs of a taxable entity**? This could be problematic





## Royalties – Mailing List Rental

- Dual purpose relationships best practices:
  - IRS would prefer two separate agreements, usually not necessary
  - Clearly identify and bifurcate the royalty and service payments in the agreement
  - Be reasonable
  - Do not title the agreement “Service Agreement”



## Royalties – Affinity Card

- Courts have ruled that payments received by organizations through affinity card relationships are for valuable intangible property – the organization’s name, logo, and mailing lists
- The issue is whether an organization is receiving a payment for the goodwill associated with the organizations name and logos or a payment for promotional and mailing list management services
- Courts have held that the amount of services does matter



## Cause-Related Marketing



## Cause Marketing

- **Attributes**
  - Commercial entity uses your name or logo in its advertisements with promise to pay a portion of purchase price to you
  - Passive
  - Lack of control
- **Rewards**
  - Increased donations
  - Increased awareness of your organization
- **Risks**
  - No control over where advertisements are displayed
  - Possible state reporting requirements
  - Problems with having underlying product associated with your organization



## Commercial Co-Ventures

- **Commercial Co-Venture (“CCV”)** – An arrangement between a charity and a commercial entity under which the commercial entity advertises in a sales or marketing campaign that the purchase or use of its goods or services will benefit a charity or charitable purpose
- *“When you buy our new iPhone app, 50% of the purchase price will go to the Lincoln Center!”*
- Frequently referred to as **“charitable sales promotions”** or **“cause-related marketing”**
- Excellent fundraising and marketing mechanism for both the charity and commercial co-venturer



## Regulation of Commercial Co-Ventures: State Law

- **More than 40 states have laws that regulate** various methods of fundraising, including charitable solicitations and CCVs
- About **20 states have laws that specifically regulate CCVs**
- Purpose of laws – **consumer protection**
- Ex: **General Mills/Yoplait “Save Lids to Save Lives”** campaign in late 1990s to Benefit Breast Cancer Research Foundation
  - GA Secretary of State concluded that the disclosures regarding the donation amount were misleading to consumers (GA Secretary of State press release: <http://sos.georgia.gov/pressrel/pr991221.htm>)



## Regulation of Commercial Co-Ventures: State Law

- Statutory language and requirements vary by state → always check language of the statute
- NY definition of “commercial co-venturer” is fairly standard:
  - “Any person who for profit is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds or any other thing of value for a charitable organization and who advertises that the purchase of goods, services, entertainment, or any other thing of value will benefit a charitable organization.” [N.Y. Exec. Laws § 171-a]
- Compare with broader MA statute:
  - “[A]ny person who for profit or other commercial consideration conducts, produces, promotes, underwrites, arranges or sponsors a performance, event, or sale to the public of any good or service which is advertised in conjunction with the name of any charitable organization or as benefitting to any extent any charitable purpose.” [Mass. Gen. Laws ch. 68, § 18, 22-28]

## Regulation of Commercial Co-Ventures: State Law

- State Law Requirements, Generally:
  - *Registration*
  - *Bonding*
  - *Written Contract*
  - *Advertising Disclosures*
  - *Accounting & Recordkeeping*
- **Registration** – Several states require advance registration by co-venturer, including AL, HI, IL, MA, ME and SC
- **Bonding** – A few states, including AL, MA and ME require the co-venturer to obtain a surety bond

## Regulation of Commercial Co-Ventures: State Law

- **Written Contract** –
  - Many states (including NY and NJ) require a written contract, which must be filed with the state by co-venturer
  - Handful of states (including AR, CT, NH and UT) require the charity to file a copy of the contract. Some states require specific terms to be included in contract, including:
    - Identification of charity or charitable purposes benefited
    - Description of sales promotion, including good/services and estimated number to be sold
    - Description of offer to be made to the public regarding amount to be given to charity [N.Y. Exec. Law § 170-b(2)]
    - Terms relating to charity's right to cancel [N.Y. Exec. Law § 174-a]
    - Charity authorization, e.g., MA requires the signatures of 2 officers [Mass. Laws Ch. 68 § 22(a)]
    - Location, start, and end dates of sales promotion
  - Both parties must keep a copy of the contract

## Regulation of Commercial Co-Ventures: State Law

- **Advertising Disclosures**
  - Ads must disclose anticipated portion of the sales price, % of the gross proceeds, dollar amount per purchase, or other consideration or benefit received by charity. [N.Y. Exec. Law § 174-c]
  - Some states require disclosure on a per-unit basis
- **Accounting & Recordkeeping**
  - Most states require commercial co-venturers to keep records, provide the charity (and sometimes the state) with a final accounting of the campaign, and keep that accounting for a specified number of years
  - CA: Funds raised must be given to charity every 90 days during campaign [Cal. Gov't Code § 12599.2]

## Regulation of Commercial Co-Ventures: State Law

- **Co-venturer obligations** – States generally impose requirements on the commercial co-venturer only
- **Charity obligations** –
  - A few states impose certain CCV requirements (filing of notice, contract, and accounting) on the charity
  - Charities should be registered to solicit funds under charitable solicitation laws in states where sales promotion will run
- Requirements vary by state. Check the statute!
- Most state laws and forms can be found via the National Association of State Charity Officials website: [www.nasconet.org/agencies](http://www.nasconet.org/agencies)



## Regulation of Commercial Co-Ventures: BBB Standards

- **BBB Wise Giving Alliance Standards for Charity Accountability** – [www.bbb.org/us/charity-standards](http://www.bbb.org/us/charity-standards)
- **BBB Standard 19**
  - Should clearly disclose how charity benefits from sales promotion.
  - Ensure that sales promotions disclose the following at the point of solicitation:
    - the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to ABC charity for every XYZ company product sold)
    - the duration of the campaign (e.g., the month of October) and
    - any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of \$200,000)



## Federal Tax Law and Maximizing CCV Income

- If charity plays a wholly passive role, the funds it receives from the CCV should count as public support
- If charity has a more **active role** and/or provides any **“return benefit”** to co-venturer (e.g., including the co-venturer’s name and logo on charity website in connection with the promotion), then **UBIT may be triggered**
- In that case, structure as a **qualified corporate sponsorship payment**



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## How to Approach Commercial Co-Ventures

- **Identify CCVs.** Ensure staff is able to recognize a charitable sales promotion and informed about CCV regulations. Consider developing a checklist of issues to address in selecting and working with commercial entities
- **Advance Planning.** Pick co-venturer wisely—you want them to be established, organized, and serious about compliance. Give yourself and co-venturer plenty of time to meet state requirements—particularly disclosures on ad copy—well in advance of start date
- **Written Contract.** Required by most regulating states, the written contract should contain any required terms and standard legal protections, and should be signed by charity officer (or two, in MA)
- **Monitor Co-Venturer for Compliance.** Nobody wants a state investigation. It is in the charity’s best interests to encourage the co-venturer to meet state requirements and to enforce terms of the CCV contract, both before and after to the start of the promotion



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## Questions?

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## **Sponsorships, Advertising, Endorsements, and Cause Marketing**

### ***Allocating Costs to Unrelated Business Activities***

*June 16, 2011  
Presentation*



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## **IRS Concerns**

- Over allocating costs to unrelated activities and away from exempt activities
- Consistent reporting of losses from unrelated business activities raises questions
- Applying losses from one UBIT activity against net income of another
- Same of line business as for-profits may face further scrutiny



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## Problems

- Cost allocation methods aren't consistent
- Cost allocation methods employed by the NPO are not established or properly supported and adequately documented
- Concise guidance from GAAP, IRS and courts is lacking



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## Technical Guidance

- IRS Regulations – *a directly connected expense having “proximate and primary relationship to the carrying on of that business.”*
- Rensselaer Polytechnic Institute case – *allocation based on time used, not time available for use deemed reasonable*
- IRS continues to argue “available for use” is the required method



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## Allowable UBI Deductions

- To qualify as a deduction in computing net unrelated business taxable income, an expense must be:
  - An allowable deduction for income tax purposes; and,
  - Directly or indirectly connected with fulfillment of the unrelated business activity.
- Deductible expenses fall into two broad categories: direct and indirect costs.



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## Direct Costs

- Examples of “allowable direct deductions” include:
  - Salaries, wages, and employee benefit costs when the effort devoted and the benefit derived are directly identifiable with a specific UBI-applicable activity
  - Supplies and other general expenditures including travel, telephone and technology charges, etc.
  - Equipment purchases
  - For self-sustaining operations, equipment, depreciation, operations and maintenance of plant, and institution general administrative support charges
  - Interest paid to third parties during building construction, maintenance, and remodeling prior to occupancy/ capitalization



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## Exploitation Rules

- NPO may generate goodwill, a brand or other intangibles in performance of its exemption function that can be exploited
- If the activity does not contribute to the exempt function, it is UBI
- If so, a portion of the expenses, depreciation and similar items that are related to the conduct of the exempt activity may be deducted from the UBI



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## Indirect Costs

- Examples of “allowable indirect deductions” include:
  - Building usage
  - Equipment usage
  - Operations and maintenance costs
  - General institutional administrative costs
  - Departmental administrative costs



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## Dual Use of Facilities or Personnel

- Costs attributable to an unrelated business activity but shared with other sources of income or operational areas
- An allocation of indirect expense arises when facilities and personnel are used for dual purposes
- The dual purpose expenses must be allocated on a **reasonable basis**
- IRS continues to argue “available for use” as the required method with varying success



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## Reminder/Summary

- Pick a reasonable method for determining allocable costs and apply it consistently or the IRS or courts will choose a method for you
- Be careful not to be too aggressive in the “over allocation” of expenses to your UB activities
- NPO’s are held to a different standard concerning allowable deduction; therefore, a uniform allocation method that will not distort your true cost structure should be established within your NPO



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## Speaker Biographies



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Jeffrey Tenenbaum chairs Venable's Nonprofit Organizations Practice Group, as well as its Credit Counseling and Debt Services Industry Practice Group. He is one of the nation's leading nonprofit attorneys, and also is an accomplished author, lecturer and commentator on nonprofit legal matters. Based in the firm's Washington, D.C. office, Mr. Tenenbaum counsels his clients on the broad array of legal issues affecting trade and professional associations, charities, foundations, advocacy groups, and other nonprofit organizations, and regularly represents clients before Congress, federal and state regulatory agencies, and in connection with governmental investigations, enforcement actions, litigation, and in dealing with the media.

Mr. Tenenbaum was the 2006 recipient of the American Bar Association's Outstanding Nonprofit Lawyer of the Year Award, the inaugural (2004) recipient of the *Washington Business Journal's* Top Washington Lawyers Award, the 2004 recipient of The Center for Association Leadership's Chairman's Award, and the 1997 recipient of the Greater Washington Society of Association Executives' Chairman's Award. He also was a 2008-09 Fellow of the Bar Association of the District of Columbia and is AV Peer-Review Rated by *Martindale-Hubbell*. He started his career in the nonprofit community by serving as Legal Section manager at the American Society of Association Executives, following several years working on Capitol Hill.

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 Automotive Aftermarket Industry Association  
 The College Board  
 Council on Foundations  
 Cruise Lines International Association  
 Foundation for the Malcolm Baldrige National Quality Award  
 Homeownership Preservation Foundation



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California Society of Association Executives

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International Association of Exhibitions and Events  
LeadingAge  
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Public Relations Society of America  
Recording Industry Association of America  
Romance Writers of America  
Texas Association of School Boards  
Trust for Architectural Easements  
Volunteers of America

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Recipient, *Washington Business Journal* Top Washington Lawyers Award, 2004

Recipient, The Center for Association Leadership Chairman's Award, 2004

Recipient, Greater Washington Society of Association Executives Chairman's Award, 1997

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Listed in *Who's Who in American Law* and *Who's Who in America*, 2005-present editions

## ACTIVITIES

Mr. Tenenbaum is an active participant in the nonprofit community who currently serves on the Editorial Advisory Board of the American Society of Association Executives' *Association Law & Policy* legal journal, the Advisory Panel of Wiley/Jossey-Bass' *Nonprofit Business Advisor* newsletter, and the ASAE Public Policy Committee. He previously served as Chairman of the *AL&P* Editorial Advisory Board and has served on the ASAE Legal Section Council, the ASAE Association Management Company Accreditation Commission, the GWSAE Foundation Board of Trustees, the GWSAE Government and Public Affairs Advisory Council, the Federal City Club Foundation Board of Directors, and the Editorial Advisory Board of Aspen's *Nonprofit Tax & Financial Strategies* newsletter.

## PUBLICATIONS

Mr. Tenenbaum is the author of the book, *Association Tax Compliance Guide*, published by the American Society of Association Executives, and is a contributor to numerous ASAE books, including *Professional Practices in Association Management*,

*Association Law Compendium, The Power of Partnership, Essentials of the Profession Learning System, Generating and Managing Nondues Revenue in Associations,* and several Information Background Kits. He also is a contributor to *Exposed: A Legal Field Guide for Nonprofit Executives*, published by the Nonprofit Risk Management Center. In addition, he is a frequent author for ASAE and many of the other principal nonprofit industry organizations and publications, having written more than 300 articles on nonprofit legal topics.

## SPEAKING ENGAGEMENTS

Mr. Tenenbaum is a frequent lecturer for ASAE and many of the major nonprofit industry organizations, conducting over 30 speaking presentations each year, including many with top Internal Revenue Service, Federal Trade Commission, U.S. Department of Justice, Federal Communications Commission, and other governmental officials. He served on the faculty of the ASAE Virtual Law School, and is a regular commentator on nonprofit legal issues for *The New York Times*, *The Washington Post*, *Los Angeles Times*, *The Washington Times*, *The Baltimore Sun*, *Washington Business Journal*, *Legal Times*, *Association Trends*, *CEO Update*, and other periodicals. He also has been interviewed on nonprofit legal issues on Voice of America Business radio.



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### AREAS OF PRACTICE

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Nonprofit Organizations and Associations  
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Attorney, Internal Revenue Service

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Massachusetts  
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### EDUCATION

LL.M., Georgetown University Law Center, 2006

J.D., Northeastern University School of Law, 2003

B.A., Marquette University, 1999

Matt Journy is an associate in Venable's Washington, D.C. office, where he practices in the Nonprofit Organizations and Associations practice group. In his practice, Mr. Journy counsels trade and professional associations, public charities, private foundations, and other nonprofits on a variety of tax, governance, and general corporate matters, including tax exemption applications, audits, tax planning, joint ventures, unrelated business income tax issues, lobbying, and charitable solicitation, among other issues.

Having worked both as a regulator and tax consultant in the nonprofit community, Mr. Journy draws upon his prior experience to provide clients with reliable and thorough advice on the wide array of legal issues faced by nonprofits. Before joining Venable, Mr. Journy worked at Ernst & Young, LLP in the National Tax Practice, where he provided nonprofit clients with tax advice relating to corporate reorganizations, expenditure responsibility for international grants, fundraising activities, commercial co-ventures, unrelated business income, and post-issuance compliance for private activity bonds. In addition to providing tax advice, Mr. Journy provided tax compliance services, including the technical review of various federal and state tax and information returns. Prior to joining Ernst & Young, Mr. Journy worked in the Tax-Exempt/Government Entities Division of the IRS Office of Chief Counsel, where he prepared legal and technical advice for field agents and composed legal memoranda on a variety of issues affecting tax-exempt organizations.

### PUBLICATIONS

- June 13, 2011, IRS Nonprofit College & University Compliance Project: Findings, Examinations and Mock Audits
- May 13, 2011, IRS Denies 501(c)(3) Status to Bankruptcy Counseling Agency
- April 12, 2011, Internal Revenue Code Section 501(q) and Its Critical Implications for the Nonprofit Housing Counseling Industry in Light of Recent IRS Guidance
- March 8, 2011, Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits
- December 16, 2010, So You Want To Be On The Internet<sup>®</sup>
- October 18, 2010, Avoiding UBIT Pitfalls
- June 3, 2010, A Lesson in Compliance: IRS Releases Interim Report on Nonprofit Colleges and Universities Compliance Project (Long Version)
- June 3, 2010, A Lesson in Compliance: IRS Releases Interim Report on Nonprofit Colleges and Universities Compliance Project (Short Version)
- May-June 2010, The IRS Tax-Exempt Examination Process, *Taxation of Exempts*
- April 27, 2010, IRS Provides Guidance to Nonprofits Assisting Homeowners
- April 9, 2010, Legal Traps of Internet Activities for Nonprofits

- March 9, 2010, Intermediate Sanctions: Why You Should Be Concerned about Excess Benefit Transactions and How You Can Avoid Them
- January 12, 2010, FIN 48: What Every Nonprofit Needs to Know
- December 10, 2009, Avoiding IRS Audit Risks: Protecting Your Club's Tax Exemption
- October 6, 2009, Legal Traps of Internet Activities for Nonprofits
- June 17, 2009, Unrelated Business Income Tax
- June 2008, Advertising Considerations for Tax-Exempt Social Clubs
- June 2008, Requirements for Tax-Exempt Status under IRC § 501(c)(7): A Primer for Social Clubs

## SPEAKING ENGAGEMENTS

- June 29, 2011, "Nonprofit Executive Compensation" for Association TRENDS
- June 16, 2011, Sponsorships, Advertising, Endorsements and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits
- June 13, 2011, "Internal Revenue Service (IRS) Compliance Project: Findings and Examinations; 990 Discussions," 9th Annual Higher Education Compliance Conference
- April 12, 2011, Internal Revenue Code Section 501(q) and Its Critical Implications for the Nonprofit Housing Counseling Industry in Light of Recent IRS Guidance
- April 10, 2011, "Top Tax Issues Relating to Income Generated by State and Municipal Organizations Exempt under Sections 115, 501(c)(3) and 501(c)(4)" at the 2011 IMLA Mid-Year Seminar
- March 8, 2011, Legal Quick Hit: "Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- October 18, 2010, "Confusing Stuff You Need to Know to Keep You and Your Chamber Out of Trouble" for the Western Association of Chamber Executives (WACE)
- June 8, 2010, Legal Quick Hit: "Lessons in Tax Compliance: The Broad Impact of the IRS' Interim Report on the Colleges and Universities Compliance Project" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- April 9, 2010, "Legal Traps of Internet Activities for Nonprofits" a Lorman Teleconference
- March 16, 2010, The Form 990: Dealing with the Fall Out (Audioconference)
- March 9, 2010, Legal Quick Hit: "Intermediate Sanctions: Why You Should Be Concerned about Excess Benefit Transactions and How You Can Avoid Them" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- February 12, 2010, "Avoiding IRS Audit Risks: Protecting Your Club's Tax Exemption Status from IRS Scrutiny" at the Club Managers Association of America (CMAA) World Conference on Club Management
- January 12, 2010, Legal Quick Hit: "FIN 48: What Every Nonprofit Needs to Know" for the Association of Corporate Counsel
- October 6, 2009, Legal Traps of Internet Activities for Nonprofits
- September 16, 2009, "The Impact of the New IRS Form 990 on Healthcare Philanthropy: The Changes That You Need to Know About" to the Association for Healthcare Philanthropy



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### EDUCATION

J.D., Duke University School of  
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*Duke Journal of Comparative and  
International Law*

B.A., Political Science, Smith  
College, 1996

### MEMBERSHIPS

Chair, ASAE Legal Symposium  
Planning Committee  
ASAE Legal Section Council  
ASAE Association Law "Tool Kit"  
Task Force  
ASAE Technology Resources  
Committee

Ms. Hix concentrates her practice on counseling charities, trade and professional associations, and other nonprofits on a wide range of legal topics, including tax exemption, intellectual property, corporate governance, and antitrust, among others.

Ms. Hix has broad experience in the nonprofit sector, having served in various capacities at nonprofit organizations, including as the Founding Executive Director of the Memorial Institute for the Prevention of Terrorism (MIPT) and Development Director of East Harlem Block Schools. This experience has included representation before Members of Congress and federal agencies. She also worked in the nonprofit practice of a large national law firm for four years before joining Venable.

### PUBLICATIONS

- May 13, 2011, Online Social Media and Nonprofits: Navigating the Legal Pitfalls
- April 28, 2011, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts
- April 20, 2011, Navigating Nonprofit Partnerships, Joint Ventures and Commercial Co-Ventures: How Arts Organizations Can Avoid the Legal Pitfalls
- March 29, 2011, Dangers and Opportunities: Navigating Nonprofit Partnerships, Collaborations, Joint Ventures and More
- March 8, 2011, Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits
- February 3, 2011, Top Ten Legal Issues for Associations: Common Mistakes, and How to Avoid Them
- December 16, 2010, So You Want To Be On The Internet<sup>®</sup>
- December 6, 2010, Mergers, Alliances, Affiliations and Acquisitions for Nonprofit Organizations: Financial and Legal Issues
- November 10, 2010, Legal Issues in Publishing – Copyright and Reprint Requests
- November 3, 2010, Cyberspace Risk: What You Don't Know Could Hurt You
- September-October 2010, The Ins and Outs of Alliances and Affiliations, *Associations Now*
- September 24, 2010, Doing Business in a Changing Economy: Contracts, Liability, and Understanding Risk
- September 21, 2010, Legal Aspects of Social Networking and Online Media Platforms
- September 20, 2010, Best Practices for Negotiating Meeting Contracts in the Current Economy
- August 24, 2010, Association Alliances, Partnerships and Mergers

- May 7, 2010, Combinations and Alliances Among Nonprofit Associations
- January 26, 2010, The Building Blocks for a Successful Nonprofit Merger
- December 15, 2009, Hotel Contract Clauses That Work: Understanding the Fine Print
- December 15, 2009, Best Practices for Negotiating Hotel Contracts in the Current Economy
- April 16, 2009, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center, and Meeting Contracts
- March 12, 2009, IM N, R U? Managing the Nonprofit Legalities of Social Networking and Online Media Platforms
- November 18, 2008, The Ten Most Common Online Legal Pitfalls for Nonprofits...and How to Avoid Them
- September 16, 2008, Obtaining and Maintaining Tax-Exemption for Your Affiliates: The Mechanics, Pros and Cons of Group Exemption

## SPEAKING ENGAGEMENTS

- August 8, 2011, "Cyberspace Risk: The Top Legal Traps for Associations," 2011 ASAE Annual Meeting
- June 16, 2011, Sponsorships, Advertising, Endorsements and Cause Marketing: Understanding Critical UBIT Issues for Nonprofits
- May 18, 2011, "Mastering Tradeshow Contracts" at the 2011 Annual Association Law Symposium in Chicago
- May 17, 2011, "Legal Aspects/Issues of Social Media Platforms" for the Kansas Society of Association Executives
- May 13, 2011, "Cyberspace Risk: The Top Legal Traps for Associations," ASAE Finance, HR & Business Operations Conference
- April 29, 2011 - May 3, 2011, "Trends in Law, Practice and Management of Copyright and Licensing of Content" for the Council of Science Editors
- April 28, 2011, "Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts" at ASAE's 2011 Springtime Expo
- March 29, 2011, "Dangers and Opportunities: Navigating Nonprofit Partnerships, Collaborations, Joint Ventures and More" for Better Business Bureau New York
- March 8, 2011, Legal Quick Hit: "Sponsorships, Advertising, Endorsements, and Cause Marketing - Understanding Critical UBIT Issues for Nonprofits" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- February 7, 2011, "Legal Update: What Every Tax-Exempt Association Should Know" for the Commercial Real Estate Development Association
- February 3, 2011, "Top Legal Issues for Tax-Exempt Associations" for the Mid-Atlantic Society of Association Executives
- December 6, 2010, Mergers, Alliances, Affiliations and Acquisitions for Nonprofit Organizations: Financial and Legal Issues
- November 10, 2010, "Copyright and Reprint Requests" to the Coalition of Education Association Publications
- November 3, 2010, "Cyberspace Risk: What You Don't Know Could Hurt You," Nonprofit Risk Management Center
- September 24, 2010, "Doing Business in a Changing Economy: Contracts, Liability, and Understanding Risk," at the 2010 Annual Association Law Symposium in Washington, DC
- September 21, 2010, "Legal Aspects/Issues of Social Networking and Media Platforms" at the Texas Society of Association Executives Annual Conference
- September 20, 2010, "Best Practices for Negotiating Meeting Contracts in the Current Economy" at the Texas Society of Association Executives Annual Conference
- August 24, 2010, "Association Alliances, Partnerships and Mergers" at the 2010 Annual Meeting & Expo of the American Society of Association Executives (ASAE)

- August 14, 2010, "Overview of Association Law" at the National Institute of Governmental Purchasers Annual Conference
- August 4, 2010, "Avoiding Legal Pitfalls When Using On-Line Social Media" for the Indiana Grantmakers Alliance, in collaboration with various State Grantmakers Alliances
- April 13, 2010, Legal Quick Hit: "Best Practices for Negotiating Hotel Contracts in the Current Economy" for the Association of Corporate Counsel's Nonprofit Organizations Committee
- December 10, 2009, Two presentations on hotel contracts at PMPI's 4th Annual Mid-Atlantic Conference and Expo (MACE)
- September 25, 2009, American Society of Association Executives (ASAE) Annual Association Law Symposium
- June 22, 2009, Building Member and Supporter Buy-In Through Improved Governance Practices
- June 9, 2009, Legal Quick Hit: Copyright Law Basics and Pitfalls for Nonprofits
- April 16, 2009, Steering Clear of the Most Common Legal Hazards in Hotel, Convention Center and Meeting Contracts
- November 18, 2008, Association of Corporate Counsel Webcast: The Ten Most Common Online Legal Pitfalls for Nonprofits ... and How to Avoid Them
- 2008, "Developing Security Policies and Procedures to Protect Member Data" at the 2008 ASAE Association Technology Conference & Expo, Washington, DC
- 2007, "Overtime for Employees on Travel" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Board of Directors' Responsibilities" at the 2007 Society for Women's Health Research Board Orientation, Washington, DC
- 2007, "Legal Considerations in Nonprofit Mergers" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Understanding and Managing Fiduciary Responsibility" at the 2007 Finance and Administration Roundtable, Washington, DC
- 2007, "Update on Hotel Contracts: Attrition and Other Key Issues" at the Association of Corporate Counsel "Legal Quick Hit"
- 2007, "Intellectual Property Challenges in the Life of an Association" at the 2007 ASAE Annual Association Law Symposium, Washington, DC
- 2006, "Legal Issues for Nonprofit Organizations" at the American College of Cardiology, 2006 General Scientific Session, Atlanta, Georgia
- 2006, "Contracts Insurance & Liability: What Every Meeting Professional Should Know" at the 2006 ASAE Meetings Management Institute Issues in Hotel Meeting Contracts, ASAE Hotel Operations Program, Washington, DC
- 2006, "Opening General Session Panel: The Year in Review - Legal Style" at the 2006 ASAE Finance & Business Operations Symposium, Baltimore, MD



Thomas J. Raffa is Founder and Managing Partner of Raffa, which he founded specifically to service the nonprofit community. During his 30-year career, Tom has provided accounting, auditing, tax services and business consulting to the nonprofit sector, conducting studies on management structure, internal and operational controls, and management information systems. Many Raffa clients have also enlisted Tom's assistance in assembling compensation and fringe benefits packages, executive compensation and retirement plans, fundraising efforts, investment policies, and financial projections.

To complement Raffa's service offerings, Tom founded two affiliate organizations, Raffa Financial Services, Inc. (RFSI) and Raffa Wealth Management (RWM). RFSI, formed in 1999, provides insurance and investment products and services, while RWM, started in 2005, provides investment consulting and financial planning to private foundations and high-wealth individuals who support the nonprofit sector.

In 2008 Tom was voted CPA of the Year by his professional peers and was given the Lifetime Achievement Award from the Alliance for Nonprofit Management. His professional and volunteer support of nonprofits has garnered him several other recent awards including Volunteer Achievement Award from the Accountants for the Public Interest and *SmartCPA* two years running from *SmartCEO Magazine*. In 2007 he was also one of four finalists for the 2007 Community Service Award covering Virginia, Maryland and Washington, DC.

Tom shares his expertise through articles in national publications such as *The Nonprofit Quarterly*, *The Nonprofit Times* and the *Chronicle of Philanthropy* which cover issues affecting the nonprofit sector. He also has been an instructor and speaker for many nonprofit training programs and conferences and various Federal agencies

With a CPA certificate from the District of Columbia and a license to practice in 6 states, Tom is an active member of the American Institute of Certified Public Accountants, its Taxation Division and the subcommittee on nonprofit taxation. He is also a founding board member of the Alliance for Nonprofit Management and the Alliance for Nonprofit Insurance.

Tom is a graduate of Georgetown University, member of the Georgetown University Alumnae Admissions Program, and has been a mentor at the Georgetown University McDonough Business School for more than 15 years.



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## **Additional Information**

## AUTHORS

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## RELATED INDUSTRIES

Nonprofit Organizations  
and Associations

## ARCHIVES

2011 2007 2003  
2010 2006 2002  
2009 2005 2001  
2008 2004

## Articles

May 1, 2002

### Corporate Sponsorship: The Final Regulations

Related Topic Area(s): Tax and Employee Benefits

On April 25, 2002, the Internal Revenue Service ("IRS") published final regulations (T.D. 8991) regarding the tax treatment of corporate sponsorship payments received by exempt organization. The release of these final regulations comes almost 10 years after an initial set of regulations were proposed, and almost five years since the enactment of a federal law, the *Taxpayer Relief Act of 1997* (Public Law 105-34, Section 965), that created a statutory safe harbor for sponsorship payments.

The final regulations are not significantly different from proposed regulations released in 2000. Perhaps the most notable change is the final regulations' inclusion of two new examples designed to demonstrate the IRS' position on whether providing an Internet hyperlink from a tax-exempt organization's Web site to a sponsor's Web site would jeopardize the tax-exempt organization's ability to treat a payment as subject to the corporate sponsorship safe harbor.

#### Background

In the early 1990s, the corporate sponsorship issue arose in connection with monies received by the sponsors of the Mobil Cotton Bowl college football game. The sponsoring organization was a tax-exempt organization that received a considerable payment from the Mobil Corporation. In exchange, the Cotton Bowl became known as the Mobil Cotton Bowl. On audit, the IRS determined that the money received by the Cotton Bowl organizers should be characterized as taxable advertising income, given the considerable exposure that the Mobil Corporation received in return for the payment. This action caused a stir in Washington, D.C. and led to the drafting of the first set of corporate sponsorship proposed regulations in 1993. The regulations were not finalized before the enactment of the 1997 law, which superseded those regulations.

The 1997 law amended the Internal Revenue Code of 1986 (the "Code") to provide that the receipt of "qualified sponsorship payments" by a tax-exempt organization does not constitute the receipt of income from an "unrelated trade or business." In addition, for Code Section 501(c)(3) public support test purposes, "contributions" include "qualified sponsorship payments" in the form of money or property (but not services). The new law created a new section of the Code (Section 513(i)) clarifying that these qualified sponsorship payments will not be considered taxable income to a tax-exempt organization. It is important to note that Code Section 513(i) is a "safe harbor" — if a payment received by an exempt organization does not meet the definition of a qualified sponsorship payment, it is not necessarily taxable income to the organization. Rather, such a payment may qualify for one of numerous exceptions to the unrelated business income tax ("UBIT"), or it might not otherwise meet the definition of what constitutes taxable unrelated business income.

Below is a description of key provisions of the final regulations.

#### Definition of "Qualified Sponsorship Payment"

A "qualified sponsorship payment" is defined as "any payment [of money, property or services] by any person engaged in a trade or business with respect to which there is no arrangement or expectation that the person will receive any substantial return benefit." In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the recipient organization's tax-exempt purposes. It also is irrelevant whether the sponsored activity is temporary or permanent.

#### Definition of "Substantial Return Benefit"

A "substantial return benefit" is defined as any benefit *other than*: (i) goods, services or other benefits of "insubstantial value" (as described below); or (ii) a "use or acknowledgment" (as described below). Good, services or other benefits of "insubstantial value" are those that have an aggregate fair market

value of not more than 2% of the amount of the payment. Note that if the fair market value of the benefits exceeds 2% the entire fair market value (as opposed to the cost) of such benefits, not merely the excess amount, is considered a substantial return benefit.

A substantial return benefit includes:

- advertising (as described below);
- providing facilities, services or other privileges to the sponsor (or persons designated by the sponsor), unless such privileges are of "insubstantial value" (as described above);
- granting the sponsor (or persons designated by the sponsor) an exclusive or non-exclusive right to use an intangible asset (e.g., name, logo, trademark, copyright, patent) of the tax-exempt organization. Note that while payment for providing a sponsor with the right to use such an intangible asset will not constitute a qualified sponsorship payment, it may constitute a tax-free royalty; or
- designating a sponsor as an "exclusive provider" (defined below).

#### **Use or Acknowledgment**

As stated above, a substantial return benefit does not include a "use or acknowledgment" of the name or logo (or product lines) of the sponsor's trade or business in connection with the activities of the tax-exempt organization. Use or acknowledgment does not include advertising (as described below), but may include:

- sponsor logos and slogans that do not contain qualitative or comparative descriptions of the sponsor's products, services, facilities, or company;
- a list of the sponsor's locations (e.g., addresses), telephone numbers, facsimile numbers, or Internet addresses;
- value-neutral descriptions (including displays or visual depictions) of the sponsor's product line(s) or services;
- sponsor brand or trade names and product or service listings; and
- designating a sponsor as an "exclusive sponsor" (defined below).

Logos or slogans that are an established part of the sponsor's identity are not considered to contain qualitative or comparative descriptions. Mere display or distribution (whether for free or remuneration) of a sponsor's product by the sponsor or the tax-exempt organization to the general public at a sponsored activity will not be considered an inducement to purchase, sell or use the sponsor's product and thus will not affect the determination as to whether a payment constitutes a qualified sponsorship payment.

#### **Advertising**

"Advertising" is defined as any message or other programming material that is broadcast or otherwise transmitted, published, displayed, or distributed, and that promotes or markets any trade or business, or any service, facility or product. Advertising includes:

- messages containing qualitative or comparative language;
- price information or other indications of savings or value;
- an endorsement; or
- an inducement to purchase, sell or use any company, service, facility, or product.

A *single* message that contains both advertising and an acknowledgment is considered advertising. The above rules do not apply to activities conducted by a sponsor on its own (e.g., if a sponsor purchases broadcast time from a television station to advertise its product during commercial breaks in a sponsored program, the tax-exempt organization's activities will not thereby be converted to advertising).

#### **Hyperlinks**

The IRS addresses the provision of an Internet hyperlink in two new examples (Examples 11 and 12). In one example, providing an acknowledgment on a tax-exempt organization Web page that includes a link to the sponsor's Internet address (no specification is made as to whether the link in this example is to the sponsor's home page or to some other page on the sponsor's Web site) is determined not to be a substantial return benefit to the sponsor. In the second example, the tax-exempt organization ("X") provides a link to a page on the sponsor's Web site that includes an endorsement by the tax-exempt organization of the sponsor's product. The IRS states that "the endorsement is advertising," and thus "only the payment, if any, that X can demonstrate exceeds the fair market value of the advertising on the ... company's Web site is a qualified sponsorship payment." It is interesting to note that the IRS does not affirmatively state that the fair market value of the provision of the hyperlink on

the tax-exempt organization's Web site would be considered advertising income to the organization in this example; rather, the example focuses on the value of the benefit conferred through the endorsement.

### **Exclusivity Arrangements**

*Exclusive sponsor.* An arrangement that acknowledges the sponsor as the exclusive sponsor of a tax-exempt organization's activity, or the exclusive sponsor representing a particular trade, business or industry, generally will not, by itself, result in a substantial return benefit. For example, if in exchange for a payment, a tax-exempt organization announces that its event or activity is sponsored exclusively by the sponsor (and does not provide any advertising or other substantial return benefit to the sponsor), then the sponsor has not received a substantial return benefit.

*Exclusive provider.* An arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities in connection with a tax-exempt organization's activity generally will result in a substantial return benefit. For example, if in exchange for a payment, a tax-exempt organization agrees to permit only the sponsor's products to be sold in connection with its event or activity, then the sponsor has received a substantial return benefit.

### **Allocation of Payment**

If there is an arrangement or expectation that the sponsor will receive a substantial return benefit with respect to any payment, then only the portion (if any) of the payment that *exceeds* the fair market value of the substantial return benefit (determined on the date the sponsorship arrangement is entered into) will be considered a qualified sponsorship payment. In other words, if, in exchange for a payment to a tax-exempt organization in connection with a sponsored event or activity, the sponsor receives advertising benefits as well as an acknowledgment, then UBIT will be assessed only on the fair market value of the portion allocable to the advertising benefits (subject to the burden of proof described below). However, if the tax-exempt organization fails to establish that the payment exceeds the fair market value of any substantial return benefit, then *no* portion of the payment will constitute a qualified sponsorship payment. The UBIT treatment of any payment (or portion thereof) that does not constitute a qualified sponsorship payment will be determined by application of the standard UBIT rules and exclusions. For example, payments related to a tax-exempt organization's provision of facilities, services or other privileges to the sponsor (or persons designated by the sponsor), advertising, exclusive provider arrangements, a license to use intangible assets of the tax-exempt organization, or other substantial return benefits, will be evaluated separately in determining whether the tax-exempt organization realizes any unrelated business taxable income.

### **Fair Market Value**

The fair market value of any substantial return benefit provided as part of a sponsorship arrangement is the price at which the benefit would be provided between a willing recipient and a willing provider of the benefit, neither being under any compulsion to enter into the arrangement, both having reasonable knowledge of the relevant facts, and without regard to any other aspect of the sponsorship arrangement.

### **Valuation Date**

In general, the fair market value of a substantial return benefit will be determined when the benefit is provided. However, if the parties enter into a binding, written sponsorship agreement, the fair market value of any substantial return benefit provided pursuant to that agreement is determined on the date the parties enter into the agreement. If the parties make a material change to a sponsorship agreement (including an extension or renewal of the agreement, or a more-than-incidental change to the amount of consideration), it is treated as a new sponsorship agreement as of the date the material change is effective.

### **Anti-Abuse Provision**

To the extent necessary to prevent avoidance of the "Allocation of Payment" rule described above, where the tax-exempt organization fails to make a reasonable and good faith valuation of any substantial return benefit, the IRS may determine the portion of a payment allocable to such substantial return benefit and may treat two or more related payments as a single payment.

### **Written Agreements**

The existence of a written sponsorship agreement will not, by itself, cause a payment to fail to constitute a qualified sponsorship payment. The terms of the agreement, not its existence or degree of

detail, are relevant to the determination of whether a payment constitutes a qualified sponsorship payment. Similarly, the terms of the agreement, not the title or responsibilities of the individual(s) that negotiate the agreement, will determine whether a payment (or any portion thereof) made pursuant to the agreement constitutes a qualified sponsorship payment.

### **Contingent Payments**

A qualified sponsorship payment does not include any payment the amount of which is contingent, by contract or otherwise, upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to the sponsored event or activity. The fact that a payment is contingent upon sponsored events or activities actually being conducted will not, by itself, cause the payment to fail to constitute a qualified sponsorship payment.

### **Determining Public Support (for 501(c)(3) Organizations)**

With respect to 501(c)(3) organizations, qualified sponsorship payments in the form of money or property (but not services) will be treated as "contributions" received by the tax-exempt organization for purposes of determining public support to the organization.

### **Deductibility of Payments by Sponsors**

The fact that a payment constitutes a qualified sponsorship payment that is treated as a contribution to the tax-exempt organization does not determine whether the payment is deductible to the sponsor as a business expense or as a charitable contribution.

### **Exception for Trade Show Activities and Periodicals**

The unrelated business income exception for qualified sponsorship payments does not apply with respect to: (i) payments made in connection with qualified convention and trade show activities (which are governed by a separate exception in the Code); or (ii) income derived from the sale of advertising or acknowledgments in periodicals of tax-exempt organizations. For this purpose, the term "periodical" means regularly scheduled and printed material published by or on behalf of the tax-exempt organization that is not related to and primarily distributed in connection with a specific event conducted by the tax-exempt organization. The IRS clarified that periodicals may include some forms of electronic publication.

### **Examples**

The final regulations issued by the IRS contain 12 detailed examples illustrating the application of the proposed regulations to the sponsorship and related activities of tax-exempt organizations.

## Articles

August 1, 2000

### Association Endorsements: The Current State of the Tax Law

#### AUTHORS

Jeffrey S. Tenenbaum

#### RELATED INDUSTRIES

Nonprofit Organizations  
and Associations

#### ARCHIVES

2011 2007 2003  
2010 2006 2002  
2009 2005 2001  
2008 2004

Related Topic Area(s): Tax and Employee Benefits

When an association endorses a vendor's product or service to its members - and is compensated by the vendor for that endorsement - is that compensation taxable to the association? In whole or in part? How can association endorsement contracts be structured to minimize the adverse tax consequences to the association? What can the association do or provide to the vendor that is still consistent with the tax-free treatment of such compensation? The answers to the questions have been slowly evolving in recent years. While definitive answers are still not available, it is important for associations to know where the law stands at this point in time so their endorsement deals can be structured to maximum tax advantage. This article seeks to accomplish that task. It also provides detailed, practical guidance for structuring association endorsement contracts, based on the current state of the law.

#### Background.

**Unrelated Business Income.** While income derived from association activities that are substantially related to the association's tax-exempt purposes is generally exempt from federal corporate income tax, income from unrelated business activities - regularly carried on business activities that are not substantially related to the association's purposes - is generally taxable as unrelated business income ("UBI"). However, in certain circumstances, even income from activities that fit this definition and that would otherwise constitute taxable income may be exempt from tax if the income qualifies for one of several *exclusions* from UBI contained in the federal tax code. One of the most important and widely-utilized exclusions is that for "royalty" income.

**Royalties.** "Royalties" (and deductions directly connected with royalties) are excluded in computing the unrelated business taxable income ("UBTI") of tax-exempt associations. This exclusion does not apply to debt-financed income or to royalties received from a "controlled subsidiary." The Internal Revenue Service ("IRS") defines a royalty as any payment received in consideration for the use of a valuable intangible property right, whether or not payment is based on the use made of the intangible property. Payments for the use (even on an exclusive basis) of trademarks, trade names, service marks, copyrights, photographs, facsimile signatures, and members' names are ordinarily considered royalties and are tax-free. However, payments for services (such as marketing or administrative services) provided in connection with the granting of this type of right are not royalties - and are generally taxable as UBI (unless such services are substantially related to the association's purposes, which, in most cases, they are not).

#### Examples.

1. In an example provided a federal appeals court in the *Sierra Club* case, if the Sierra Club manufactured and sold T-shirts with the organization's logo or other designs on them, the income earned from the sale of such T-shirts would be taxable, as the activity of manufacturing and selling T-shirts is not substantially related to the Sierra Club's tax-exempt purposes. However, if the Sierra Club created the designs to be screened onto the T-shirts and then licensed those designs to a T-shirt manufacturer in exchange for a fee (perhaps calculated as a percentage of gross T-shirt sales), that income would constitute tax-free royalty income.

2. In an example provided by the IRS in a pair of Revenue Rulings, payments for the use of a professional athlete's name, photograph, likeness, and/or facsimile signature (provided by and through a tax-exempt organization) are generally considered royalties. However, payments for personal appearances and interviews by the athlete (similarly provided by and through a tax-exempt organization) are not excluded as royalties and must be included as income from an unrelated trade or business.

**Endorsements.** When an association endorses a vendor's product or service (often referred to as an

association "affinity" program) but does nothing to market the product or service to its members (leaving this task to the vendor), this can be viewed as, in essence, nothing more than an exclusive license of the association's name, logo and (generally) membership mailing list to the vendor (in connection with the vendor's promotion and sale of that product or service to the association's members, and possibly to others in the industry as well). As stated above, if the association gets paid for this exclusive license - even if such payments are calculated as a percentage of gross sales of the endorsed product or service to the association's members - then the payments will constitute royalties and will be tax-free to the association. If, however, the association does market the product or service to its members, then the tax issues become more complex, as described more fully below.

Endorsements can be a useful means for associations to generate non-dues revenue from both members and non-members; promote the association's name and identity, and, by extension, the industry or profession in general; and provide a service (e.g., "tailored" products and services, discounted rates/fees, etc.) to members.

### **Evolving IRS Position.**

For many years, IRS rulings and court decisions have left associations uncertain as to the taxability of the endorsement arrangements described above, as well as of income earned from the rental of their membership mailing lists to others. The litigation that has been undertaken regarding the proper characterization of income as a (tax-free) royalty or as payment for services (and therefore taxable) has focused on the role of the association - namely, what is the association providing in exchange for its compensation. Is it merely providing a license of intangible property (and exercising quality control over its use), or is it also providing marketing and administrative services in connection with the license? In other words, is the vendor paying the association merely for its license of intangible property, or is it also paying for promotional and/or administrative services to be provided by the association?

Note that, even under the IRS' historic positions on this issue, payments for the licensing of intangible property are eligible for royalty treatment even if the intangible property (such as the association's name and logo) is licensed on an *exclusive* basis, and even if the payments are calculated as a percentage of *gross sales* of the product or service. As a cautionary note, payments calculated as a percentage of *net sales* of the product or service can turn otherwise tax-free income into taxable income, as income based on net revenues is indicative of a joint venture.

In the past, the IRS has taken the position that the provision of services of any kind by the association (even in de minimis amounts) in connection with an endorsement/licensing arrangement will "taint" all of the income earned under the arrangement and make it ineligible for royalty treatment, no matter how passive the association's role. In other words, the IRS has maintained that if the association did *anything* to generate the income beyond the licensing of its intangible property (and exercising quality control over the use of such property by the vendor), then all of the income generated under the arrangement would be taxable. Moreover, the IRS also has historically maintained that the provision of an association's membership mailing list to a vendor in connection with an endorsement arrangement will similarly taint all of the income earned under the arrangement, as the IRS has historically not viewed a mailing list as a form of intangible property.

In many respects, though, the courts that have addressed these issues have held very different views of them, consistently rebuffing the IRS' attempts to tax what the courts consider tax-free royalty income, expressly permitting certain limited association activity in connection with the licensing of intangible property, and clearly stating that association mailing lists are merely another form of intangible property.

Senior IRS officials have recently suggested in public comments that the IRS is considering abandoning its long-held positions on these royalty issues and submitting to the will of the courts that have addressed these issues of late. Moreover, at the suggestion of the U.S. Tax Court, the IRS reportedly is considering the institution of a new enforcement scheme whereby the provision of services (such as marketing or administrative services) by an association in connection with a royalty arrangement would not "taint" the royalty income (as the IRS has maintained in the past), but rather would generate a stream of taxable income for the provision of services, separate but alongside the tax-free royalties earned for the licensing of intangible property (e.g., name, logo, mailing list). The division of the association's two income streams presumably would be based on a fair market allocation.

While recent decisions by an array of federal courts provide guidance to associations in structuring

endorsement and licensing arrangements, unless and until the IRS formally conforms its enforcement policy to these decisions, there remains ambiguity and many unclarified issues - and thus potential tax risk - in this area.

### **Options for Structuring Endorsement Arrangements.**

**1. Royalties-Only.** The endorsement or licensing contract that carries the lowest risk of unrelated business income tax ("UBIT") liability is one in which the association license(s) its name, logo and/or mailing list, exercises quality control over the use of its intangible property by the vendor, and not much more. However, even under this scheme, the IRS and the courts have indicated that the association may engage in certain limited activities without jeopardizing the tax-free royalty treatment of its income. Guidelines for what the association may and may not do under this scheme are set forth below.

**2. Royalties to Association; Services Income to Third-Party or Taxable Subsidiary.** If administrative and/or marketing services are required, from a tax perspective, it is generally preferable to "outsource" such services to an unrelated third-party, or to the association's taxable subsidiary (with the association and subsidiary entering into separate, independent contracts with the vendor). In a 1999 Private Letter Ruling issued to the American Association of Retired Persons ("AARP"), the IRS validated the use of an AARP-owned taxable subsidiary to provide such administrative and/or marketing services, provided it is done on an arm's length basis (e.g., fair market valuation of the payments to each entity, financial separation, employee time records, etc.).

**3. Royalties to Association; Services Income to Association.** If such services must be provided by the association directly, then separate, independent, unrelated contracts should be drafted to provide for the name, logo and/or mailing list licensing on the one hand, and the administrative and/or marketing services on the other - recognizing that (at least for now) such a bifurcation of contracts by no means ensures that the IRS will respect such bifurcation and not treat all of the income as UBI. The fees earned by the association should be divided between the two contracts pursuant to some fair market valuation. The former should be treated as tax-exempt royalty income; the latter as taxable UBI. Public comments by senior IRS officials indicate that for such a structure to be respected by the IRS (at least for now), evidence must exist that the contracts are truly separate and not interdependent - in other words, that the parties might have entered into one contract without entering into the other. If the contracts were entered into at significantly different points in time, for instance, this might constitute such evidence, according to IRS officials. In most cases, this will be very difficult to establish. Of course, at some point in the future, the IRS may officially determine that separate contracts are not necessary, and that a fair market division between the tax-free licensing and the taxable services can be done within the same contract. However, based on current IRS precedent, such an approach carries with it a certain degree of tax risk. In some cases, though, the unwillingness of a vendor to enter into separate contracts may give the association no practical choice.

**Guidelines for Drafting Association Endorsement Contracts.** In light of the recent court decisions and IRS rulings in this area and pursuant to current legal precedent, the following guidelines should be followed when drafting endorsement contracts to minimize an association's potential UBIT liability. Note that, among other things, the guidelines below set forth what activities an association may engage in and what an association may provide to an endorsed vendor without jeopardizing the tax-free royalty treatment of its endorsement income. The same guidelines apply for purposes of all three options set forth above. In each instance, the association earns a stream of royalty income, and the following guidelines describe what activities the association may engage in directly without jeopardizing the tax-free status of that income. Other activities that are not consistent with royalty treatment may be provided by the vendor, by the association's taxable subsidiary, by an unrelated third-party, or, if necessary, by the association itself (in exchange for a separate stream of taxable services income). The guidelines below presume that the provision of marketing and/or administrative services (by whomever will be providing them) will be addressed in a separate contract (or, if necessary, in a separate section of a single contract):

1. The contract should be called a "Royalty Agreement" or "License Agreement," and the fees to be earned by the association should be expressly referred to in the contract as "royalties."
2. The contract should specify that fees to be earned by the association are solely in consideration for the association's licensing of its intangible property (and not for any services), and such intangible property to be licensed should be specified (e.g., name, logo, membership list, facsimile signatures, letterhead stationery design, etc.). Moreover, the contract should expressly state that it is a wholly independent contract that is not tied to any other agreement or obligation of the association.



3. The contract should specify that the association may exercise quality control over all uses of its intangible property. Specifically, the contract should reserve to the association the right to review and approve in advance all marketing materials and all other uses of its intangible property in order to protect the association's name and goodwill. Note that under federal trademark law, trademark owners are obligated to exercise control and supervision over the use of their trademarks by others to avoid jeopardizing their trademark rights. Moreover, the IRS has clearly stated that the exercise of such quality control rights is fully consistent with tax-free royalty income.

4. The contract should not list any required duties or activities pursuant to which the association will assist the vendor in the marketing or administration of its products or services (e.g., providing free advertising space in the association's magazine, providing free exhibit space at the association's trade show, drafting and sending letters to the association's members to promote the product or service, processing applications for the product or service, answering questions about or fielding problems with the product or service). All marketing and administration of the product or service should be conducted and paid for - at fair market rates - by the vendor, an unrelated third party, or the association's taxable subsidiary (e.g., the association's regular rates should be paid for advertising space in the association's publications, exhibit booth space at the association's trade shows, etc.). The association's programs or facilities (such as the association's magazine, trade show, membership mailings, or broadcast fax or e-mail system) may only be used to promote the vendor's product or service if such promotions are created and paid for by the vendor or a party other than the association. For instance, the association should not be involved in or pay for the cost of creating magazine advertisements, designing trade show booths, or drafting marketing letters. The association, may, however, review, edit and approve such items as part of the exercise of its quality control rights. However, the vendor or other party must then pay fair market value for the placement of the ad in the association's magazine (taxable advertising income to the association), for the exhibit booth at the association's trade show (tax-free trade show income to the association), or for the right to be included in an association membership mailing, new member packet, broadcast fax or e-mail, etc. (taxable advertising income to the association). The association should not share in the vendor's expenses for such items.

5. The association may list and refer to one or more endorsed products or services in printed lists of member benefits, but such listings should be of minimal descriptiveness so as to not be construed as ads or promotions on behalf of the vendor. Similarly, it should be permissible for a staff member or volunteer leader of the association to verbally mention an endorsed product or service at an association meeting or conference, but anything more than a brief mention in passing could be construed as a promotion of the vendor. If a listing of the endorsed product or service is provided on the association's Web site, it currently is unclear whether the association also may, consistent with royalty treatment, provide a hyperlink to the vendor's Web site. If the association charges other vendors for the right to maintain a hyperlink to their Web site on the association's site, then the association certainly should charge an endorsed vendor in the same manner. Moreover, the IRS has suggested informally that if the link goes directly to a page on the vendor's Web site where the endorsed product or service may be ordered, this is more likely to constitute the provision of an advertising service and should be paid for by the vendor. Even if the association does not otherwise charge vendors for the right to maintain hyperlinks, and even if the link is to the home page of the endorsed vendor's Web site, a modest charge to the endorsed vendor in consideration for this right would be prudent, at least unless and until the IRS says otherwise. Of course, such charges will constitute taxable income to the association.

6. It is permissible for the association to license the facsimile signature of one of its staff members or volunteer leader for use on a marketing letter that is drafted and paid for by the vendor; this is merely the licensing of intangible property. Moreover, it is permissible for the association to license its letterhead stationery design to the vendor for use in preparing such marketing letters - again a mere license of intangible property - so long as the vendor pays or reimburses the association for the costs of the printing and paper on which the letterhead design is printed. Finally, of course, the vendor should pay the costs of sending the letters (through whatever medium - mail, fax, e-mail, etc. - they are sent).

7. Always use *gross* income as a measurement tool for determining royalty payments (e.g., royalties calculated as a percentage of gross sales of the endorsed product or service to members). The association should never contract for any percentage of *net profits* from the sale of the product or service, as this is indicative of a joint venture and can turn otherwise tax-free royalty income into taxable UBI.

8. The contract should expressly state that it is not intended to create a "joint venture" or "partnership" between the parties. In addition, the contract should avoid the word "agent." The vendor should not be referred to as an agent of the association, nor should the association be referred to as an agent of the vendor.

9. The endorsed product or service always should be referred to as the vendor's product or service, and should never be referred to as a product or service of the association.

10. All miscellaneous documents, such as marketing materials, correspondence and board meeting minutes, should be consistent with the contract. A "paper trail" that is inconsistent with the terms of the contract can undermine the beneficial tax treatment the association might otherwise enjoy.

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*For more information, contact Mr. Tenenbaum at 202/216-8138 or [jstenenbaum@venable.com](mailto:jstenenbaum@venable.com).*

# Corporate Sponsorship: Acknowledgment or Advertising?

by Thomas J. Raffa

On February 29, 2000, the Internal Revenue Service (IRS) and the Treasury Department issued new proposed regulations relating to the tax treatment of sponsorship payments received by tax-exempt organizations. To understand the new proposal, a history of the related regulations and Internal Revenue Code may be helpful.

The IRS first proposed regulations covering the circumstances in which income derived from sponsorship payments would be subject to *unrelated business income tax* (UBIT) back in 1993. These proposed regulations were modeled on the rules that the Federal Communications Commission (FCC) has applied to public broadcast stations for more than a decade.

The 1993 proposed regulations focused on the nature of the services provided by the exempt organization rather than the benefit received from the sponsor. The nature of the services provided were to be categorized and defined as *advertising* versus an *acknowledgement*. Proposed regulation 1.513-4(b) defined *advertising* as any message that promotes or markets any company, service, facility or product. The regulation stated that the distinctive quality of an *acknowledgement* is that it merely recognizes the sponsorship payment and identifies, but does not promote, the sponsor or its products or services (Prop. Reg. 1.513-4(c)).

## Acknowledgments

Under the 1993 proposed regulations, the following constituted acknowledgments if they merely "identify":

- Logos and slogans that do not contain comparative or qualitative descriptions.
- Sponsor's address or telephone numbers.
- Value-neutral descriptions of sponsor's product line or services.
- Brand or trade names.
- Product and service listings.

*I have found  
that most sponsors  
will work with  
my exempt clients  
to satisfy the  
IRS criteria.*

## Advertisements

Conversely, under the 1993 proposed regulations, messages that include the following were considered advertisements:

- *Qualitative or comparative language.* The message could not comment on the quality of the product or service to others.
- *Price information or indication of savings or value.* The message could not refer to price, savings, value, or monetary motives in general.
- *A call to action.* The message could not direct the recipient to take any sort of action, as this was considered an epitome of promotional language. In an example given in the proposed regulation the phrase *give them a*

*call today at...* constituted advertising.

- *An endorsement.* This was extremely vague; however, the FCC has repeatedly found that dramatized acknowledgments, such as one by a satisfied customer, to be promotional. It was considered likely the IRS would follow the same line of thinking.

- *An inducement to buy, sell, rent, or lease the sponsor's products or services.*

If acknowledgments were to be given for corporate sponsorship, it was particularly important that the message put into print was reviewed for the above characteristics to ensure classification as acknowledgment not advertising. Under the *tainting rule* provision present in the 1993 proposal, if any single activity, message, or programming material presented in exchange for a sponsorship payment was deemed to constitute advertising, then *all* related activities, messages, or programming materials were also advertisement for UBIT purposes, even if they were genuine acknowledgments.

## The New February 2000 Proposed Regulations

The Taxpayer Relief Act of 1997 amended the Internal Revenue Code by adding section 513(i). Although this section codifies the 1993 proposed regulations in many respects, there are significant differences, including the elimination of the tainting rule. Because of these differences, it was necessary to propose new regulations and withdraw the 1993 proposed regulations. The new proposal (issued on February 29, 2000) reflect a number of

changes to the 1993 proposal while addressing some additional areas of importance.

Section 513(i) defines qualified sponsorship payments (which are not subject to UBIT) as those made by a person engaged in a trade or business with no arrangement or expectation that the sponsor will receive any *substantial return benefit* other than the use or acknowledgement of the name or logo of the person's trade or business. Like the 1993 proposal, such acknowledgements do not include advertising messages which are those containing qualitative or comparative language, price information, indications of savings or value or an endorsement or inducement to purchase, sell or use the sponsor's services or products. Sponsorship can include the use of logos or even slogans if they are an established part of the sponsor's iden-

tity. The newly proposed regulations go on to clarify the legislation and its definition of *substantial benefit* by allowing for the inclusion of such information as the sponsor's location, telephone number, and Internet address. Value-neutral descriptions, including the sponsor's product line or services, are also considered acceptable.

As noted above, the tainting provisions proposed in 1993 are not a part of Section 513(i); rather, the section specifically provides that to the extent a portion of a payment would qualify as sponsorship (if made separately), it can be considered sponsorship. For example, if a sponsor is entitled to advertising or acknowledgement, the amount in excess of the fair market value of the advertisement remains qualified sponsorship.

Providing services (e.g., complimentary passes to the conference,

reception, golf tournament and the like) to a sponsor in connection with a sponsorship arrangement will also be evaluated as a separate transaction in determining whether the tax-exempt organization has UBIT. Under the new regulations, the IRS proposes that providing goods or services of an insubstantial nature will not jeopardize the tax-free nature of a sponsorship payment. However, insubstantial is defined by the IRS as having either a fair market value of no more than 2% of the total sponsorship payment or \$74, whichever is less. So, if the sponsor is treated to a round of golf that has a fair market value of \$80, the entire \$80 of the sponsorship payment may be considered taxable.

Under Section 513(i), qualified sponsorships can not include payments, which are contingent upon the quantity of public exposure received.

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For example, while a payment that is contingent upon the sponsored activity actually occurring, (e.g., a conference), will pass as sponsorship, a contingency based on the number of attendees at the conference will not (Section 513(i)(2)(B)(i)).

The proposed regulations also provide that the right to be the only sponsor of an activity or the only sponsor representing a particular industry, trade or business is generally not a substantial benefit. However, exclusive provider arrangements that allow only the sponsors products to be sold at the activity, for example, are considered by this proposal to be a substantial return benefit.

The proposed regulations also clarify that sponsorship payments in the form of money or property (but not services) are treated as contributions received by the exempt organization for the purposes of determining the public support test (under section 170 (b) (1) (A) (vi) or section 509(a)).

Interestingly enough, the proposed regulations do not address the Internet activities of an exempt organization. However, we may not have to wait long. The IRS and the Treasury Department are reviewing the application of existing tax laws governing exempt organizations, including the UBIT rules, to Internet activities.

A 501(c)(3) organization faces two possible consequences in conducting an unrelated trade or business. One is unrelated business income tax; the other is a possible loss of exemption if that business becomes the organization's principal purpose. The factor to be considered is the size and extent of the trade or business versus the size and extent of the activities carried on in furtherance of its tax-exempt purpose. Under most usual circumstances, the risk of an organization doing so much advertising to lose its tax-exempt status should be remote.

For my clients, I have found the best method in dealing with the distinction between a permissible sponsorship activity and one that is taxable is to develop practical internal policies and procedures covering Section 513(i) and the proposed regulations and designate the person or person(s) to be responsible for such compliance. All employees involved in the process should understand the policies. It may also be valuable to alert the potential sponsors to the IRS-defined differences between advertising and acknowledgment. I have found that most sponsors will work with my exempt clients to satisfy the IRS criteria. If not, and an *advertisement* is necessary to satisfy the customer, my advice is to do so. With a knowledge of the rules, it may be foolish to turn away an alternative source of revenue simply because it may be subject to unrelated business income tax.

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Thomas J. Raffa is the managing partner of Raffa & Associates, P.C., a certified public accounting and consulting firm based in Washington, D.C. with a financial services subsidiary in Maryland. The firm currently employs 100 professionals who serve the nonprofit sector by providing a wide variety of services to over 300 international, national and community-based organizations. Mr. Raffa has 24 years of experience and currently serves on the board of directors of two national nonprofit organizations. He often speaks at seminars and training workshop on accounting, tax and business-related matters.