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IRS Finalizes Regs Covering Sponsorships

Payments will be considered charitable contributions where there is no arrangement that the sponsor will receive 'any substantial return benefit in exchange for the payment'

The Internal Revenue Service has published final Regulations to determine whether sponsorship payments for charity fund raisers are considered charitable contributions or unrelated, and possibly taxable, income.

Based on the new section 513(i) of the Tax Code added in 1997, the final Regs have only minor modifications from the proposals published more than two years ago, but do add two modestly helpful examples to distinguish sponsorships from advertising on an Internet website. (Reg. 1.513-4, *Fed. Reg.*, 4/25/02.)

Generally, the rules provide that a sponsorship payment will be considered a charitable contribution where there is no arrangement or expectation that the sponsor will receive "any substantial return benefit in exchange for making the payment."

The sponsorship can be for a single event, like a bowl game, a walkathon or television program, a series of related events, such as a concert series or sports tournament, an activity of indefinite duration, such as an art exhibit, or an organization's general operations.

A substantial benefit means any benefit other than (a) an acknowledgment of the sponsor's name or logo in connection with the activity, or (2) the provision of certain goods or services that have an insubstantial value.

An acknowledgment permits use of logos or slogans that do not include "qualitative or comparative descriptions" of the sponsor's goods or services, although logos that are "an established part of a payor's identity" are not considered to contain qualitative or comparative descriptions no matter what they say.

The acknowledgment can also include a list of the sponsor's locations, phone numbers or Internet address, "value neutral descriptions" including displays or pictures, and the use of brand or trade names. "Mere display or distribution, whether for free or remuneration" of the payor's product at the sponsored activity will not be considered advertising.

Advertising is a message that "promotes or markets any trade or business, or any service, facility or product." The message is deemed to be advertising if it "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" a product, service or facility.

Generally an inducement would require a "call to action." A message that contains both advertising and acknowledgment is considered to be entirely advertising.

A payment is not a sponsorship payment if it is contingent upon the level of attendance at the event, broadcast ratings or "other factors indicating the degree of public exposure to the sponsored activity." It may be a sponsorship if it is contingent on the event actually being conducted or being broadcast on radio or tv.

The charity may grant a sponsor exclusive sponsorship rights to the activity, or exclusive rights for a particular trade or business dealing with the activity, without converting the payment from sponsorship contribution to other income. But if the arrangement limits the sale, distribution, availability or use of competing products or services in connection with the exempt organization's activity, it will generally be considered a substantial return benefit.

This rule is in reaction to exclusivity arrangements prevalent in the 1990s, such as those in which soft drink companies "sponsored" activities on college campuses in return for the exclusive right to sell their products on campus.

If any part of the payment is deemed to be in return for substantial benefit, the charity must make a good faith estimate of the value of the benefit, and only the excess amount can be considered a contribution. Under a 1993 proposed Reg, issued prior to the 1997 statutory amendment, if any of the payment was not a sponsorship, the entire payment was "tainted" and considered to be other income. The tainting concept was eliminated in the proposed Regulations in 2000.

Return benefits can include not only the value of advertising, but also a sponsor's dinner for corporate executives, passes to an event, playing spots in a pro-am golf tournament, and other economically valuable benefits.

A return benefit is considered insubstantial, and therefore disregarded, if it is less than 2% of the payment from the sponsor. The proposed Regulation had defined insubstantial so that it could not exceed a value, indexed for inflation, of about $79. The final Regs eliminate the ceiling and go with 2% of the payment, whatever the amount.

It is up to the exempt entity to determine the fair market value of the return benefit as of the date the benefit is provided, or if provided pursuant to a written contract, the date of the contract. If the parties make a "material change" to the contract, the date of the change will be the date of

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the new valuation.

This is another version of the "quid pro quo" rules for valuing contributions in excess of the goods or services received in return, but disregarding de minimis benefits to the donor.

(The final Regs make clear that return benefit worth less than 2% of the payment will be disregarded in calculating the public support percentage of the charity. The entire payment will be considered a contribution.)

The final Regs add two new examples to deal with Internet issues. In the first, a symphony orchestra maintains a web site, which includes a list of its sponsors. The site does not promote the sponsors or advertise their products, but provides a hyperlink to the sponsors' web sites. The link alone is not a substantial benefit and the entire payment remains a sponsorship contribution.

In the second example, a health-based charity receives funding from a pharmaceutical company which manufactures a drug used in treating a particular medical condition. The manufacturer helps the charity prepare educational information for distribution and posting on the web site. The charity's web site provides a link to the manufacturer's web site, on which appears an endorsement by the charity, reviewed and approved by the charity, of the manufacturer's product. The IRS says that the endorsement is advertising and that only the portion of the sponsorship payment that exceeds the value of the advertising portion can be considered a qualified sponsorship payment and treated as a contribution.

The final Regs do not cover two important areas for many charities. They do not cover trade show income, or income from periodical publications. The term "periodical" means "regularly scheduled and printed material published by or on behalf of the exempt organization that is not related to and primarily distributed in connection with a specific event." For purposes of this definition of "printed," electronic publishing is included. Acknowledging sponsors in an organization's regular newsletter, therefore, can present problems.

Income from a payment is not necessarily taxable even if it is not considered a contribution. To be taxable, it must meet the definition of unrelated business taxable income, which is income from an unrelated trade or business regularly carried on. A one-evening fund raiser would not be regularly carried on and advertising income from that event alone would not be taxable. UBTI also has exclusions for activities that are carried on primarily by volunteers and other exclusions. (See Ready Reference Pages Nos. 13 and 15, June and September, 1998.)

The characterization of the income to the charity is generally immaterial to the payor. In most cases the payor is a business, which will deduct the payment as an ordinary and necessary business expense and will not need a charitable deduction. If the sponsor is an individual, the individual will not need "advertising" unless he or she is in business. An acknowledgment would be a contribution.

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