

**FIFTH ANNUAL  
WESTERN CONFERENCE ON TAX-EXEMPT  
ORGANIZATIONS**

**LOS ANGELES, CALIFORNIA**

**NOVEMBER 1 & 2, 2001**

**PLANNING CORPORATE SPONSORSHIP AND AFFINITY PROGRAMS**

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## **CORPORATE SPONSORSHIPS: PROPOSED REGULATIONS OFFER NEW GUIDANCE**

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The proposed regulations under Section 513(i), issued on February 29, 2000, mark the beginning of the final chapter in the long-standing controversy over the treatment of corporate sponsorship payments received by tax-exempt organizations.<sup>1</sup> The proposed regulations reflect a commendable effort to respond to comments received on earlier proposed regulations issued in 1993 (prior to the enactment of Section 513(i)), as well as to incorporate changes required by Section 513(i). This outline will review the evolution of corporate sponsorship leading to the enactment of Section 513(i), then describe the proposed regulations issued last year. Final regulations are expected before the end of this year.

### **A. Prior IRS Guidance Regarding Donor Recognition**

During the past decade, charities have sought out corporate sponsorship opportunities as an important form of fundraising. From a tax standpoint, the issue is whether such sponsorship payments are nontaxable contributions to exempt organizations for which the donors are given public recognition, or whether they constitute payments for the provision of commercial-type advertising. The mere recognition or acknowledgment of a contribution by an exempt organization is considered incidental to the making of the contribution and does not cause the contribution to be treated as a payment for advertising services. However, if the sponsorship payment is made as a quid pro quo for advertising or promotional services, the payment may be deemed to constitute advertising subject to UBIT under Section 511(a).

Rev. Rul. 77-367,<sup>2</sup> the leading IRS ruling on the subject of donor recognition, involved a corporate sponsor that donated land and monetary support to an exempt organization in return for the latter's agreement to (1) name a village operated by the organization after the sponsor, (2) use the sponsor's name in the organization's publications and (3) allow the sponsor to associate its name with the village in the sponsor's own advertising. Although the sponsor clearly benefited from the relationship by having the village named after it, being associated with the exempt organization and the village in its own advertising and having its name mentioned in exempt organization publications, the IRS determined that those benefits were "merely incidental" to the benefit that flowed to the public from having access to the village and its historic structures.

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<sup>1</sup> The 2000 proposed regulations are available at 65 Fed. Reg. 11012 (Mar. 1, 2000).

<sup>2</sup> 1977-2 C.B. 193.

Priv. Ltr. Rul. 7851003, involving an amateur athletic organization, provided additional -- albeit nonprecedential -- guidance. In that case, an exempt organization entered into a sponsorship agreement with a corporate sponsor pursuant to which it agreed to (1) recognize the corporation as the exclusive sponsor of the annual event, (2) give credit to the sponsor in all publicity releases about the event and (3) include the corporation's name in the logo for the annual event. In the PLR, the IRS determined that the sponsorship payment was not subject to UBIT because the publicity and recognition accorded the sponsor was incidental, and ruled that the sponsor could "be recognized for its financial support without raising the issue of advertising income."

Collectively these and a few other regulations and rulings issued with respect to foundations<sup>3</sup> were viewed by exempt organizations as permitting, without UBIT consequences, a variety of forms of donor acknowledgment, including naming a facility after a donor, identifying the donor of an award upon presentation of the award, using a donor's name in the exempt organization's publicity about the event, allowing the donor to identify its sponsorship of an event, allowing a donor to be the exclusive sponsor of an event and using the donor's logo in the logo for the event. However, as new and lucrative types of sponsorship opportunities emerged, it was clear that the limited IRS precedent did not provide adequate guidance, either for exempt organizations structuring sponsorship arrangements or for revenue agents auditing them. The long simmering tension between the exempt organizations' need to seek critical corporate funds and the IRS' concern about commercialism of the exempt sector erupted in a full-scale debate with the release by the IRS of Priv. Ltr. Rul. 9147007, the so-called "College Bowl Ruling."

## B. The College Bowl Ruling

In Priv. Ltr. Rul. 9147007, the IRS determined that income received by an exempt organization in connection with a televised college bowl event constituted a payment for valuable advertising and promotional services and held that the income was subject to UBIT. The IRS applied a facts and circumstances test to determine whether the payment by the corporate sponsor was made with an expectation of receiving "a substantial return benefit." The IRS concluded that the payment in question was commensurate in value with the benefits that the sponsor expected from the arrangement, and thus was advertising subject to UBIT. The PLR was heavily redacted, however, and provided little information about the factual basis for the adverse determination.

## C. Proposed Examination Guidelines

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<sup>3</sup> See, e.g., Treas. Reg. §1.509(a)-3(f)(3) (distinguishing "gifts and contributions" from "gross receipts"); Treas. Reg. §53.4941(d)-2(f)(4)(Example 4) (providing that the public recognition accorded to a substantial contributor by a private foundation is merely an incidental benefit of the contribution and not an act of self-dealing); and Rev. Rul. 73-407, 1973-2 C.B. 383 (holding that a private foundation's naming of a program after a substantial contributor was incidental to the contribution and was not an act of self-dealing).

Recognizing the need for guidance in the area, the IRS soon followed with proposed audit examination guidelines, which were issued for public comment. The stated purpose of the proposed audit guidelines was to provide guidance to revenue agents in identifying sponsorship arrangements that involved more than mere recognition and therefore should be treated as the provision of advertising services.

Reiterating the “substantial return benefit” test earlier described in the College Bowl Ruling, the proposed audit guidelines set forth a list of factors “tending to indicate” the existence of an unrelated trade or business. Certain of these factors, such as incorporation of the sponsor’s name and logo in the official logo for the event and in printed materials related to the event, were commonly accepted fundraising practices that had been approved by the IRS in prior rulings. Other factors were generally perceived as overly broad, such as whether the public could reasonably be expected to purchase the sponsor’s goods and services. Finally, some factors, such as the existence of a contract covering the sponsorship activity and the exclusive nature of the sponsorship arrangement, seemed to have no bearing at all on the UBIT issue.

From a guidance standpoint, the proposed audit guidelines were simply unworkable. Virtually all sponsorship arrangements had one or more of the factors “tending to indicate” an unrelated trade or business, and the proposed guidelines provided no guidance as to whether some factors were more important than others, or whether some particular combination was required for a finding that the arrangement would be subject to UBIT. Overall, the proposed audit guidelines appeared to suggest that many forms of donor acknowledgment previously condoned by the IRS might be at risk of producing UBIT. The proposed guidelines were widely criticized in hundreds of comments, as well as in testimony at several days of public hearings.

#### D. 1993 Proposed Regulations

In 1993, the IRS again sought to provide guidance regarding corporate sponsorship payments -- this time in the form of proposed regulations. The IRS was aided in this effort by what it found to be a source of workable precedent -- the rules of the Federal Communications Commission prohibiting advertising and regulating donor acknowledgments of public broadcasters. The FCC rules contained clear, bright-line standards for the provision of donor recognition without crossing the line to advertising, reflecting the FCC’s effort to balance public broadcasters’ need to raise additional funding with a Congressional prohibition against advertising and a mandate to maintain the sector’s noncommercial character. In the preamble to the 1993 proposed regulations, the IRS stated that they were designed, to the extent possible, to parallel the statutory and regulatory framework of the FCC rules then in effect.

##### 1. Application

The 1993 proposed regulations applied to almost all sponsorship payments received by exempt organizations, with just a few important exceptions. They did not apply to a sponsorship arrangement that is part of qualified convention and trade show activity, which is generally exempt from UBIT

pursuant to Section 513(d) and Treas. Reg. §1.513-3<sup>4</sup>, nor did they apply to sponsorship payments in the form of dividends, interest and royalties that may be exempt from UBIT under Section 512(b). Finally, they did not apply to periodical advertising, the income from which remains subject to UBIT under the principles of Treas. Reg. §1.512(a)-1(f).<sup>5</sup>

## 2. Definitions of Advertising and Acknowledgments

The 1993 proposed regulations contained definitions of “advertising” and “acknowledgment.” They defined “advertising” as

any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed in exchange for any remuneration, and which promotes or markets any company, service, facility or product.<sup>6</sup>

For example, the definition included messages that contain qualitative or comparative language, price information or other indications of savings or value associated with a product or service, a call to action, an endorsement, or an inducement to buy, sell, rent or lease the sponsor’s product. The 1993 proposed regulations also treated as advertising any sponsorship payment that was contingent on broadcast ratings or the attendance at a sponsored event. They provided, however, that the distribution of a sponsor’s product at a sponsored event, whether for free or for remuneration, would not be considered an inducement to buy the sponsor’s product.

The 1993 proposed regulations defined “acknowledgments” as “mere recognition of sponsorship payments,” including (1) sponsor logos and slogans that do not contain comparative or qualitative descriptions of the sponsor’s products, services, facilities or company; (2) sponsor locations and telephone numbers; (3) value-neutral descriptions, including displays or visual depictions, of a sponsor’s product-line or services; and (4) sponsor brand or trade names and product or service listings.<sup>7</sup>

The 1993 proposed regulations provided, by way of examples, that the following activities would be considered acknowledgments rather than advertising: display of the sponsor’s name and logo on promotional fliers, newspaper advertisements, banners, signs, posters, brochures and public service announcements about the sponsored event, as well as on team uniforms, the playing field and scoreboard; inclusion of the sponsor’s name in the event title; display of the sponsor’s product (i.e., luxury automobile) at the sponsored event; and use of the sponsor’s product (refreshments) by participants at a sponsored event.

## 3. Expense Allocation Rule

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<sup>4</sup> 1993 Prop. Treas. Reg. ¶1.513-4(a).

<sup>5</sup> 1993 Prop. Treas. Reg. ¶1.513-4(a).

<sup>6</sup> 1993 Prop. Treas. Reg. ¶1.513-4(b).

<sup>7</sup> 1993 Prop. Treas. Reg. ¶ 1.513-4(c)(1).

The 1993 proposed regulations held that the expense allocation rules in the current regulations governing the exploitation of exempt activities are applicable in the corporate sponsorship context.<sup>8</sup> Under Treas. Reg. §1.512(a)-1(d)(2), an exempt organization engaging in an unrelated business activity through the exploitation of an exempt function of the kind carried on by taxable entities may offset the unrelated business income from the exploited activity by expenses associated with the exempt function activity. If this test is met, the exempt function expenses of a sponsored activity may be allocated against the income from any deemed advertising, and there would be UBIT liability only to the extent that the combined revenues from the sponsored activity exceed the combined expenses. This expense allocation rule was changed to a less permissive rule in the 2000 proposed regulations.

#### 4. Tainting Rule

The 1993 proposed regulations took a restrictive position on the treatment of mixed purpose payments – a position specifically reversed in Section 513(i). The proposed regulations provided that if any portion of a sponsorship payment was for an advertising component, the entire payment would be treated as advertising.<sup>9</sup> This so-called “tainting rule” was illustrated by an example involving a symphony orchestra that performs a series of concerts and distributes a program guide at each concert. The example provided that if any portion of the program guide promoted the sponsor’s products or services, all amounts received from the sponsor with respect to that concert would be treated as advertising, even if other items in the program guide would be treated as acknowledgments.

#### E. Section 513(i)

Section 513(i) generally codifies the positions taken by the IRS in the 1993 proposed regulations, except with respect to the tainting rule.<sup>10</sup> Rather than simply incorporating the definitions for “acknowledgments” and “advertising” contained in the proposed regulations, however, the Act creates a new definition for a “qualified sponsorship payment” which is expressly excluded from UBIT. It also eliminates the so-called tainting rule in favor of an allocation rule for mixed-purpose payments.

#### 1. Qualified Sponsorship Payment

Section 513(i) defines a “qualified sponsorship payment” as a payment from which the donor does not expect any substantial return benefit other than the use or acknowledgment of the sponsor’s name, logo, or product line in connection with the organization’s activities. It does not include a payment for which the sponsor is entitled to advertising, such as messages that contain qualitative or comparative language, price information, an endorsement, or an inducement to buy, sell, or use the donor’s products or services. This definition is quite closely related to the definitions of “acknowledgments” and

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<sup>8</sup> 1993 Prop. Treas. Reg. ¶1.512(a)-1(e).

<sup>9</sup> 1993 Prop. Treas. Reg. ¶1.513-4(c)(2).

<sup>10</sup> It is interesting to note that the Joint Committee on Taxation’s revenue estimate for Section 513(i) was listed simply as “negligible,” on the ground that the provision generally codified current law as reflected in the 1993 proposed regulations.

“advertising” in the 1993 proposed regulations. In addition, the legislative history makes it clear that a qualified sponsorship payment may include a sponsorship payment for an unrelated activity.

## 2. Contingent Payments

Section 513(i) codifies the position in the 1993 proposed regulations on contingent payments by holding that a qualified sponsorship payment does not include an amount which is contingent on the level of attendance at an event, broadcast ratings, or other indicators of public exposure to an event.

## 3. Periodical Advertising or Acknowledgments.

Section 513(i), like the 1993 proposed regulations, does not apply to payments entitling the payor to advertising in an organization’s regularly scheduled periodicals. The legislative history indicates that this exclusion also applies to payments entitling a donor to an acknowledgment in a regularly scheduled periodical, and provides that the UBIT treatment for such payments is governed by current law. In this regard, the legislative history cites various regulations, revenue rulings, private letter rulings, and the Supreme Court’s decision in *United States v. American College of Physicians*,<sup>11</sup> as sources of guidance with respect to the UBIT treatment of advertising and acknowledgments in periodicals. Section 513(i) does apply, however, to acknowledgments (but not advertising) in a program or brochure that is related to, and primarily distributed in connection with, a specific event.

## 4. Mixed Purpose Payments

Section 513(i) rejects the “tainting rule” contained in the 1993 proposed regulations and substitutes instead an allocation rule which provides that a mixed purpose payment must be allocated among its various components on a fair market value basis, and each component analyzed separately to determine its proper tax treatment. For example, the legislative history provides that if a sponsorship payment entitles a donor to both product advertising (such as an advertising page in an event brochure) and the use or acknowledgment of the sponsor’s name in connection with the event, the fair market value of the advertising component may be subject to UBIT (assuming it would meet the normal UBIT criteria) and the remainder of the payment may constitute a qualified sponsorship payment.

The legislative history of Section 513(i) makes it clear that the allocation requirement is not limited to mixed taxable and nontaxable payments but also includes mixed purpose payments which include entirely nontaxable components. This would include, for example, a sponsorship arrangement in which the donor was entitled to (1) receive a permitted acknowledgment in the name of the event and in the event program, (2) license the name and logo of the exempt organization for use in its own advertising or promotional activities, and (3) receive an acknowledgment of its sponsorship payment in any articles about the event that may appear in the organization’s regular periodicals. Under current law, none of these components would be taxable; the first would be considered a qualified sponsorship payment, the

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<sup>11</sup> 475 U.S. 834 (1986) (holding that profits from advertisements appearing in an exempt organization’s medical journal constitute unrelated business taxable income).

second would constitute a royalty, and the third would be an acknowledgment (not advertising) in a periodical.

The legislative history of Section 513(i) encourages the IRS to issue regulations minimizing the burden on exempt organizations associated with this allocation requirement, stating that

[i]n the interest of administrative convenience, the Treasury Department is encouraged to permit tax-exempt entities to provide combined reporting of payments that are both qualified sponsorship payments and nontaxable payments made in exchange for donor acknowledgments in a periodical or in connection with a qualified convention or trade show. In addition, to the extent tax-exempt organizations are required to allocate portions of payments, the Treasury Department is encouraged to minimize the reporting burden associated with any such allocations.

#### F. 2000 Proposed Regulations

Since Section 513(i) reflected a codification of most of the principles set forth in the 1993 proposed regulations, it is not surprising that the 2000 proposed regulations are generally consistent with the earlier version. There are some important changes, however, as well the addition of new provisions to implement the allocation rule which, by virtue of Section 513(i), replaces the tainting rule contained in the 1993 proposed regulations. Interestingly, the preamble to the 2000 proposed regulations also requests comments on two related issues not directly addressed in the proposed regulations: whether providing a link to a sponsor's website is advertising within the meaning of Section 513(i)(2)(A) and whether an exempt organization's website should be treated as a periodical.

##### 1. Qualified Sponsorship Payment

The 2000 proposed regulations define a "qualified sponsorship payment" as follows:

[t]he term qualified sponsorship payment means any payment of money, transfer of property, or performance of 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's exempt purposes. It is also irrelevant whether the sponsored activity is temporary or permanent.<sup>12</sup>

Observation: The latter provision is particularly helpful to clarify that a qualified sponsorship payment need not relate to a particular event, but may include sponsorship of an organization's ongoing operations.

##### 2. What Isn't a Substantial Return Benefit

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<sup>12</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(1).

Section 513(i) provides that where there is a substantial return benefit, the exempt organization is required to allocate a portion of the sponsorship payment to that benefit and treat it as a separate transaction for tax purposes. The 2000 proposed regulations provide that a “substantial return benefit” does not include

- use or acknowledgment of the sponsor’s name or logo or product lines, as long as use is not qualitative or comparative in nature (logos or slogans that are an established part of the sponsor’s identity are not considered qualitative or comparative);
- a list of the sponsor’s location, telephone number or Internet address;
- a value neutral description, including display or visual depiction, of the sponsor’s product lines or services;
- sponsor brand or trade names and product listings; and
- display or distribution of the sponsor’s product, whether for free or for a charge, at a sponsored activity.<sup>13</sup>

These factors essentially derived from the 1993 proposed regulations.

In addition, the 2000 proposed regulations provide that the following benefits are disregarded altogether and therefore are not considered “substantial return benefits”:

- goods, services or other benefits which have an aggregate fair market value of the lesser of not more than 2% of the amount of the payment or \$74 (adjusted for inflation); and
- low-cost, token items bearing the organization’s name or logo, such as bookmarks, calendars, tee-shirts, key chains and mugs.<sup>14</sup>

Observation: In determining what is a “disregarded benefit,” the 2000 proposed regulations rely on the Section 170 standard applicable to charitable contributions (i.e., a benefit valued at the lesser of 2% of the contribution or \$74; certain token items having a minimal cost, etc.). This was not mandated by Section 513(i) or suggested in the legislative history of that provision, and a number of comments on the proposed regulations have questioned whether that standard is appropriate, given the fact that Section 513(i) is applicable to transactions arising in a business context. Some comments suggested that consideration be given to providing a safe harbor for return benefits that have an insubstantial value (i.e., 15% or less) of the sponsorship payment.

### 3. What Is a Substantial Return Benefit

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<sup>13</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(2)(iii).

<sup>14</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(2)(ii).

The 2000 proposed regulations provide, of course, that advertising is a substantial return benefit.<sup>15</sup> The definition of advertising is almost unchanged from the 1993 proposed regulations, and includes

[m]essages 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.<sup>16</sup>

The proposed regulations provide that a single message containing both advertising and an acknowledgment will be treated as advertising.

The 2000 proposed regulations also provide that an “exclusive provider arrangement” (i.e., an arrangement whereby a sponsor becomes an exclusive provider of a particular product or service) is a substantial return benefit (although the proposed regulations do not characterize the tax treatment of that benefit).<sup>17</sup> The most common of these exclusive provider arrangements are the soft drink “pouring rights” arrangements on many college campuses.

Observation: The treatment of an exclusive provider arrangement as a substantial return benefit is one of the most controversial aspects of the 2000 proposed regulations. Although the proposed regulations do not attempt to characterize such arrangements as taxable or nontaxable, their carve-out from the definition of a qualified sponsorship payment was viewed by some as an indication that the IRS intends to challenge the characterization of such payments as tax-exempt. However, in a recent field memorandum to Director, EO Examinations from Tom Miller, Acting Director, EO Rulings & Agreements, the IRS dispelled any notion that exclusive provider agreements are automatically subject to UBIT. (A copy of the field memorandum is attached.) The field memorandum states explicitly that “this assumption is incorrect,” and that “there are various ways an exclusive provider arrangement may not give rise to UBIT.” It suggests that the proper focus of the analysis should be on the nature of the arrangement, including whether it involves the provision of substantial services by the exempt organization such as promotional and marketing activities on behalf of the provider (which may be taxable) The memorandum also notes that some exclusive provider agreements may involve nontaxable rents, royalties or product discounts. The memorandum does not address the subject of allocation in the case of exclusive provider arrangements which involve some component of advertising or promotion as part of the overall arrangement. For example, assume that an exclusive provider arrangement with a soft drink provider includes provision for advertising in programs of athletic events or in stadium signage. Logically the allocation principles reflected in the proposed regulations would be applicable by analogy, and the IRS would respect reasonable allocations of consideration among various taxable and nontaxable components (see discussion below). In this regard, it is important for exempt organizations to identify, value and treat as unrelated business income any such components of the exclusive provider arrangement, in order to minimize any argument that these components taint the overall arrangement.

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<sup>15</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(2)(i).

<sup>16</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(2)(iv).

<sup>17</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(c)(2)(v).

#### 4. Allocation of Taxable and Nontaxable Mixed Purpose Payments

Consistent with Congressional rejection of the “tainting rule” in Section 513(i), the 2000 proposed regulations require that a mixed-purpose payment be allocated into its separate components based on fair market value standards and that each component be examined separately to determine its appropriate tax treatment.<sup>18</sup> Accordingly, the consideration for an arrangement which includes both an advertising component and a sponsorship component must be allocated between these components on a fair market value basis, and the consideration for the advertising component must be treated as income from an unrelated business, while the consideration from the sponsorship payment may be treated as a qualified sponsorship payment. The proposed regulations include an “anti-abuse” provision which provides that if an exempt organization fails to make a “reasonable and good faith” valuation, the IRS may substitute its own determination.<sup>19</sup>

Observation: In some cases, the required allocation will not be burdensome as the value of the advertising benefit can be calculated by reference to the amount charged to other parties for such advertising benefits (such as the cost charged to other parties for advertising in the event brochure). In other cases where there is no directly comparable transaction, it will be more difficult to determine the fair market value of an advertising benefit. Despite the valuation difficulties, however, exempt organizations are clearly better off with the allocation rules contained in Section 513(i) than with the tainting rule contained in the 1993 proposed regulations. The allocation rule in Section 513(i) is also consistent with the principles of Rev. Rul. 67-246,<sup>20</sup> which has long required exempt organizations to make allocations in the context of certain types of mixed taxable and nontaxable payments.

#### 5. Allocation of Nontaxable Mixed Purpose Payments

The above-described allocation rule is not limited to mixed purpose payments which include a taxable component; it also includes mixed purpose payments which include exclusively nontaxable components. For example, the rule would require an exempt organization to allocate consideration for an arrangement involving both a qualified sponsorship payment and a payment for the use of the exempt organization’s name and logo by the sponsor in its own advertisements (such as the arrangement described in Rev. Rul. 77-367, cited above).

Observation: as currently drafted, the “substantial return benefit” standard in the 2000 proposed regulations, coupled with the allocation rule, require organizations to allocate consideration to, and treat as separate transactions, components of a sponsorship payment that may (i) have no value apart from the sponsorship arrangement, (ii) represent a minor part of the arrangement, (iii) be extremely difficult to value, and (iv) be nontaxable in any event. This requirement may impose substantial administrative burdens on exempt organizations. Comments on the 2000 proposed regulations urged the IRS to develop a simpler and less burdensome approach, which might include some or all of the following:

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<sup>18</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(d)(1).

<sup>19</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(d)(2).

<sup>20</sup> 1967-2 C.B. 104.

disregarding certain return benefits that are merely incidental to a sponsorship arrangement (such as the acknowledgment of a sponsorship arrangement in an exempt organization's publicity about the event), creating a safe harbor for return benefits that are insubstantial (i.e. 15% or less of the sponsorship payment), and permitting exempt organizations to make a reasonable allocation of the value of any return benefits that have a substantial value (i.e., more than 15% of the sponsorship payment).

#### 6. Expense Allocation Rule

The 2000 proposed regulations changed an example in Prop. Treas. Reg. §1.512(a)-1(e) to clarify expense allocation rules when an exempt organization has income and expenses in connection with an unrelated business activity that exploited an exempt activity. Under the 1993 proposed regulations, an exempt organization was permitted to apply excess expenses directly connected with the exploited exempt activity to offset income from the unrelated business activity. The new example involves the sale of advertising in a museum's exhibition catalog and makes clear that only expenses directly connected with publishing the catalog are permitted to offset the net unrelated business income from the sale of advertising. Expenses from the exempt activity of the exhibition itself, which is the subject of the catalog, are not directly connected with the advertising activity, and therefore those expenses are not allowed to offset the unrelated business taxable income.<sup>21</sup>

#### 7. Treatment of Qualified Sponsorship Payments for 990 Reporting

The 2000 proposed regulations provided helpful clarification concerning the reporting of corporate sponsorship payments on IRS Form 990 and the treatment of such payments for purposes of the public support tests under Sections 509(a)(1) and (2). Under the proposed regulations, qualified sponsorship payments are reported as contributions, and are treated as such for purposes of the public support test. In addition, the proposed regulations make it clear that this treatment is not determinative of whether the corporate sponsor's payment is properly deductible under Section 162 or Section 170.<sup>22</sup>

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<sup>21</sup> 2000 Prop. Treas. Reg. ¶ 1.512-1(e)(Example 2).

<sup>22</sup> 2000 Prop. Treas. Reg. ¶ 1.513-4(e)(3).

## 8. Comments Relating to Link as Advertising

As noted, the preamble to the 2000 proposed regulations asked for comments on the question of whether the provision of a link to a corporate sponsor's Internet site as part of a sponsorship arrangement is a permissible form of acknowledgment. The IRS received many comments on this subject, uniformly expressing the view that the provision of a link should be a permissible form of acknowledgment. In this regard, comments pointed out that a link is devoid of content, does not promote or market anything, and does not disturb or distract a viewer who has no interest in the sponsor, since it can only be activated by the viewer herself. Accordingly, they recommended that the final regulations provide explicitly that the provision of a link to a sponsor's Internet site is not advertising but instead a permissible form of acknowledgment.

## 9. Comments Relating to Internet as Periodical

Prop. Reg. 1.513-4(b) provides that the provisions of Section 513(i) do not apply to income derived from the sale of advertising or acknowledgments in exempt organization periodicals. The preamble to the proposed regulations requests comments regarding whether an exempt organization's Internet site should be treated as a periodical for this purpose. In general, comments expressed the view that the IRS should not treat Internet sites of exempt organizations as periodicals on a wholesale basis, and should instead consider how a particular site functions. Where the site contains an on-line version of a periodical, it may be appropriate to treat that portion of the site as a periodical. Otherwise, comments suggested that an Internet site should not be treated as a periodical simply because it has text that changes from time to time.

## G. Case Study

A local symphony orchestra enters into a corporate sponsorship arrangement with a corporation for the sponsorship of the fall series of concerts. Under the terms of the arrangement, the sponsor receives the following:

- the right to be acknowledged (in nonqualitative terms) as the sponsor in all publicity about the series, including publicity in any paid media advertising taken out by the symphony as well as in its regular newsletters to supporters and on its website, with the latter including a link to the main page of the corporate sponsor's website;
- the right to have free samples of its products distributed at the series;
- the right to one page in the symphony orchestra's program for the series;
- the right to use the symphony orchestra's name and logo in advertising taken out by the corporate sponsor to promote the event; and
- the right to include the symphony orchestra's name and logo on the corporate sponsor's website, including a link to the symphony orchestra's website.

Questions:

- (1) Is the corporate sponsor's payment a qualified sponsorship payment?
- (2) Are any components that are not part of a qualified sponsorship payment treated as unrelated business income?
- (3) Are any components that are not part of a qualified sponsorship payment nontaxable on some other basis?
- (4) How should the symphony orchestra structure this arrangement to minimize any tax issues?
- (5) How should the symphony orchestra report this arrangement on its IRS Form 990?