

Tax Treatment of Sponsorship Payments Received by Exempt Organizations

Generally, payments received by exempt organizations from commercial sponsors that do not rise to the level of advertising will not be treated as unrelated trade or business income (UBI).

Advertising is any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed, and which 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 such products or services. A single message that contains both advertising and an acknowledgment is advertising. Advertising is subject to unrelated business income tax (UBIT).

The IRS has provided guidance and safe harbor rules on what types of sponsorship payments are not subject to UBIT. These rules are explained below. The safe harbor rules do not apply to payments made in connection with qualified convention and trade show activities or acknowledgments in an exempt organization's printed or electronic periodicals.

Qualified Sponsorship Payments

A qualified sponsorship payment is any payment made by a person engaged in a trade or business, where there is no "arrangement" or "expectation" that the person will receive any "substantial return benefit" for the payment.

Example: A local charity organizes a marathon and walkathon at which it serves drinks and other refreshments to participants; a corporation provided these refreshments free of charge. The corporation also gives the charity prizes to be awarded to winners of the event. The charity recognizes the corporation's support by listing the corporation's name in promotional fliers, in newspaper advertisements of the event and on t-shirts worn by participants. The charity also changes the name of its event to include the corporation's name. The charity's activities constitute acknowledgment of the sponsorship. The drinks, refreshments and prizes provided by the corporation constitute a qualified sponsorship payment, which is not income from a trade or business.

Substantial Return Benefit

A "substantial return benefit" means any benefit other than (1) a use or acknowledgment of the payor's name or logo in connection with the exempt organization's activities or (2) certain goods or services that have an insubstantial value. Benefits can include advertising, exclusive provider arrangements, goods, facilities, services, or other privileges, and the right to use an intangible asset.

Use or acknowledgment (not considered a substantial benefit and thus not subject to UBIT) includes the following:

- Exclusive sponsorship arrangements;
- Logos and slogans (including logos or slogans that are an established part of a payor's identity) that do not contain qualitative or comparative descriptions of the payor's products, services, facilities or company;
- A list of the payor's locations, telephone numbers or Internet address;
- Value-neutral descriptions, including displays or visual depictions, of the payor's product-line or services; and
- The payor's brand or trade names and product or service listings.

The regulations disregard benefits having an FMV of not more than two percent (2%) of the payment. The FMV should be an arms-length price. The FMV of the substantial return benefit is to be determined on the date the parties enter into binding, written sponsorship contracts. If the parties make material changes such as an extension or renewal of the contract, this will be treated as a new sponsorship contract and the FMV of any substantial return benefits must be revalued. As long as all the benefits received by the payor are less than two percent (2%), there is no substantial return benefit. If the benefit exceeds the two percent (2%) threshold, then the entire payment does not meet this safe harbor. Only that portion, if any, of the payment that exceeds the FMV of the substantial return benefit is a qualified sponsorship payment.

Tax Treatment of Sponsorship Payments Received by Exempt Organizations—Cont.

Example: An art museum organizes an exhibition and receives a large payment from a corporation to help fund the exhibition. The art museum recognizes the corporation's support by using the corporate name and established logo in materials publicizing the exhibition, which include banners, posters, brochures and public service announcements. The art museum also hosts a dinner for the corporation's executives. The FMV of the dinner exceeds two percent (2%) of the total payment. The art museum's use of the corporate name and logo in connection with the exhibition constitutes acknowledgment of the sponsorship. However, because the FMV of the dinner exceeds two percent (2%) of the total payment, the dinner is a substantial return benefit. Only that portion of the payment, if any, that the art museum can demonstrate exceeds the FMV of the dinner is a qualified sponsorship payment.

Contingent Payments

A qualified sponsorship payment does not include payments which are contingent upon the level of attendance at one or more events, broadcast ratings or other factors indicating the degree of public exposure to the sponsored activity. However, a qualified sponsorship payment includes a payment contingent on an event taking place.

Exclusivity Arrangements

An exclusive provider arrangement results in a substantial return benefit to the sponsor. An exclusive provider arrangement limits the sale, distribution, availability or use of competing products, services or facilities in connection with an exempt organization's activity.

In contrast, an exclusive sponsor arrangement acknowledges the payor as the exclusive sponsor of an exempt organization's activity, which does not result in a substantial return benefit, and the sponsor's payment will be treated as a qualified sponsorship payment.

Example: A soft drink manufacturer enters into a binding, written contract with a liberal arts college that provides for a large payment to be made to the college's English department in exchange for the college agreement to name a writing competition after the manufacturer. The contract also provides that the college will allow the manufacturer to be the exclusive provider of all soft drinks sales on campus. The FMV of the exclusive provider component of the contract exceeds two percent (2%) of the total payment. The college's use of the manufacturer's name in the writing competition constitutes acknowledgment of the sponsorship. However, the exclusive provider arrangement is a substantial return benefit. Only that portion of the payment, if any, that the college can demonstrate exceeds the FMV of the exclusive provider arrangement is a qualified sponsorship payment.

Internet

Address hyperlinks from an exempt organization's Web site to its sponsor's Web site may or may not be advertising. A mere acknowledgement and hyperlink from a charity's Web site to a sponsor's Web site is not a substantial return benefit. On the other hand, an endorsement by a charity on a sponsor's Web site is advertising and constitutes a substantial return benefit.

Example: A symphony orchestra maintains a Web site containing pertinent information and its performance schedule. A music shop makes a payment to the symphony to fund a concert series, and the symphony posts a list of its sponsors on its Web site, including the music shop's name and Internet address, which is a hyperlink. The symphony's posting of the music shop's name and Internet address constitutes an acknowledgement of the sponsorship and the entire payment is a qualified sponsorship payment, which is not income from a trade or business.

Example: A large pharmaceutical company manufactures a drug that is used in treating a particular medical condition, and it provides funding for the initiative that helps a health-based charity produce educational materials for distribution and post information on its Web site. On the pharmaceutical company's Web site, the statement appears, "this charity endorses the use of our drug, and suggests that you ask your doctor for a prescription if you have this medical

Tax Treatment of Sponsorship Payments Received by Exempt Organizations—Cont.

condition.” The charity reviewed the endorsement before it was posted on the pharmaceutical company’s Web site and gave permission for the endorsement to appear. The endorsement is advertising. The FMV of the advertising exceeds two percent (2%) of the total payment received from the pharmaceutical company. Only that portion of the payment, if any, that the charity can demonstrate exceeds the FMV of the advertising on the pharmaceutical company’s Web site is a qualified sponsorship payment.

Conclusion

Sponsorship payments for the mere use or acknowledgment of a sponsor’s name or logo fall within the safe harbor of qualified sponsorship payments, which are not subject to UBIT. Qualified sponsorship payments also may be included as contributions received by the exempt organization for purposes of determining public support. Careful solicitation and use of sponsorship payments can result in a significant source of tax-free revenue for exempt organizations.