Corporate Sponsorship Tax Guidance
Considerations When Adopting a Sponsorship Policy

Corporate sponsorships have been the subject of repeated discussion by the IRS and Congress since 1991, when the IRS determined that payments by Mobil Oil to the Cotton Bowl were taxable. In TAM 9147007, the IRS concluded that the organization had provided a *quid pro quo* (by advertising) in exchange for Mobil’s payment, and that the payment had been made by Mobil with an expectation of receiving a substantial return benefit. This is an issue that should be considered when drafting/adopting a corporate sponsorship policy. In fact, there should be clear guidelines as to what constitutes a “Qualified Sponsorship Payment” (QSP) that will not subject the organization to Unrelated Business Income Tax (UBIT) and will enable the organization to actively pursue corporate sponsorships as an important source of funding.

The Cotton Bowl Ruling, along with TAM 9231001 and IRS Announcement 92-15, affected many charitable organizations dependent on such sponsorships, such as museums, NPR, theaters and even Little League Teams. The proposed audit guidelines issued by the IRS in 1992 were widely criticized and created much controversy. Consequently, in 1993, the Service responded with guidelines that were more “taxpayer friendly” and differentiated between corporate sponsorships that were ‘acknowledgments’ and others that were ‘advertisements’. The 1993 proposed regulations were never finalized. Instead, Section 513(i) was added to the Internal Revenue Code in 1997, codifying the provisions of the proposed regulations. Final Regs (Treas. Reg 513.4.) were promulgated in 2002.

Under current law, a QSP is defined as any payment by any person engaged in a trade or business with respect to which there is no arrangement or expectation that the person will receive a substantial return benefit. It is irrelevant if the sponsored activity is related or unrelated to the organization’s exempt purpose or if the activity is temporary or permanent (criteria that are dispositive in a UBIT analysis). The key question here is whether there is a *quid pro quo* for the sponsorship payment. The analysis distinguishes between an ‘acknowledgement’ and an ‘advertisement’. The following factors should be considered when writing a corporate sponsorship policy.

1. By definition, advertisements are payments in expectation of a benefit return. They are automatically considered substantial return benefits. According to the Regs - there is no substantial return benefit if the organization acknowledges the payment with the sponsor’s logo, name, or product line. An example would be: “General Motors is a
proud sponsor of NPR.” That statement constitutes an acknowledgement of a gift and is not an advertisement.

2. The organization can exhibit or display the sponsor’s product. An example would be a charity that serves refreshments and gives prizes provided by its sponsor. The refreshments and prizes would qualify as QSP’s if they simply acknowledged the corporate sponsorship and displayed the sponsor’s address, phone number and Internet address - **BUT** the payment would not be a QSP if the acknowledgment included any qualitative or comparative language, price information, indications of savings or value or any endorsement/inducement to purchase, sell or use the product or services. Should those questionable elements be included, the IRS would classify the payment as a substantial return benefit rather than a QSP. A charitable organization should be careful to avoid using language that may say: “Be sure to test drive one of GM’s *superior* new models.”

3. A payment cannot be contingent on the level of attendance at one or more sponsored events, broadcast ratings, or other factors indicating the degree of public exposure to the sponsored event.

4. The corporate sponsor cannot include an ‘acknowledgment’ in a regularly scheduled periodical or newspaper, because the IRS will regard that publication as an advertisement. The acknowledgment can appear in printed material produced by the organization for a sponsored event, but publication in a regularly scheduled periodical technically constitutes an advertisement. Under the Code, the term periodical means “regularly scheduled and printed materials published by or on behalf of the charity that is not related to and distributed in connection with a specific event conducted by the organization.” Treas. Reg. §1.513-4(b). Material that is published electronically is considered a periodical.

5. A corporate sponsor will be deemed to receive a substantial return benefit in other ways besides advertising. For example, if the sponsor gains the right to use an intangible asset of the charity or if it receives something worth more than 2% of the sponsorship payments - it will not qualify as a QSP.

6. Exclusivity agreements can be tricky. Exclusivity arrangements, by themselves, do not result in a substantial return benefit. It must be clear that the only benefit received by the sponsor is an announcement that it is the exclusive sponsor of the event. It would be considered a substantial return benefit if the organization agreed not to sell any competing products, services or facilities in connection with the activity.
7. An organization may place a hyperlink on its website to the sponsor’s website. The question here is whether that link constitutes an acknowledgement of a QSP or a substantial return benefit? If the organization simply acknowledges a sponsor on its website by a hyperlink, that link will be considered an acknowledgement. If, however, the organization approves of a statement on the sponsor’s website or endorses the sponsor’s products - there would be a substantial return benefit that would disqualify the payment as a QSP.

8. A sponsorship payment will not be taxable, regardless of whether or not it constitutes a QSP, if it is excluded from the UBIT definition in the Code (“trade or business, regularly carried on and not substantially related to the organization’s exempt purpose”).

9. QSPs are treated as public support, ie, contributions from the general public under the public support tests used to distinguish public charities from private foundations.

   It is interesting to note that when allocating a sponsorship payment, the fair market value of the return benefit is determined as of the date the parties enter into a sponsorship contract. That allows an organization to value the benefit one time, even if it increases in value over time. If a material change is made to the sponsorship contract, the modified contract will be treated as a new agreement as of the effective date of the change. A material change is an extension, a renewal or a more-than-incidental change to the benefit itself.

   When considering strategies to maximize the use of corporate sponsorships, it is important to be familiar with the governing rules and definitions. The simplest rule of thumb would be to guard against confusing acknowledgment with advertisement - and staying away from endorsing the sponsor’s product, inducing its sale, comparing its pricing, promoting its quality or otherwise touting its value in any way.