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Corporate Sponsorship or Taxable Advertising?

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Generally, exempt organizations are taxed on income from any unrelated trade or business activities regularly carried on by the organization, less any permitted deductions. Promotion of private companies is generally considered advertising – an unrelated business activity. If the recognition given to corporate sponsors is deemed to be advertising, then the sponsorship payment may be taxed as unrelated business income and will not be counted as public support for purposes of qualifying as a public charity.

Fortunately, the IRS has created a safe-harbor to help tax-exempt organizations distinguish between taxable advertising and mere acknowledgement of sponsors. The IRS exempts payments that fit within the safe harbor, known as “qualified sponsorship payments,” from unrelated business income tax (“UBIT”). To ensure this favorable tax treatment, it is important that the sponsorship be structured so that it is a qualified sponsorship payment rather than taxable advertising.

Qualified Sponsorship Safe harbor. Payments accepted with no expectation that the sponsor will receive a “substantial return benefit” in exchange for the payment are not considered taxable advertising.

The use or acknowledgement of a sponsor’s name, logo, or product lines in connection with charitable activities is not considered a substantial return benefit and will not cause a sponsorship payment to be treated as taxable advertising income.

Payments that are contingent on the level of attendance at events, broadcast ratings, or other factors indicating the degree of public exposure will not qualify for the sponsorship safe harbor.

Substantial return benefits do not include goods or services that have an insubstantial value. The regulations disregard benefits having a fair market value of less than 2% of the sponsorship payment. In determining whether the 2% threshold has been exceeded in any year, all return benefits (other than use or acknowledgement) must be considered. If the fair market value of the benefit is greater than 2%, only the portion of the payment that can be demonstrated to be a qualified sponsorship payment will avoid UBIT.

The right to be the only sponsor of an activity or the only sponsor representing a particular trade, business or industry is generally not a substantial return benefit. The portion of any payment attributable to an exclusive sponsorship arrangement, therefore, may be a qualified sponsorship payment. However, if the exempt organization agrees to limit distribution of competing products or services in connection with the payment, the benefit will be deemed a substantial return benefit and will be taxable.

Activities that are considered to fall within the safe harbor include:

- an acknowledgment of a sponsor as the exclusive sponsor of an activity of the organization;
- use of a sponsor’s logo or slogan (so long as they do not contain qualitative or comparative

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descriptions of the sponsor’s products, services, facilities or company) in connection with an exempt organization’s activities;

- a list of the sponsor’s locations, telephone numbers or Internet addresses, and value-neutral descriptions on the nonprofit’s website or in connection with its activities.

Taxable Advertising. In contrast, taxable advertising is defined as any message or material (whether broadcast, transmitted, published, displayed, or distributed) that promotes or markets the sponsor’s trade or business or any of its services, facilities, or products. This includes any messages containing:

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

Conclusion. The corporate sponsorship regulations enable exempt organizations to recognize the support of a sponsor without having to pay tax on the income. If, however, the nonprofit promotes or markets the goods or services of a sponsor, the sponsorship will be treated as advertising and the income may be taxable as UBI and will not count as public support.

To protect corporate sponsorship payments from treatment as taxable advertising, nonprofits should consider entering into written Corporate Sponsorship Agreements that appropriately limit acknowledgment to communications or displays that qualify for the sponsorship safe harbor.

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