

UNDERSTANDING CORPORATE SPONSORSHIPS

Paula Cozzi Goedert
Barnes & Thornburg LLP
One North Wacker Drive, Suite 4400
Chicago, Illinois 60606
(312) 214-5660
paula.goedert@btlaw.com

For the last decade, corporate sponsorship income has been the subject of scrutiny by the Internal Revenue Service and Congress. The IRS recognized that non-profits were earning significant revenue from corporate sponsorship, and issued guidelines which would have made virtually all corporate sponsorship income taxable. Thanks to some quick and effective lobbying on the part of charities, the Internal Revenue Service changed its position and issued regulations which make many types of corporate sponsorship income tax-free. The regulations were codified in 1997. By following a few simple rules, a non-profit has great flexibility in accepting tax-free corporate sponsorship revenue.

Definition of Corporate Sponsorship.

Corporate sponsorship is financial support by an outside party, usually a corporation, for the good works of a non-profit organization. It is distinguished from a charitable contribution in that a corporate sponsor is typically motivated by a desire to receive a public acknowledgment in exchange for its support. For example, the cereal companies that pay the Olympics Committee for the right to put “Official Sponsor of the Olympics” on their products would be treated as corporate sponsors rather than charitable donors.

Basic Rules

The law permits a non-profit to receive corporate sponsorship income tax-free if what is given the corporate sponsor in return for its payment is an acknowledgment of thanks. This acknowledgment can take a variety of forms. The non-profit can hang a banner in its headquarters, or in the room where the sponsored event is taking place. It can take space in a conference program to thank the sponsor, or the staff or volunteer leaders can stand at a podium and thank the corporate sponsor. The acknowledgment of thanks can list the corporate sponsor’s name, logo, address, telephone number, and products. The corporate sponsor can distribute samples of its products at the sponsored event. In short, the law places few restrictions on the format of the acknowledgment of thanks.

Prohibitions

There are, however, two important prohibitions. First, the non-profit cannot make a qualitative judgment on the corporate sponsor's products or services. This means that acknowledgments of thanks should not contain comparative language or language that implies good quality. Words like "best", "finest", "top-notch service", and the like must be eliminated from any copy which will be included in an acknowledgment of thanks for a tax-free payment. This can usually best be achieved if the non-profit writes the acknowledgment of thanks, rather than permitting the corporate sponsor to write its own copy.

The second prohibition is that the non-profit cannot ask its members or the public to buy the products or services of the corporate sponsor. Even an innocent phrase like "please patronize our sponsors" would jeopardize the tax-free nature of the corporate sponsorship payment.

Endorsements

One item which a non-profit may not provide without allocating a portion of its revenue as taxable income is an endorsement. An endorsement would be considered as a request for members of the public to buy the product or service of the corporate sponsor. Endorsements also carry product liability, public relations, and other risks. Many non-profits use the taxability of corporate sponsorship income when exchanged for an endorsement as a good reason to tell their corporate sponsors that providing an endorsement of the product or service is simply out of the question.

Periodicals

The 1997 codification of the corporate sponsorship law contained a troublesome addition. It states that, if the acknowledgment of thanks were contained in a periodical which was not published in connection with a sponsored event, the corporate sponsorship payment would not qualify for tax-free treatment. This seems even less logical than the typical Internal Revenue Code provision. Why prohibit acknowledgments in periodicals, when such great flexibility is otherwise permitted? Recent pronouncements show that the IRS is rethinking this point and more flexible guidance may be issued in the future. In the meantime, acknowledgments in periodicals should be tied to some special event, like a sponsored conference or educational program. For example, "we wish to thank the following companies, which are providing corporate support for our upcoming conference ..." might be published in a special conference edition of a newsletter.

Allocations

The 1997 law added a very helpful aspect of flexibility to the rules. If a non-profit violates one of the rules, the entire corporate sponsorship payment will not necessarily be taxable. Only a portion would be taxable, which is fairly allocable to the value of the taxable benefit provided to the sponsor. For example, if a non-profit received a \$10,000 sponsorship payment in return for a banner at the sponsored event and a half-page ad in the conference program, only a portion of the \$10,000 would be taxable. That portion would be determined by the fair market value of the half-page ad, which may be easy to value based on how much other advertisers paid for similar space.

If the non-profit knows at the time the deal is struck that a portion of the payment will be taxable income, but the value is not easy to estimate, it may wish to consider valuing that item in the contract or other written agreement with the corporate sponsor, to avoid having the IRS later assign too great a value to that portion of the consideration.

Substantial Return Benefits

Regulations issued in 2000 defined “substantial return benefits.” To the extent of the value of a sponsor’s substantial return benefit, the sponsorship payment will not be exempt from UBIT.

A substantial return benefit is “any benefit other than goods, services, or other benefits of insubstantial value” received by the sponsor in consideration of its payment. For example, if a sponsor receives free advertising, certain facilities or privileges such as complimentary event tickets or products, the sponsor may have received a substantial benefit return. The exempt organization must pay tax on a portion of the sponsorship payment, measured by the fair market value of the substantial return benefit, but only if benefit would produce taxable income if sold separately. For example, including a free exhibit booth in a conference sponsorship would not result in taxable income, because exhibit booth rental is not taxable income.

Exclusivity

The regulations make a distinction between exclusive sponsorship arrangements and exclusive provider arrangements. In an exclusive sponsorship arrangement, the exempt organization acknowledges the sponsor as the exclusive sponsor of a specific activity. These arrangements generally do not create a substantial return benefit. If the organization promises to buy products in a category only from the sponsor, the portion of the sponsorship payment allocable to this benefit is taxable.

Web Sites

The regulations state that a non-profit may thank its corporate sponsor on its web site and link to the corporate sponsor's home page without allocating a portion of the corporate sponsorship revenue to taxable income.

Corporate sponsorship has become big business for non-profits. Large and small non-profits alike are seeking and receiving significant revenue from companies that want to have their names associated with the good works of the non-profit organizations. By attending to a few details up-front and keeping the basic rules in mind, non-profits can avoid paying tax on their corporate sponsorship revenue and keep more dollars in their coffers to carry on their educational, charitable, professional, and other non-profit programs.