

Receipt of Sponsorship Payments May be a “Taxing” Experience for an Exempt Organization

By John J. Hess

ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, NY 10020-1182
(212) 278-1000
Fax: (212) 278-1733

ANDERSON KILL & OLICK, P.C.
1600 Market Street
Philadelphia, PA 19103
(215) 568-4202
Fax: (215) 568-4573

ANDERSON KILL & OLICK, P.C.
One Gateway Center
Suite 901
Newark, NJ 07102
(973) 642-5858
Fax: (973) 621-6361

ANDERSON KILL & OLICK, L.L.P.
2100 M Street, N.W.
Suite 650
Washington, DC 20037
(202) 218-0040
Fax: (202) 218-0055

ANDERSON KILL & OLICK (Illinois), P.C.
1821 Walden Office Square
Suite 400
Schaumburg, IL 60173
(847) 925-5430
Fax: (847) 925-5431

ANDERSON KILL & OLICK, P.C.
Two Sound View Drive
Suite 100
Greenwich, CT 06830
(203) 622-7668
Fax: (203) 622-0321

www.andersonkill.com

Many tax-exempt organizations solicit businesses to sponsor one or more of its exempt activities (such as a special exhibition at a museum). These entities may offer inducements to the potential sponsor such as public acknowledgement, free advertising or free tickets to an event. However, the receipt of these sponsorship payments without careful planning may result in a portion of such payments being subject to unrelated business income tax (“UBIT”).

An exempt organization is generally not subject to federal income tax on its passive income (such as dividends) or income substantially related to its exempt purpose (such as college tuition fees received by a university). However, most exempt organizations are subject to UBIT if they generate unrelated business taxable income (“UBTI”). UBTI is defined as net income from a trade or business that is regularly carried on by an exempt organization that is not substantially related to its exempt purpose. For example, income from advertising placed in an exempt organization’s periodical is generally subject to UBIT. This is so because such advertising income is generally considered revenue from a trade or business that is regularly carried on and is not substantially related to an organization’s exempt purpose (other than to generate income).

“...sponsorship payments ...
may result in ... UBIT.”

However, for many years there was controversy over whether certain types of sponsorship payments by a business (such as payments to sponsor a college sporting event) constituted advertising income subject to UBIT. In 1997 Congress enacted section 513(i) of the Internal Revenue Code (“Code”) which provides for exempting from UBIT sponsorship payments which are “qualified sponsorship payments.” The IRS issued final regulations regarding qualified sponsorship payments on April 25, 2002.

Section 513(i) of the Code defines a qualified sponsorship payment as “any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of such person’s trade or business in connection with the activities of the organization that receives such payment.” The statute specifically provides that such “acknowledgement” does not include advertising the sponsor’s product or services. In addition, section 513(i) provides that it does not apply to payments that are contingent on attendance (or other factors indicating public exposure to an event). Furthermore, a payment entitling the payer to an acknowledgement in the exempt organization’s period-



who's who

John J. Hess is a shareholder in the New York office of Anderson Kill & Olick. John has

extensive experience in the areas of taxation, employee benefits and ERISA. John is a member of the Association of the Bar of the City of New York, the New York State Bar Association (and its Section on Taxation), and the American Bar Association. John can be reached at (212) 278-1811 or jhess@andersonkill.com.

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We hope you have found this issue of the Not-for-Profit Advisor informative. We invite you to contact the members of the Editorial Board, listed below, with your questions or concerns:

KRISTA M. ABRAHAMS
(212) 278-1526
kabrahams@andersonkill.com

ROBERT S. COOK
(212) 278-1203
rcook@andersonkill.com

ISAAC E. DRUKER
(212) 278-1475
idruker@andersonkill.com

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ical (as distinguished from an acknowledgement in the program guide for the sponsored event) are not treated as qualified sponsorship payments. Finally, the statute provides that where there is a substantial return benefit, the sponsorship payment must be treated as though divided into two payments; one being a qualified sponsorship payment and the other being a payment for something else (such as advertising).

The final regulations make clear that goods and services provided to the sponsor (other than an acknowledgement of the sponsor's name, logo or products) with a fair market value up to 2% of the sponsorship payment will not be treated as substantial return benefits. Thus, for example, if a sponsorship payment of \$100,000 for a college football game entitles the sponsor to free advertising and tickets to the game which are worth \$2,000 (in addition to the acknowledgement of the sponsor), then the entire \$100,000 payment would be a qualified sponsorship payment. However, if the value of these items were \$2,500, then \$97,500 would be a qualified sponsorship payment and \$2,500 would be a payment for advertising and football game tickets. Nevertheless, the final regulations reiterate that just because a payment is not a qualified sponsorship payment does not mean that such payment, being revenue in exchange for a substantial return benefit, is therefore necessarily subject to UBIT; it is merely outside the exemption from UBIT that is provided to qualified sponsorship payments. Thus, in the previous example, the portion of the \$2,500 payment that is allocable to the football game tickets would nonetheless be (under current law) treated as resulting in income that is substantially related to the college's exempt function and, therefore, not subject to UBIT.

The final regulations reiterate that the burden of showing the fair market value of any substantial return benefit in relation to the qualified sponsorship payment is on the exempt organization. If the exempt organization fails to establish that the sponsorship payment exceeds the fair market value of the substantial return benefits, then no part of the sponsorship payment will be a qualified sponsorship payment. Finally, these regulations provide fourteen examples of how the rules relating to qualified sponsorship payments operate.

In conclusion, the final regulations for section 513(i) provide further clarification of what payments to an exempt organization are exempt from UBIT as qualified sponsorship payments. However, it is also clear that careful planning by the exempt organization in obtaining sponsorship support from businesses is necessary in order to avoid having part of that support subject to UBIT, a result that can be a very "taxing" experience. ■

Mark Your Calendar

Not-For-Profit Real Estate Issues

Date: October 26, 2004
Place: Harvard Club of NYC, 27 West 44th Street, NYC
Time: 4:30 - 6:00 (Cocktails 6:00 - 7:00 pm)

Please join us for this free seminar which will be of interest to all not-for-profit institutions, whether you own or lease your premises. This seminar will be of particular interest to not-for-profit institutions that are contemplating new construction. Learn more about the special status which the law accords not-for-profit institutions and ensure that you are in compliance with the applicable laws. Topics to be discussed include: Construction Financing, Land Use Issues, Architectural and Construction Contracts and Real Estate Tax Exemptions. For more information and to register, please visit our website at www.andersonkill.com or call Michele Elie at (212) 278-1318.