Corporate Sponsorships

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Corporate Sponsorships

The IRS has released new final regulations governing the tax treatment of corporate sponsorship payments received by tax-exempt organizations.

The key phrases you will need to understand relative to this issue are:

- Taxable Corporate Sponsorship
- Qualified Sponsorship Payment
- Substantial Return Benefit
- Exclusive Provider

Many not-for-profit organizations operate fund-raising events with the aid of local businesses. Hopefully these are profitable for the not-for-profit. That profit, however, will be reduced if the support from the local business is termed a “taxable corporate sponsorship” subjecting the not-for-profit to unrelated business income (UBI) and the unrelated business income tax (UBIT).

This has always been a very gray area and these final regulations by the Internal Revenue Service do much to clarify the situation. This white paper explains some of the key points in the regulations.

Many institutions may encounter significant tax liabilities as a result of these regulations and should carefully consider their impact on current as well as future sponsorship arrangements. There are many different arrangements under which corporations become involved with charities. Some provide products at the event; some make a payment and receive acknowledgement at the event and in publicity; some make a payment to the charity related to the sales activity they achieved at an event or during a promotion.

Differences are as varied as the imagination of the two parties entering into the arrangement. Whether a corporate sponsorship payment, such as income from a "pouring rights" arrangement with a beverage supplier, is taxable depends upon its eligibility for treatment as a qualified sponsorship payment. In turn, that decision is based upon what the sponsor receives in return for its payment.

Qualified Sponsorship Payment (this is what you want)

A qualified sponsorship payment is not unrelated business income. It is defined as a payment made by a sponsor where there is no arrangement or expectation that the sponsor will receive any substantial return benefit in exchange for the payment.

The mere display or distribution of the sponsor's products, by the sponsor or the exempt organization, at the sponsored activity will not, in and of itself, affect the determination of whether the payment is a qualified sponsorship payment. This applies whether the product distribution is for free or the products are sold.

Qualified Sponsorship Payments are exempt from UBI consideration by Section 513(i) of the Internal Revenue Code. If a payment from a corporation does not qualify as a Qualified Sponsorship Payment, then that payment must be evaluated to determine if it represents unrelated business income. Therefore, payments that are not Qualified Sponsorship Payments are not automatically unrelated business income, they are merely not part of the safe harbor that protects such payments from UBI classification.
**Substantial Return Benefit** (this is what to avoid)

A substantial return benefit is defined as any benefit *other than*

1. The use or acknowledgment of the payer's name or logo in connection with the organization's activities, or
2. The provision of certain goods or services that have an insubstantial value under existing IRS guidelines.

When the arrangement calls for acknowledging the sponsor, the form of that acknowledgement is important. Any acknowledgements that include messages containing qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use a sponsor's products or services, will be termed a substantial return benefit. If the payment otherwise meets UBI criteria, the payment will be taxable as unrelated business income.

Therefore, you can display a company’s logo and even a message from that company as long as you avoid the items noted in the above paragraph.

Activities which generate qualified sponsorship payments may include a single event (a bowling event), a series of related events (a concert series or sports tournament), an extended activity (an art exhibit), or continuing support of the organization's operations.

Giving something back to the corporation is also a way to generate a substantial return benefit. This is the second item noted above.

If a corporation provides you with financial assistance to stage an event and, in exchange for their financial assistance, you provide them with admission tickets, those tickets may be a substantial return benefit. Benefits with a minimal fair market value are disregarded under these final regulations. The value is considered minimal as long as the value of the returned benefits is 2% or less than the financial assistance received. (*e.g.* a corporation who provides $10,000 of financial assistance can only receive up to $200 of tickets in order for that returned benefit to be disregarded.)

The final regulations list four kinds of benefits that may be provided to sponsors:

1. Goods, facilities, services or other privileges;
2. Exclusive or nonexclusive rights to use an intangible asset such as a trademark, patent, logo or designation;
3. Advertising; or
4. Exclusive provider arrangements.

All of these benefits are subject to the 2% rule. Let’s look more closely at the last two, as these can be a little more complex that the first two.

**Advertising**

The regulations define advertising as any message or material that promotes or markets the sponsor's trade or business or any of its services, facilities, or products. Advertising includes messages containing qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use a sponsor's products or services. If a message contains both advertising and mere acknowledgement, the entire message will be termed advertising.
If the fair market value of the advertising exceeds 2% of the financial assistance provided by the sponsor, it will be treated as a substantial return benefit.

**Exclusive Provider Arrangements**

Any arrangement limiting the sale, distribution, availability, or use of competing products, services, or facilities in connection with a sponsorship activity constitutes an “exclusive provider” arrangement and will be termed a substantial return benefit. However, referring to a sponsor as the exclusive sponsor does not result in a substantial return benefit.

Therefore, you can have Pepsi sell or distribute drinks at your event and receive financial assistance in exchange for that arrangement. You can refer to Pepsi as the exclusive sponsor of the event. You can acknowledge Pepsi, use their logo on your tickets and use their phrase “The joy of Pepsi”. However, if you endorse or provide qualitative information or inducements to purchase Pepsi, or if you sign an agreement with Pepsi agreeing not to have another brand of soft drink at your event, you will have created a substantial return benefit.

**Summary**

Charities can receive financial assistance from corporations and businesses and acknowledge those businesses in their operations. This is usually referred to as a sponsorship arrangement. Public television and radio refer to this as “underwriting” and have been doing an excellent job of providing “underwriting acknowledgement” in recognition of this financial assistance. They should serve as a model for all other charities.

Acknowledgement of financial assistance will not result in the charity recognizing unrelated business income as long as the sponsor does not receive a substantial return benefit. When the sponsor does not receive a substantial return benefit, the payment that the sponsor made to the charity is termed a qualified sponsorship payment and is protected from being classified as unrelated business income under the safe harbor protection of Internal Revenue Code Section 513.

It is possible that a sponsorship arrangement will result in only a portion of the financial assistance being termed a qualified sponsorship payment. The portion of the financial assistance that is not a qualified sponsorship payment must then be evaluated to determine if it represents unrelated business income to the charity.

**From the IRS**

The following are the specific examples included in the regulations and IRS publications regarding sponsorship arrangements.

**Exception for contingent payments.** A payment is not a qualified sponsorship payment if its amount is contingent, by contract or otherwise, upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to one or more events. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast does not, by itself, affect whether a payment qualifies.
**Exception for periodicals.** A payment is not a qualified sponsorship payment if it entitles the payer to the use or acknowledgment of the business name, logo, or product lines in the organization's periodical. For this purpose, a periodical is any regularly scheduled and printed material (for example, a monthly journal) published by or on behalf of the organization. It does not include material that is related to and primarily distributed in connection with a specific event conducted by the organization (for example, a program or brochure distributed at a sponsored event).

**Exception for conventions and trade shows.** A payment is not a qualified sponsorship payment if it is made in connection with any qualified convention or trade show activity.

**Example 1:** A local charity, organizes a marathon and walkathon at which it serves to participants drinks and other refreshments provided free of charge by a national corporation. The corporation also gives out prizes to be awarded to winners of the event. The charity recognizes the assistance of the corporation by listing the corporation's name in promotional fliers, in newspaper advertisements of the event and on T-shirts worn by participants. The charity changes the name of its event to include the name of the corporation. The charity's activities constitute acknowledgment of the sponsorship. The drinks, refreshments and prizes provided by the corporation are a qualified sponsorship payment, which is not income from an unrelated trade or business.

**Example 2:** An art museum organizes an exhibition and receives a large payment from a corporation to help fund the exhibition. The 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 museum also hosts a dinner for the corporation's executives. The fair market value of the dinner exceeds 2% of the total payment. The museum's use of the corporate name and logo in connection with the exhibition constitutes acknowledgment of the sponsorship. However, because the fair market value of the dinner exceeds 2% of the total payment, the dinner is a substantial return benefit. Only that portion of the payment, if any, that the museum can demonstrate exceeds the fair market value of the dinner is a qualified sponsorship payment.

**Example 3:** Company X coordinates sports tournaments for local charities. An auto manufacturer agrees to underwrite the expenses of the tournaments. Company X recognizes the auto manufacturer by including the manufacturer's name and established logo in the title of each tournament as well as on signs, scoreboards and other printed material. The auto manufacturer receives complimentary admission passes and pro-am playing spots for each tournament that have a combined fair market value in excess of 2% of the total payment. Additionally, Company X displays the latest models of the manufacturer's premier luxury cars at each tournament. Company X's use of the manufacturer's name and logo and display of cars in the tournament area constitute acknowledgment of the sponsorship. However, the admission passes and pro-am playing spots are a substantial return benefit. Only that portion of the payment, if any, that Company X can demonstrate exceeds the fair market value of the admission passes and pro-am playing spots is a qualified sponsorship payment.

**Example 4:** Company B conducts an annual college football bowl game. Company B sells to commercial broadcasters the right to broadcast the bowl game on television and radio. A major corporation agrees to be the exclusive sponsor of the bowl game. The detailed contract between Company B and the corporation provides that in exchange for a $1,000,000 payment, the name of the bowl game will include the name of the corporation. In addition, the contract provides that the corporation's name and established logo will appear on player's helmets and uniforms, on the
scoreboard and stadium signs, on the playing field, on cups used to serve drinks at the game, and on all related printed material distributed in connection with the game. Company B also agrees to give the corporation a block of game passes for its employees and to provide advertising in the bowl game program book. The fair market value of the passes is $6,000, and the fair market value of the program advertising is $10,000. The agreement is contingent upon the game being broadcast on television and radio, but the amount of the payment is not contingent upon the number of people attending the game or the television ratings. The contract provides that television cameras will focus on the corporation's name and logo on the field at certain intervals during the game. Company B's use of the corporation's name and logo in connection with the bowl game constitutes acknowledgment of the sponsorship. The exclusive sponsorship arrangement is not a substantial return benefit. Because the fair market value of the game passes and program advertising ($16,000) does not exceed 2% of the total payment (2% of $1,000,000 is $20,000), these benefits are disregarded and the entire payment is a qualified sponsorship payment, which is not income from an unrelated trade or business.

Example 5: Company A organizes an amateur sports team. A major pizza chain gives uniforms to players on Company A’s team, and also pays some of the team's operational expenses. The uniforms bear the name and established logo of the pizza chain. During the final tournament series, Company A distributes free of charge souvenir flags bearing Company A’s name to employees of the pizza chain who come out to support the team. The flags are valued at less than 2% of the combined fair market value of the uniforms and operational expenses paid. Company A’s use of the name and logo of the pizza chain in connection with the tournament constitutes acknowledgment of the sponsorship. Because the fair market value of the flags does not exceed 2% of the total payment, the entire amount of the funding and supplied uniforms are a qualified sponsorship payment, which is not income from an unrelated trade or business.

Example 6: School A is a liberal arts college. A soft drink manufacturer enters into a binding, written contract with School A that provides for a large payment to be made to the college's English department in exchange for School A agreeing to name a writing competition after the soft drink manufacturer. The contract also provides that School A will allow the soft drink manufacturer to be the exclusive provider of all soft drink sales on campus. The fair market value of the exclusive provider component of the contract exceeds 2% of the total payment. School A’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 School A can demonstrate exceeds the fair market value of the exclusive provider arrangement is a qualified sponsorship payment.

Example 7: WJJR15 is a noncommercial broadcast station that airs a program funded by a local music store. In exchange for the funding, WJJR15 broadcasts the following message: “This program has been brought to you by the Music Shop, located at 123 Main Street. For your music needs, give them a call today at 555-1234. This station is proud to have the Music Shop as a sponsor.” Because this single broadcast message contains both advertising and an acknowledgment, the entire message is advertising. The fair market value of the advertising exceeds 2% of the total payment. Thus, the advertising is a substantial return benefit. Unless WJJR15 establishes that the amount of the payment exceeds the fair market value of the advertising, none of the payment is a qualified sponsorship payment.

Example 8: A symphony orchestra performs a series of concerts. A program guide that contains notes on guest conductors and other information concerning the evening's program is distributed by the orchestra at each concert. The Music Shop makes a $1,000 payment to the orchestra in support
of the concert series. As a supporter of the event, the Music Shop receives complimentary concert tickets with a fair market value of $85, and is recognized in the program guide and on a poster in the lobby of the concert hall. The lobby poster states that, “The orchestra concert is sponsored by the Music Shop, located at 123 Main Street, telephone number 555-1234.” The program guide contains the same information and also states, “Visit the Music Shop today for the finest selection of music CDs and cassette tapes.” The fair market value of the advertisement in the program guide is $15. The orchestra’s use of the Music Shop’s name, address and telephone number in the lobby poster constitutes acknowledgment of the sponsorship. However, the combined fair market value of the advertisement in the program guide and complimentary tickets is $100 ($15 + $85), which exceeds 2% of the total payment (2% of $1,000 is $20). The fair market value of the advertising and complimentary tickets, therefore, constitutes a substantial return benefit and only that portion of the payment, or $900, which exceeds the fair market value of the substantial return benefit, is a qualified sponsorship payment.

Example 9: A national charity X dedicated to promoting health, organizes a campaign to inform the public about potential cures to fight a serious disease. As part of the campaign, charity X sends representatives to community health fairs around the country to answer questions about the disease and inform the public about recent developments in the search for a cure. A pharmaceutical company makes a payment to the campaign to fund charity X’s booth at a health fair. Charity X places a sign in the booth displaying the pharmaceutical company’s name and slogan, “Better Research, Better Health,” which is an established part of the company’s identity. In addition, Charity X grants the pharmaceutical company a license to use Charity X’s logo in marketing its products to health care providers around the country. The fair market value of the license exceeds 2% of the total payment received from the company. Charity X’s display of the pharmaceutical company’s name and slogan constitutes acknowledgment of the sponsorship. However, the license granted to the pharmaceutical company to use U’s logo is a substantial return benefit. Only that portion of the payment, if any, that charity X can demonstrate exceeds the fair market value of the license granted to the pharmaceutical company is a qualified sponsorship payment.

Example 10: A trade association publishes a monthly scientific magazine for its members containing information about current issues and developments in the field. A textbook publisher makes a large payment to the scientific magazine to have its name displayed on the inside cover of the magazine each month. Because the monthly magazine is a periodical within the meaning of paragraph (b) of this section, the section 513(i) safe harbor does not apply. See §1.512(a)-1(f).

Example 11: A symphony orchestra, maintains a website containing pertinent information and its performance schedule. The Music Shop makes a payment to the orchestra to fund a concert series, and the orchestra posts a list of its sponsors on its website, including the Music Shop's name and Internet address. The orchestra’s website does not promote the Music Shop or advertise its merchandise. The Music Shop's Internet address appears as a hyperlink from the website to the Music Shop's website. The orchestra’s posting of the Music Shop’s name and Internet address on its website constitutes acknowledgment of the sponsorship. The entire payment is a qualified sponsorship payment, which is not income from an unrelated trade or business.

Example 12: A health-based charity sponsors a year-long initiative to educate the public about a particular medical condition. A large pharmaceutical company manufactures a drug that is used in treating the medical condition, and provides funding for the initiative that helps X produce educational materials for distribution and post information on X's website. X's website contains a hyperlink to the pharmaceutical company’s website. On the pharmaceutical company's website, the statement appears, “X endorses the use of our drug, and suggests that you ask your doctor for a
prescription if you have this medical condition.” X reviewed the endorsement before it was posted on the pharmaceutical company's website and gave permission for the endorsement to appear. The endorsement is advertising. The fair market value of the advertising exceeds 2% of the total payment received from the pharmaceutical company. Therefore, only the portion of the payment, if any, that X can demonstrate exceeds the fair market value of the advertising on the pharmaceutical company's website is a qualified sponsorship payment.

The tax treatment of corporate sponsorship payments received by tax-exempt organizations can be tricky. If your not-for-profit organization operates fund-raising events these details are essential to know and understand in order to run a profitable event.

* Please note that this White Paper is a general summary of law and omits many important details, footnotes, and caveats. It is no substitute for informed advice from a tax professional based on your particular circumstances.

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