Sponsorship Versus Advertising

Released April 24, the Internal Revenue Service's (IRS) final regulations on corporate sponsorship offer a few clarifications but no earthshaking changes. The essential safe harbor characteristics of a nontaxable sponsorship remain virtually unchanged from their first appearance in 1993. Mere "use or acknowledgment" of the sponsor by the exempt organization will not render a payment taxable. This use or acknowledgment may include

- exclusive sponsorship (as opposed to exclusive provider) arrangements;
- the sponsor's location, telephone number, or Internet address;
- value-neutral descriptions, including displays or visual depictions, of the sponsor's product line or services;
- displays of brand or trade names and product or service listings;
- logos or slogans that are an established part of the sponsor's identity; and
- mere display or distribution (for free or at a cost) of the sponsor's product at a sponsored activity.

Use or acknowledgment does not include *advertising*, defined as "any message distributed by any means that promotes or markets the sponsor's business, service, facility, or product." Advertising messages contain

- qualitative or comparative language;
- price information or other indications of savings or value; or
- an endorsement or inducement to purchase, sell, or use the sponsor's service, facility, or product.

A single message containing advertising and acknowledgement is considered 100 percent advertising.

The periodical trap

Although this trap has been around for 10 years, we all seem to fall into it at some point. The issue of nontaxable sponsorship versus taxable advertising does not apply to periodicals. If it looks like a qualified sponsorship, as defined above, but it appears in a periodical, it's most likely a taxable advertisement.

A *periodical* is defined as "regularly scheduled and printed material that is published by or on behalf of the exempt organization that is not related to and primarily distributed in connection with a specific event . . . and for this purpose, printed material includes material that is published

electronically." So if your journal or newsletter has an online edition, that's a periodical, too. However, meeting and convention programs are not periodicals, so for those publications, the safe harbor rules for nontaxable sponsorships apply.

It seems safe to say that your Web site is not a periodical, but the regulations strongly suggest that it can't be all one big, nontaxable sponsored activity, either. A hyperlink to a sponsor's corporate Web site, as long as it's just a link, is a nontaxable sponsorship. But if the exempt organization endorses the sponsor, either on its Web site or the sponsor's, that's taxable advertising.

So, what's a sponsorship?

The final definition of *qualified sponsorship payment* is "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 any substantial return benefit." In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related to the recipient organization's exempt purpose and whether it is temporary or permanent. The IRS has dropped the initial proposed requirement that a qualified sponsorship must be in connection with an event.

Don't assume that everything that doesn't appear in a periodical is a sponsorship; it could be a qualified trade show activity. To most of you, that means an exhibit. Since the 1970s, convention-floor exhibits have been tax-excluded. Under that exclusion, sales orders may be taken on the floor, but the exhibit-space rent is not taxable. Although it's confusing, this sponsorship issue isn't the trap the periodical issue is, because the tax rules on exhibits are more liberal than the rules for sponsorships.

IRS culture versus marketing culture

The two couldn't be further apart. Marketing people and IRS officials use many of the terms in this article completely differently. As a finance professional, it's up to you to learn to speak both languages--and to keep them straight.

When reviewing arrangements called *sponsorships, partnerships*, *joint ventures*, or even *royalty agreements*, understand that those words alone don't explain themselves in terms of the tax code. In fact, these words all mean one thing to the IRS and quite another to most of the rest of us.

Partnerships and *joint ventures* are worry words in tax parlance. To the IRS, they suggest profit-sharing arrangements whereby the net income of an activity is split between an association and a for-profit. If it's an exempt-purpose activity--other than something specifically excluded from unrelated business income tax, such as exhibits or true royalties (no services provided in return)--then to the IRS, it raises the possibility of private inurement, introducing issues of intermediate sanctions and possible loss of exempt status.

It is impractical to try to keep all worry words out of agreements and promotional materials or insist that those materials use terms strictly as they are defined by the IRS. Even the IRS, at least at the senior level, knows that. You must teach yourself to look beyond the terminology to the substance of the arrangement, and analyze it according to everything you know about the tax rules on sponsorships, advertising, exhibitor activities, royalties, and so forth.

Keep worry words and red flags to a minimum, and learn to read and analyze agreements, contracts, and promotional materials with respect to the tax rules. And while the final corporate sponsorship regulations haven't made these tasks much easier, they are final, so we might as well get used to them.

David M. Duren is tax principal, Tate and Tryon, Washington, D.C.

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