DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

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AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

Comments on Proposed Regulation Section 1.513 (REG 209601-92)

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The American Society of Association Executives ("ASAE") is a Washington, D.C.-based association comprised of more than 25,000 professionals who manage approximately 11,000 trade, individual, and voluntary organizations. Almost all the associations represented by ASAE's membership are exempt from taxation under §501(c)(3), 501(c)(4) or 501(c)(6) of the Internal Revenue Code.

ASAE welcomes the opportunity to comment on rules proposed March 1, 2000, by the Internal Revenue Service (the "Service" regarding the tax treatment of sponsorship payments received by tax-exempt organizations (REG-209601-92). ASAE's comments set forth below will address specific areas of concern regarding these proposed regulations, particularly as they would apply to those exempt organizations represented within ASAE's membership.

A. Summary of ASAE's Comments

The statute (26 U.S.C. §513(i)) provides that the safe harbor for qualified sponsorships does not apply to that portion of a payment which constitutes a "substantial return benefit" to the sponsor (other than use or acknowledgment of name, logo or product lines. The proposed regulations seek to define "substantial return benefit" by reference to certain existing tests for *in*substantiality of return benefits received by charitable donors. ASAE believes this interconnection is not directed by the statute, and would add to, rather than subtract from, confusion in the application of the qualified sponsorship standard.

Also in the area of substantial return benefits, ASAE believes that the Service has overlooked one element in the legislative history regarding the periodical advertising exception to the safe harbor. A key modification made in the Conference Report appears not to have been considered in drafting the proposed regulations.

Additionally, ASAE disagrees with the apparent presumption that an "exclusive provider arrangement" would *per se* be a substantial return benefit.

The proposed regulations would impose an extra burden of proof (over and above that normally required of the taxpayer). Namely, the document contains a specific statement that exempt organizations bear the burden of proving the fair market value of any given substantial return benefit, and absent sufficient proof of that value, the *entire* payment will be deemed a substantial return benefit, not eligible for the qualified sponsorship safe harbor. ASAE believes that this provision would place exempt organizations, including those with the most innocent of intentions, at a substantial disadvantage under an IRS examination.

One section of the IRS's proposed regulations addresses an entirely separate area of the unrelated business income tax, namely, the "exploited exempt activity" rules. ASAE believes the Service is proposing a substantial modification to those rules and, since there is no necessary connection to the subject of sponsorships, the section should be removed from these proposed regulations.

Finally, in response to the Service's general invitation for suggestions in the area of Internet activities, ASAE offers certain observations regarding "virtual trade shows" and electronic links in relation to qualified sponsorships.

The following are ASAE's specific comments in each of these areas.

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B. Substantial Return Benefit

The proposed regulations define "substantial return benefit" as any benefit other than "goods, services or other benefits of insubstantial value…". Goods, services or other benefits are of insubstantial value if they have an aggregate fair market value of not more than 2% of the amount of the payment, or $74 (adjusted for inflation), whichever is less. Also, certain other benefits may be disregarded as insubstantial if they are provided to the payor or persons designated by the payor and are token items with an aggregate cost within the limit established for low cost articles under §513(h)(2).

I. The Charitable Substantiation Test

The first test listed above (2% or $74, whichever is less) reflects existing regulations regarding the substantiation of charitable contributions. This evidences an approach to define "substantial return benefit" as being the converse of an "insubstantial benefit" that might be provided in return for a charitable gift under the tests of Treasury Regulation §1.170A-13(f) and Rev. Proc. 90-12, 1990-1 C.B. 471. Under the charitable substantiation rules, the value of an insubstantial return benefit does not have to be reported to the donor, and the donor does not have to reduce its charitable contribution deduction by that amount.

ASAE does not believe that §513(i) of the Internal Revenue Code was intended to be an extension of the charitable contribution deduction rules. Its placement within the unrelated business income tax ("UBIT") rules shows clearly that it is intended to provide an exclusion from that tax and is not related to rules regarding charitable contribution deductions. Furthermore, §513(i) clearly applies to many categories of exempt organizations other than those eligible to receive charitable contributions. Hence, there is ***no*** reason to believe that "substantial return benefit" in §513(i) means the exact opposite of "insubstantial benefit" in the rules under §170.

ASAE acknowledges that, in all likelihood, the Service is not attempting to equate these two disparate portions of the Internal Revenue Code, but rather is attempting to simplify the application of a new statute by borrowing some of the rules already in common use for another statutory purpose by many (but by no means all) tax-exempt organizations.

ASAE would applaud that motivation, were it not for the fact that, in this case, the practical result would be to impose additional burden and confusion rather than to simplify. Even many experienced practitioners have been confused initially by this juxtaposition of the qualified sponsorship and charitable contribution rules. At this stage, we are only beginning to experience the difficulty of attempting to explain it to smaller, less sophisticated exempt organizations, particularly those not eligible to receive charitable contributions.

It is already a sufficiently convoluted concept that failure to meet one statutory exclusion does not automatically make a payment subject to UBIT, since there are numerous other exclusions that may be applicable. The proposed regulations would add the further complication that a payment which fails to meet the requirements for a charitable contribution deduction will probably (but not in all cases) fail to meet the qualified sponsorship exclusion from unrelated business income tax, but would not necessarily fail to meet some other exclusion, such as the exclusion from UBIT for royalties or dividends. The latter element in this tangle may be necessary under the statute, but the first element is not.

This proposed "insubstantial" test would likely have the largest impact on smaller exempt organizations that receive smaller sponsorship payments. For example, if the sponsor that gives $100 to an exempt organization receives a free lunch valued at $15.00, the exempt organization must treat that portion of the payment as not a qualified sponsorship payment and must go through the tedious process of determining whether that $15.00 must be treated as taxable, and, if it is taxable, track the expenses involved and report this payment on its Form 990-T. The amount of paperwork involved in this transaction is hardly worth the pennies in tax revenue that would be gained. ASAE urges the Service to come up with a less confusing test for determining insubstantial value that would allow for a higher limit than is provided by the 2%-or-$74 benchmark.

II. Low-Cost Items

In proposed regulation §1.513-4(c)(2)(ii), the Service sets forth a regulatory scheme that is not typical in the sponsorship context. That Section provides that "goods, services, or other benefits provided to the payor" are disregarded as substantial return benefit if the fair market value is not more than 2% of the amount of the payment or $74, whichever is less, or if the return benefits to the payor or persons designated by the payor are token items such as key chains, mugs, or posters of low cost as defined by Section 513(h)(2). Under this proposal, the exempt organization must spend time trying to calculate the fair market value of key chains, and other items provided to the payor in amounts that could potentially be under one dollar. Further, this provision addresses a situation that ASAE believes to be rare among exempt organizations. That is, exempt organizations generally do not want to give funds back to the sponsor they had to work so hard to get money from, and it is very unlikely that the exempt organization would feel compelled to funnel back to the sponsor or its employees all sorts of items with the exempt organization's logo. While this may be the case for large bowl games, it is not the case for most sponsored activities of trade or professional associations.

What is much more typical is that the attendees at exempt organization conferences or meetings will be given key chains, tote bags, or tee shirts bearing the name and logo of the corporate sponsor. It appears that there may be confusion in the exempt organization community among those who believe that it is these giveaways to members, attendees, and other members of the constituency that are subject to the above referenced provisions. ASAE believes that the proposed regulations were not intended to apply to such giveaways since the benefit is not to the sponsor but to individuals attending a sponsored event. In fact, this type of giveaway is arguably covered by the provision allowing product samples to be distributed by sponsors. Still, it would be most helpful to associations and other membership-based exempt organizations for the Service to expressly clarify in any final regulations that if a sponsor's gives any items away (regardless of value) to attendees at an exempt organization's functions or events, these items should not be considered of substantial value to the sponsor, and an exempt organization need not account for these items for the purposes of § 513(i).

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III. Periodicals

A guiding principle of the Service's 1993 proposed regulations and the Service's interpretation of the corporate sponsorship rules is that the mere recognition or acknowledgment of a corporate contributor or sponsor does not subject the payment to UBIT. "Acknowledgment" is distinguished from advertising, which has traditionally given rise to UBIT. Congress understood this principle, but also sought to make clear that the safe harbor for qualified sponsorship payments does not apply to periodicals by adding the following as §513(i)(2)(B)(ii):

> The term 'qualified sponsorship payment' does not include —
>
> (I) any payment which ***entitles*** the payor to the use or acknowledgment of the name or logo (or product lines) of the payor's trade or business in regularly scheduled and printed material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization, … (Emphasis added.)

Then, according to the legislative history supporting the House of Representatives bill, as described in the Conference Report accompanying H.R. 2014 (Report number 105-220):

> The provision does not apply to the sale of advertising or acknowledgments in tax-exempt organization periodicals. For this purpose, the term "periodical" means regularly scheduled and printed material published by (or on behalf of) the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization. For example, the provision will not apply to payments that lead to acknowledgments in a monthly journal, but will apply if the sponsor receives an acknowledgment in a program or brochure distributed at the sponsored event.

The Service follows this guidance in proposed regulation §1.513-4(b). However, this guidance does not reflect Congress' final determination as to how acknowledgments in periodicals are to be treated. The Conference Agreement, developed after the House's initial report, makes a specific clarification on this issue. Specifically, the Conference Agreement states that it follows the House bill and Senate amendment:

> … ***except*** that the conference agreement clarifies that the qualified sponsorship payment provision does not apply to payments that ***entitle*** the payor to the use or acknowledgment of the payor's trade or business name or logo (or product lines) in exempt organization periodicals. (Emphasis added.)

In other words, the provisions in the legislative history relied on by the Service related to periodicals are from the House bill, and the Service does not recognize the subsequent Conference Agreement clarification. As a result, the entire discussion in the House bill portion of the legislative history should not be relied upon as an accurate statement of the intention of Congress in this regard.

Additionally, the statutory language states only that the safe harbor does not apply when payments "entitle" the corporate sponsor to use or acknowledgment of the sponsor's name or logo in a periodical. Therefore, based on the plain language of the statute and the Conference Agreement's clarification, if an agreement between a sponsor and an exempt organization "entitles" the sponsor to specific acknowledgments in the organization's periodicals, then the safe harbor would not apply. However, if the exempt organization simply on its own volition acknowledges the sponsor in any periodical, then that activity should be included in the safe harbor and the payments from the sponsor should be consider qualified sponsorship payments.

The Service should make clear in final regulations that pure recognition and acknowledgment of corporate sponsors is permissible and associated payments will not be treated as UBIT, except in those limited circumstances where the sponsor is ***entitled*** to such recognition in periodicals unrelated to the sponsored event or activity.

IV. Exclusive Sponsor and Exclusive Provider

ASAE supports the Service's position in its proposed regulations regarding exclusive sponsor arrangements. That is, there is no substantial return benefit to a sponsor by virtue of being named an exclusive sponsor by an exempt organization. ASAE also supports the Service's further clarification that an exclusive sponsorship representing a particular trade of business (*i.e.*, "XYZ Air is the exclusive airline sponsor of this activity") is not a substantial return benefit.

However, ASAE does not support the Service's determination that exclusive provider relationships do inherently give rise to a substantial return benefit. There is no reference to exclusive provider arrangements in §513(i), nor is there reference in any of the accompanying legislative history. In fact, this portion of the proposed regulations appears to be in conflict with the intent of Congress as evidenced in the legislative history of §513(i). According to the Conference Agreement accompanying H.R. 2014 (Report number 105-220): "mere distribution or display of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, *whether for free or for remuneration*, will be considered to be 'use or acknowledgment' of the sponsor's product lines (as opposed to advertising), and thus will not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment" (Emphasis added.) Thus, Congress clarified that an arrangement allowing the distribution or sale of a sponsor's product at the sponsored event does not create a substantial return benefit. Given Congress' position on the sale or distribution of products generally, one would certainly expect that if it had intended a major exception to this rule along the lines of the Service's exclusive provider proposal, it would have noted so expressly in the legislative history.

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Also, it should be noted that some of the Service's own examples, as included in the proposed regulations, highlight the difficulty inherent in adopting this *per se* approach to exclusive provider arrangements. In the first example, the Service describes "M," a local charity that organizes a marathon and walkathon at which it serves drinks and other refreshments provided free of charge by the sponsor. The conclusion in this example is that the drinks and refreshments are a qualified sponsorship payment, without any discussion of the possibility that the sponsor might be an exclusive provider of these items. Of course, if this were an exclusive provider arrangement, the fair market value of the benefit to the sponsor would be negligible (if not negative). Still, the proposed regulations make no exception for items that are provided free to participants.

In addition to the example described above, there are a number of other questions that arise as we look to what the practical effect of the exclusive provider provisions might be. For instance: What if the sponsorship agreement between the exempt organization and the sponsor includes no reference to an exclusive provider arrangement, and yet the sponsor is the *de facto* exclusive provider at the sponsored activity? Would the Service then rely on the anti-abuse provisions to state that the mere fact of exclusivity is enough evidence to show an agreement to provide that exclusivity? Would it then be incumbent upon the exempt organization to actually solicit companies that are in competition with the sponsor to also make their wares available at the sponsored activity in order to avoid a steep tax bill? ASAE does not believe that this result was intended by Congress.

Given the clear legislative history and the compliance nightmares that would certainly arise if the exclusive provider provisions remained intact, the Service should revise its regulations by removing its apparent *per* se rule that an exclusive provider arrangement would be a substantial return benefit in all cases. Rather, it should apply a facts-and-circumstances test that looks to the degree of commerciality and profit potential surrounding any given exclusive provider arrangement in making such a determination.

C. Burden of proving fair market value

As previously mentioned, the statute excludes from unrelated business income any sponsorship payment for which there is no arrangement or expectation that a payor engaged in a trade or business will receive a substantial return benefit other than use or acknowledgment of its name or logo (or product lines) in connection with the sponsored activities (§513(i)(2)(A)). The statute then goes on to say that where a single payment contains both a qualified sponsorship portion and another portion, the two portions will be treated separately (§513(i)(3)). This eliminated the so-called "tainting" rule of the 1993 proposed regulations.

The way the new proposed regulations approach the problem of bifurcating a payment into its qualified and non-qualified portions is by placing the burden on the exempt organization to prove the fair market value of the non-qualified portion (the substantial return benefit), leaving the residual of the payment to be treated as a qualified sponsorship payment. Absent that proof, the proposed regulations make the entire payment non-qualified. ASAE does not believe that this one-sided approach is justified by the statutory language that the two portions of a sponsor payment are to be "treated separately."

Furthermore, since a non-qualified payment is received from a person engaged in a trade or business, the exempt organization must necessarily either report it as unrelated business income, or establish that the payment qualifies for some other exclusion from UBIT, such as royalty, qualified convention and trade show activity, or not regularly carried on.

The practical effect of this proposal is to create a rebuttable presumption that no part of the payment is a qualified sponsorship unless the exempt organization can prove the fair market value of the non-qualified portion. Intangible benefits, which will generate the vast majority of disputes in this area, are notoriously difficult to value, and ASAE suggests that a great many exempt organizations, otherwise acting in good faith, will fail to meet this first burden of proof. As a result, the organization will be immediately faced with what amounts to another rebuttable presumption that the payment is unrelated business taxable income. Nothing in the statute or its legislative history suggests that Congress intended such a result.

In the preamble to the new proposed regulations, the Service states that it has decided to place the burden of proof on the exempt organization because it "has superior access to relevant information regarding its sponsorship arrangements." ASAE respectfully differs, not with that statement as such, but with its relevance. Exempt organizations may have access to the raw information necessary for a valuation of an intangible benefit, but are highly unlikely to possess the resources or expertise in valuation techniques necessary to use that information, or even to know what information they need to obtain.

In other contexts, where the Service proposed regulations placing adverse rebuttable presumptions on exempt organizations, the regulations at least went on to offer some safe harbor methods by which the exempt could rebut the presumption. Yet here, in the context of what is arguably the most arcane area of valuation, namely that of intangibles (see §1.482-4 of the Treasury Regulations, among others, as evidence of that complexity), the Service offers no safe harbor methods. This places the typical exempt organization in an untenable position should any payments it has reported as qualified sponsorship come under IRS examination.

The Service should either introduce some simple safe harbor methods that exempt organizations might use (certainly for payments below certain dollar thresholds) or else delete this burden from the proposed regulations.

D. Exploited exempt activities

ASAE regards the unrelated business income rules involving exploited exempt activities as a separate and distinct topic from that of the tax treatment of corporate sponsorship. The exploited exempt activities rule of Treasury Regulation §1.512(a)-1(d) concerns clearly taxable activities that take place within the context of a larger exempt activity. We see no necessary overlap between that issue and the subject of certain corporate sponsorships being excluded from the definition of unrelated trade or business.

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The only connection between these two proposals appears to be the fact that the 1993 proposed regulations (now being withdrawn) contained some proposed additional examples of exploited exempt activities taking place at the same event as a corporate sponsorship activity. Those additional examples did in fact appear to provide more latitude to the taxpayer in the realm of exploited exempt activity than does the one current example in §1. 512(a)-1(e).

Now the Service is proposing instead to insert a second example of exploited exempt activities which gives the taxpayer much ***less*** latitude than does the example that is part of existing regulations. Since the examples in the 1993 proposed regulations are being withdrawn, it is not necessary to provide a counter-weight to them in the form of a new example, especially one which seems to many to contradict the meaning of §1.512(a)-1(d). If the Service wishes to propose changes to the exploited exempt activity rules, it should do so separate and apart from the subject of corporate sponsorship and §513(i).

E. Internet Activities

The Service requested comments from the exempt organization community regarding the application of the rules governing periodicals and trade shows in §513(i)(2)(B)(ii) to an exempt organization's Internet sites, and on whether providing a link to a sponsor's Internet site is advertising within the meaning of §513(i)(2)(A) and §1.513-4(c)(2)(iv) of the proposed regulations.

I. Trade Shows and Periodicals

Section 513(i)(2)(B)(ii) states that the general §513(i)(1) safe harbor from tax on unrelated business income will not apply to any payment made in connection with any qualified convention or trade show activity, as defined in §513(d)(3)(B). Section 513(d)(3)(B) defines "qualified convention and trade show activity" as "a convention and trade show activity carried out by a qualifying organization … in conjunction with an international, national, State, regional, or local convention, annual meeting, or show conducted by an organization [exempt from tax under §501(c)(3), (4), (5), or (6)] … if one of the purposes of such organization in sponsoring the activity is the promotion and stimulation of interest in, and demand for, the products and services of that industry in general or to educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization, and the show is designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed."

This definition does not necessarily exclude the so-called "virtual" trade shows that take place over the Internet, as long as such activities otherwise qualify for the §513(d)(3) safe harbor. ASAE believes that when the Service interprets the §513(d)(3) safe harbor, the mere fact a trade show is presented at least in part on the Internet should not preclude protection under this safe harbor. If such "virtual" trade shows or other "qualified convention and trade show activity" would qualify for the §513(d)(3) safe harbor, then such activity by statute is precluded from coverage under the §513(i) safe harbor. Of course, if the Service determines that such activities do not meet the "qualified convention and trade show activity" safe harbor, then the exempt organization should have the opportunity to show that these activities do indeed qualify for the §513(i) corporate sponsorship safe harbor.

The Service also asks for comments regarding the impact of Internet activity on the §513(i)(2)(B)(ii)(I) exclusion from safe harbor for any payment which entitles the payor to the use or acknowledgment of the name or logo in "regularly scheduled and *printed*" material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization. (Emphasis added.) The plain language of the statute dictates that only printed material would be considered "periodicals" for the purpose of the exclusion to the §513(i) safe harbor. Therefore, the Service should not apply the periodicals exclusion to use or acknowledgment of the name or logo of a sponsor on an exempt organization's web page.

II. Providing Links

ASAE believes that the provision of a link from an exempt organization's web site to the sponsoring organization's web site should not be construed as a substantial return benefit. Generally, the treatment of links should be based on the content of the link or any surrounding design. The provision of such a link is very much comparable to listing the organization's web address and telephone numbers on posters, both of which are considered permissible acknowledgments under the Service's proposed regulations. As is the case with the provision of a telephone number or web address, a user who views a link to a sponsoring organization's web site must take affirmative steps to go to that sponsor's web site.

On the other hand, if a link is provided as part of an advertisement (as defined elsewhere in the proposed regulations) appearing on the exempt organization's web site, then all payments in connection with that advertisement, including the link, should be treated as advertising.

In other words, links should be viewed not as a new form of activity, but simply as adjuncts to activities already defined in the tax laws.

III. General Application

In general, ASAE believes that any other, non-Internet activity on the Internet should be treated no differently as other activity. That is, the Service should go through the same analysis for a web-based acknowledgment as it would for an acknowledgment on an event brochure or elsewhere. Thus, organizations should be able to (without fear of removing themselves from the §513(i) safe harbor) display a sponsor's name, logo, and slogan in any size or level of prominence on the Internet, as long as such use or acknowledgment does not contain qualitative descriptions.

F. Conclusion

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ASAE thanks the Service for providing the opportunity to comment on this proposal and looks forward to the Service adopting the changes indicated above. We would, of course, be pleased to assist the Service in any way as it works toward final regulations.