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Frances R. Hill

University of Miami School of Law, fhill@law.miami.edu

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ARTICLES

CORPORATE SPONSORSHIP IN TRANSACTIONAL PERSPECTIVE: GENERAL PRINCIPLES AND SPECIAL CASES IN THE LAW OF TAX EXEMPT ORGANIZATIONS

FRANCES R. HILL*

Exempt organizations depend on financial support from corporate contributors.¹ Many corporations regard charitable contributions as an element of corporate citizenship,² and tax law provides that corporate contributors may deduct their charitable

* Associate Professor, University of Miami School of Law. The author wishes to thank Professor Elliott Manning for his helpful comments. This research was supported by a University of Miami School of Law Summer Research Grant.

1. One source puts 1992 corporate contributions at \$6 billion. ANNE E. KAPLAN (ed.), *GIVING USA: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1992* (1993). John Murawski, *Fund Raising: Trends and Ideas—A Modest Rise in Donations*, *CHRON. OF PHILANTHROPY* 19, 21-22 (June 1, 1995), reports that individual contributions remain greater than corporate contributions, but notes the difficulty of determining the level of corporate giving because of “the continued rise in the number of companies that make donations to charity through their marketing or advertising departments, business expenditures that are not recorded as charitable contributions.” In 1994, the American Association of Fund-Raising Counsel’s Trust for Philanthropy reported that charitable giving rose by 3.6% overall, or only .6% after inflation. Giving by corporations fell by 2% after inflation, but the report observed that corporations are supporting exempt organizations in ways that are not counted as charitable contributions. See Karen W. Arenson, *Charitable Giving Rose 3.6% in 1994, Philanthropy Trust Says*, *N.Y. TIMES*, May 25, 1995, at A22. The American Arts Alliance has reported that, with respect to its 2,600 affiliated organizations, corporate funding provides 8 percent of the total revenue of symphony orchestras and 5 percent of the revenue of dance companies, opera companies, and museums. See American Arts Alliances comments at the July 8, 1993 hearings on the proposed regulations on corporate sponsorship (1993 Hearings)(available electronically at 93 TNT 147-23). The United States Olympic Committee reported that 30 Percent of its budget comes from corporate sponsors. *Id.*

2. Nancy J. Knauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 44 *DEPAUL L. REV.* 1 (1994), reprinted in 11 *EXEMPT ORG. TAX REV.* 1225 (June 1995).

contributions.³ As with individual contributions, corporate contributions may be publicly acknowledged by the exempt recipient. Acknowledgments vary from providing a list of contributors in a concert or theater program to mounting a plaque at the entrance to a special exhibit at a museum to putting a significant contributor's name on a university building or a hospital wing.⁴ These forms of acknowledgement raise little or no contemporary controversy.⁵

Football, television, and corporate contributions proved to be a more controversial mix. The bowl games marking the end of the college football season are operated by tax-exempt educational organizations.⁶ The bowls are financed by a combination of ticket sales, sale of broadcast rights, sale of logo items, royalty payments from licensing the bowl name and logo, concessions sales, licensing of game program sales, and contributions, largely from corpo-

3. I.R.C. § 170. All statutory references are to the Internal Revenue Code of 1986, as amended, 26 U.S.C. §§ 1 et seq. (the "Code" or the "I.R.C.").

4. Rev. Rul. 67-342, 1967-2 C.B. 187 (public broadcasting sponsor acknowledgements that do not mention the sponsor's products or services); Rev. Rul. 77-367, 1977-2 C.B. 192 (contributor's name on a facility). For a more complete discussion of permissible acknowledgements by an exempt organization, see *infra* at text accompanying notes 82-92.

5. There has been controversy over the request made by the Philip Morris Tobacco Company that the beneficiaries of its charitable largesse support its efforts to defeat or restrict a proposed ban on smoking in public places in New York City. Jonathan P. Hicks, *Tobacco Industry Fights New York Over Smoking Bill*, N.Y. TIMES, Sept. 26, 1994, at A1 (varying reactions by charities to requests for lobbying support); Jonathan P. Hicks, *Foes of Ban on Smoking Win Changes*, N.Y. TIMES, Oct. 13, 1994, at B1 (one city council member reports "a lot of pressure on Council members from cultural groups"). A New York Times editorial on October 9, 1994, stated:

Philip Morris has, to its considerable credit, been a lavish and unintrusive supporter of America's cultural institutions for nearly 40 years. Last week, however, it demanded a quid pro quo by asking city art groups it had aided to put in a good word for it with Peter Vallone [sponsor of smoking ban proposal in city council]. Many did, saying that while they were taking no position on the bill they wanted to go on record about Philip Morris's generosity to the city—and, however reluctantly, adding their weight to the tobacco company's.

6. Bowl committees are treated as I.R.C. § 501(c)(3) educational organizations. Tech. Adv. Mem. 78-51-004 (Aug. 21, 1978)(bowl committee affiliated with an intercollegiate athletic conference). Gen. Couns. Mem. 39,775 (Jan. 24, 1989)(bowl committee satisfies requirements of an amateur athletic organization under I.R.C. § 501(j) and thereby qualifies as an I.R.C. § 501(c)(3) organization). Richard L. Kaplan, *Intercollegiate Athletic Organizations and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430 (1980). For an argument that such organizations are properly taxable, see Amy Forsythe, *Implications of the Cotton Bowl Ruling on the Exempt Status of Intercollegiate Athletic Organizations*, 56 TAX NOTES 1475 (Sept. 14, 1992).

rate contributors.⁷ Controversy arose when the bowls began to acknowledge the contribution of the primary corporate contributor, sometimes referred to as the corporate title sponsor, by painting the corporate name, and often the corporate logo, on the playing field and affixing patches bearing the corporate name or logo or both to the players' uniforms. Most bowl games, with the notable exception of the Rose Bowl, now include the corporate sponsor's name in the official name of the bowl.⁸ The Internal Revenue Service (the "Service") took the position that corporate sponsorship payments were unrelated income to the bowl committees, thereby subjecting them to tax on the income and potentially jeopardizing their continued exempt status.⁹

The corporate sponsorship controversy involves significant amounts of money and the tax treatment of these amounts involves potentially significant amounts of tax revenue. The Congressional Research Service estimated that exempt organizations received \$1.1 billion in corporate sponsorship payments, of which \$64 million was paid to college football bowl organizations and the remainder to other sports, arts, music, community and cause-related events.¹⁰ The Joint Committee on Taxation estimated that bills that would not tax corporate sponsorship payments to

7. See Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (John Hancock Sun Bowl ruling) for a discussion of various sources of revenue received by the exempt bowl committee. Tax treatment of these contributions by the bowl committee is the focus of the corporate sponsorship controversy.

8. During the 1994-95 holiday season, the bowls were named the Jeep-Eagle Aloha Bowl, the CompUSA Florida Citrus Bowl, the USF&G Sugar Bowl, the Poulan Weed Eater Independence Bowl, the Outback Steakhouse Gator Bowl, the Raycom Freedom Bowl, the Weiser Lock Copper Bowl, the Thrifty Car Rental Holiday Bowl, the Jimmy Dean St. Jude Liberty Bowl, the Builders Square Alamo Bowl, the FedEx Orange Bowl, the IBM OS² Fiesta Bowl, the Mobil Cotton Bowl, and the Carquest Bowl. Bowls that did not display a corporate name or logo on the field during the 1994-95 bowl season were the Rose Bowl, the Heritage Bowl, the Sun Bowl, the Peach Bowl, and the Hall of Fame Bowl. Mobil has announced that it will no longer sponsor the Mobil Cotton Bowl. See WASH. POST, Apr. 3, 1995 at C.7. See also Richard Alm, *Corporate Carousel; Turnover of Sponsors for Sports Events on the Increase*, Dallas Morning News (May 19, 1995) at B.1. This decision by Mobil Corporation follows from the dissolution of the Southwest Conference, which supplied the host team of the Cotton Bowl. Although based in Virginia, the Mobil Corporation had a close relationship with the schools of the Southwest Conference because of their excellence in sciences and engineering required in petroleum production. Mobil Corporation made a parting gift of \$1 million to the Cotton Bowl Athletic Association.

9. See Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991) (Mobil Cotton Bowl ruling) and Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991)(John Hancock Sun Bowl).

10. Congressional Research Service, *Corporate Title Sponsorship Payments to Nonprofit College Football Bowl Games: Should They Be Taxed* 3 (CRS 92-157 E)(Feb. 11, 1992). Some reports put total corporate sponsorship payments at over \$3 billion per year. M.J. McCarthy, *Keeping Careful Score of Sports Tie-Ins*, WALL ST. J., Apr.

bowl committees would lose \$33 million in tax revenue over five years.¹¹

This issue is also important to the schools of the participating teams, which receive 75 percent of the bowl revenue.¹² The presence or absence of a corporate sponsor can affect the revenue received by the participating schools. For example, the Sun Bowl has announced that it is considering reducing the payments to the participating teams from \$1 million to \$750,000 because of the loss of its corporate sponsor, John Hancock Financial Services, after the 1993 game.¹³

The corporate sponsorship issue does not involve any question of improper deductions by the corporate contributor. If the contributor is treated as having purchased advertising, the amount is currently deductible as an ordinary or necessary trade or business expense.¹⁴ If the amount is treated as a charitable contribution, it is also currently deductible.¹⁵

Similarly, corporate sponsorship does not raise questions of misconduct by the recipient organization. The issues raised by corporate sponsorship are technical income taxation issues relating to whether the corporate sponsorship payment is taxable to

24, 1991 (corporate sponsorship payments of approximately \$3 billion made by some 4,200 corporate sponsors).

11. Joint Committee on Taxation, *Estimated Budget Effects of Conference Agreement to H.R. 11* (JCX-38-92)(Oct. 6, 1992). Because Congress at that time required that every revenue-losing provision be offset by a specifically identified revenue-raising provision, the supporters of the corporate sponsorship provision proposed to tax income received by exempt organizations from affinity credit cards, but this was estimated by the Joint Committee to produce only \$11 million in revenue over the same five years. An earlier revenue estimate in House of Representatives Rep. 102-700, Treatment of Certain Sponsorship Payments, 102d Cong., 2d Sess. (July 1992) projected an \$8 million revenue shortfall, with \$21 million in revenue foregone under the corporate sponsorship provision and \$13 million in revenue raised from taxing exempt organization's income from affinity credit cards. These shifting numbers illustrate the "illusion of precision" discussed by Michael J. Graetz, *Paint-by-Numbers Lawmaking*, 95 COLUM. L. REV. 609, 613 (1995).

12. During the 1991-92 bowl season some 100 schools received more than \$64 million from bowls according to Rep. Ed Jenkins (D-Ga.). See 138 Cong. Rec. H6636-37 (July 27, 1992). Rep. Jenkins sponsored legislation to exempt corporate sponsorship payments from taxation. See *infra* at text accompanying notes 301-14.

13. *Sun Bowl Strapped*, Wash. Post, July 28, 1995, at F5.

14. I.R.C. § 162(a). Efforts in the past to require advertising costs to be capitalized on grounds that advertising created an intangible asset that extended over more than one taxable year have never prevailed and I.R.C. § 197 makes no reference to intangibles created by advertising.

15. I.R.C. § 170(b)(2) limits a corporation's annual charitable contribution deduction to 10 percent of its taxable income as adjusted, but I.R.C. § 170(d)(2)(A) provides for a five-year carryover period for deduction of charitable contributions in excess of the annual limit.

the recipient organization as income from the sale of advertising and whether, in particular cases, the size of the corporate sponsorship payment as a share of the organization's total receipts might jeopardize its continued exempt status.¹⁶

This article analyzes these issues through a transactional model of exempt organization operations. This model identifies three core transactions that together provide a model of exempt organization operations. These three core transaction are the charitable contribution transaction, the exempt function transaction, and the unrelated business income transaction. The article then analyzes corporate sponsorship transactions in terms of this model and in light of the law applicable to these three transactions. Having concluded that corporate sponsorship fits most closely the unrelated business income transaction, the article examines the efforts made by the Service to find a basis in law for not including corporate sponsorship payments in unrelated business income and the legislative and administrative lobbying efforts mounted by certain exempt organizations and several leading practitioners not only to protect corporate sponsorship payments from inclusion in unrelated business income but also to lay the foundation for even more fundamental changes in the unrelated business income tax. Yet, what appeared to have been a stunning victory has become policy paralysis, largely due to the subsequent enactment of new statutory provisions that did not deal directly with corporate sponsorship. The article explores the concept of statutory dissonance and its implications for efforts to sustain the Service's current position on corporate sponsorship. The article suggests that the Service cannot maintain this position without undermining the existing statutory structure of the unrelated business income tax. The article concludes that excluding corporate sponsorship payment from unrelated business income through a narrowly-focused legislative provision would more effectively avoid these broader consequences of statutory dissonance than would reaching the same result through a regulatory exclusion.

16. The larger tax issues are whether corporate sponsorship involves subsidies in the form of the charitable contribution deduction and the organization's exemption and the distributional consequences of any subsidies. A subsidy analysis is beyond the scope of this article. There has been relatively little attention to the exemption as a subsidy. Slightly more attention has been devoted to the charitable contribution deduction in the context of general considerations of the problems involved in defining income for federal income tax purposes. See, e.g., Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?* 28 TAX L. REV. 37 (1972).

I. A TRANSACTIONAL MODEL OF EXEMPT ORGANIZATION OPERATIONS

Contemporary exempt organizations engage in a broad range of activities beyond simply accepting contributions which they transfer to the needy. While exempt organizations vary in the scope and complexity of their operations, few exempt organizations fit the operational stereotype of charities of a bygone era.¹⁷ Corporate sponsorship arrangements typify these contemporary realities.

The controversy over corporate sponsorship has become so intense in part because there is no theory of exempt organization operations that provides guidance in understanding the transaction by putting the corporate sponsorship transaction in a larger context of exempt organization operations. Theories of exempt organizations have focused on the purpose of the exemption, not on the operation of organizations that have been granted exempt status.¹⁸ While this question is important, focus on purpose apart from operation obscures understanding of the broad range of transactions that characterize exempt organizations operations and which may or may not be consistent with achieving an organization's exempt purposes. Purpose-based theories focus on delineating the boundaries of exempt organizations in terms of those distinctive goals that are thought to be consistent with exempt status. A transactional theory ultimately finds the basis for exempt status in the operation of the organizations by looking not only at how an organization uses its revenue but also at how it derives its funding and what activities it undertakes. Analysis of such transactions directs attention to exempt organizations' interactions with a broad range of exempt and non-exempt entities as well as with individuals, and such interactions shape exempt

17. FRANCES R. HILL and BARBARA L. KIRSCHTEN, *FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS* ¶ 1.01 (1994) (hereinafter, "Hill and Kirschten") discusses the "new entrepreneurialism" of exempt organizations.

18. See generally, Robert Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501 (1990); Boris I. Bittker and George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299 (1967)(exemption as a means of dealing with problems of defining income of exempt organizations); John D. Colombo, *Why Is Harvard Tax-Exempt? And Other Mysteries of Tax Exemption for Private Educational Institutions*, 35 ARIZ. L. REV. 841 (1993); Mark A. Hall and John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO STATE L.J. 1379 (1991); Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835 (1980); Henry B. Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54 (1981).

organizations.¹⁹ A transactional theory of the reasons for exemption would derive from interactions among the organization, its sources of income, and the beneficiaries of its activities and would treat exempt organizations as complex systems that engage simultaneously and appropriately in several types of transactions. Developing a fully-specified transactional theory of exemption is beyond the scope of the present article.

For purposes of understanding corporate sponsorship in the context of current law, the article develops a transactional model of the three core transactions of exempt organizations—the charitable contributions transaction, the exempt function transaction, and the unrelated business transaction. Each of these transactions is defined in terms of the interactions of a transferor, the recipient organization, and beneficiaries of the organization's use of the transferred amounts.

A charitable contribution transaction involves a transfer by the contributor with the intent to support the organization's exempt activities and without the expectation of any return. The organization accepts the contribution for use in the fulfillment of its exempt purposes.²⁰ The gratification that a contributor may feel from having used his or her resources for a purpose he or she finds important is not the type of benefit that creates a taxable intangible benefit that can be valued. The organization provides the contributor primarily this satisfaction, perhaps with a public acknowledgement of the contribution. In general, the exempt

19. For examples of theories that see interaction as fundamental to the understanding of social organizations, see, MARCEL MAUSS, *THE GIFT: FORMS AND FUNCTIONS OF EXCHANGE IN ARCHAIC SOCIETIES* (Norton ed. 1955); GEORGE SIMMEL, *CONFLICT AND THE WEB OF GROUP AFFILIATIONS* (R. Bendix trans. 1955) and *THE SOCIOLOGY OF GEORGE SIMMEL* (K. Wolff ed. 1950). Clifford Geertz studies meaning in terms of socio-cultural interactions between aspects of selves and the panoply of socio-cultural structures that such "selves" encounter and then looks to the selves so created to understand organizations, cultures, societies. See, e.g., CLIFFORD GEERTZ, *LOCAL KNOWLEDGE: FURTHER ESSAYS IN INTERPRETIVE ANTHROPOLOGY* (1983), which contains Geertz 1981 Storrs Lectures at the Yale Law School, entitled "Local Knowledge: Fact and Law in Comparative Perspective."

20. In practice, any effort to trace the use of contributions encounters the fungibility of money. One of the critiques of the unrelated business income tax is that exempt organizations can use deductible contributions as venture capital in taxable enterprises. The limitation on the scope of unrelated business activities represents an effort to address this problem by revoking an organization's exempt status. Another example is the use of deductible contributions to fund political activities. A third example is the use of deductible contributions to fund lobbying activities. The Omnibus Budget Reconciliation Act of 1993 ("OBRA '93") addressed this problem by amending I.R.C. § 162(e) to deny corporate contributors deductions for lobbying expenses.

organization retains discretion in how to use the amount contributed in pursuit of its exempt purposes but it does not exercise any discretion to determine whether a charitable contribution will be used for such purposes.²¹ The charitable contribution thus involves no element of an exchange and instead involves cooperation between the contributor and the recipient organization to fulfill the exempt organization's exempt purpose.²² The beneficiaries are third parties who receive services from the exempt organization in the broad sense. The contributor is not in the class of charitable beneficiaries.

The exempt function transaction involves the payment of a fee for a product or service that the organization has been granted exemption to provide.²³ The payor in this transaction makes the payment with the specific intent of receiving a particular return benefit. The exempt organization does not have any discretion as to whether it will provide the agreed-upon goods or services. The organization's obligation is very specific in this transaction. It has agreed to provide a specific service at an agreed upon price to a specific beneficiary. The organization does not acknowledge this type of payment. The service provided by the organization is the type of service that supports the organization's exempt purpose. The direct exchange between the organization and the payor is consistent with the organization's exempt purpose. The payor is not making a contribution to an organization for that organization's use in providing benefits to third parties. Instead, the payor has made a payment for a specific benefit to himself or herself. The unique feature here is that the payor is also a member of the class of beneficiaries that the organization has been granted exemption to serve. Payment of tuition by students at an exempt educational institution illustrates an exempt function transaction.

21. See the discussion of I.R.C. § 170 *infra* at Part III (A). A charitable contribution will be deductible under this section only if it is both made to a qualifying organization and made for a qualifying purpose. Thus, the structure of I.R.C. § 170 underscores the recipient organization's lack of ultimate discretion over whether to use the contribution for a qualifying purpose.

22. In fact, of course, exchanges involve elements of cooperation. For purposes of specifying a model, however, attention focuses on the relative significance of a factor rather than on its empirical incidence.

23. Reference to an exempt function transaction or exempt function income here is distinguished from the meaning given to exempt function income under I.R.C. § 512(a)(3)(B) with respect to a special rule applicable to social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts, or group legal services plans.

The unrelated business transaction involves a payment for goods or services, the provision of which is not substantially related to the organization's exempt purpose. The payor has bargained for a specific item in exchange for the payment. The organization has no discretion in providing the goods or services purchased because, it, too, has agreed to a specific exchange. There is no third party beneficiary in this transaction. The payor and the organization have agreed to an exchange that benefits them directly, but neither has any intention of benefitting one or more third parties. The payor here does not have the dual character as a payor for a specific benefit and a member of a charitable class with respect to the organization. The payor stands solely in a relationship of a purchaser with respect to the exempt organization.

The features of these three core transactions can be put into sharper relief by a series of pairwise comparisons among them. The starkest contrast is between a charitable contribution transaction and an unrelated trade or business transaction. The charitable contribution transaction is a three-party transaction that both the contributor and the organization intend will directly benefit the charitable class that the exempt organization was established to benefit. Both the contribution and the use of the contribution are directed to the exempt purpose of the organization. The unrelated business transaction is directed solely to the interests of the two parties, neither of which is acting with reference to the purpose that is the basis of the organization's exempt status. The unrelated business income transaction is indistinguishable from a commercial, two-party transaction between a purchaser and a taxable seller.

The distinction between the charitable contribution and the exempt function transaction is less stark. While the organization operates to fulfill its exempt purpose in providing the goods or services in question, the payor is not making a contribution but is instead making a payment for the personal receipt of such goods or services. In this sense, the transaction involves no charitable beneficiary and is, like the unrelated business income transaction, indistinguishable from the ordinary commercial transaction. In another sense, however, the exempt function transaction involves a benefit of a type consistent with the organization's exempt purpose and thereby makes the fee-paying recipient a member of the charitable class that the organization was granted exemption to serve.

The comparison of the exempt function transaction and the unrelated business transaction also highlights elements of commonality. The exempt function transaction as a hybrid transaction shares with the unrelated business transaction the element of a direct exchange of a payment to the organization in exchange for a benefit provided directly to the payor. The difference arises from the organization's not acting in fulfillment of its exempt purpose in the unrelated business transaction. The commonality is the payor's bargain for a direct benefit through a direct quid pro quo exchange. The benefit is not consistent with the organization's exempt purpose in the unrelated business transaction, while it is consistent with the organization's exempt purpose in the exempt function transaction.

These three core transactions provide a framework for analyzing corporate sponsorship transactions in the context of the law of exempt organizations.

II. CORPORATE SPONSORSHIP TRANSACTIONS

While actual corporate sponsorship arrangements vary, it is useful to begin by identifying common significant elements presented by the agreements relating to sponsorship of the college football bowl games.²⁴ The reason for focusing on these agreements is that they have been the center of the current controversy and the current proposed regulations have been drafted with them as the model. These core elements of corporation sponsorship transactions can then be analyzed both in terms of the three transactions that define the model of exempt organization activity and in terms of the law applicable to charitable contributions and unrelated business income. As the following analysis reveals, the common corporate sponsorship transaction shares more elements with the unrelated business income transaction than with either the charitable contribution transaction or with the exempt function transaction. In addition, the corporate sponsorship transaction does not satisfy the requirements for a deductible charitable contribution but instead satisfies the elements of the statutory definition of unrelated business income.

Corporate sponsorship payments are made pursuant to detailed contracts between the exempt recipient and the corporate payor. The corporate payor agrees to pay the exempt recipient the amount provided in the contract. The amount of the payment may

24. Tech. Adv. Mem. 91-47-007 (Dec. 2, 1991) (Mobil Cotton Bowl ruling); Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (John Hancock Sun Bowl ruling).

be fixed or contingent, paid in a lump sum or over time. The exempt recipient agrees to present the event, whether concert or performance or game identified in the agreement and to recognize in the manner provided in the contract the support provided by the contributor.

The more controversial aspects of these corporate sponsorship agreements are the obligations of the recipient exempt organizations. In the case of the bowl games, the bowl committee may agree to change its name to include that of the corporate sponsor and to redesign its logo (or permit the corporate sponsor to redesign the bowl game logo) to incorporate the corporate sponsor's logo. The corporate sponsor's name or logo or both are prominently displayed on the playing field and generally on the players as well. In addition, the bowl committee agrees to ensure that television coverage of the game displays the portion of the field showing the logo for a specified amount of time. For example, in one bowl game, television viewers saw the corporate sponsor's name and logo approximately sixty times and heard the sponsor's name approximately fifty times.²⁵ Broadcast graphics may also display the corporate name or logo as incorporated in the bowl name and logo, and some agreements give the corporate sponsor a veto over the broadcast organization providing the television and radio coverage.²⁶ In addition, the corporate sponsor may agree to purchase a stated amount of advertising time during the game broadcast.²⁷ The bowl committee may offer tickets to executives of the corporate sponsor and may arrange special social events for the sponsor's employees and guests. At least one bowl in the 1994-95 bowl season featured an appearance by the corporate sponsor's chief executive riding in a convertible during the half-time show in a parade that also featured a convertible-borne bowl queen and her court.²⁸ The chief executive (but not the bowl queen) was interviewed by the on-field sports analyst. The sponsor's products may be available exclusively at the event. A corporate sponsor may be the exclusive sponsor or displays of other corporate supports may be displayed less prominently, for example, on the scoreboard or along the sidelines rather than on the field.

25. Tech. Adv. Mem. 92-31-001 (Oct. 22, 1991) (referring to names and logos on football fields as "well-positioned visual images").

26. *Id.*

27. *Id.*, citing Randall Rothenberg, *More Caution by Sponsors After Shoal Creek Furor*, N. Y. TIMES, Aug. 10, 1990, at A17 (to the effect that a corporate sponsor will commonly buy one quarter to one third of the advertising time).

28. The IBM OS² Fiesta Bowl of January 2, 1995.

Corporate sponsors may acquire broad influence over the event itself. The recent decision to move the FedEx Orange Bowl from the Orange Bowl to Joe Robbie Stadium beginning with the New Year's Day 1997 game is a case in point.²⁹ FedEx, the title sponsor, paid \$26 million for title sponsorship over six years. This substantial corporate sponsorship payment is second only to the \$82 million paid by CBS for the right to broadcast the game for six years. The Orange Bowl is one of the three games in a new national championship system that will feature the number one and number two ranked teams in one of the three games each year on a rotating basis.³⁰ To win a spot in this rotation, the Orange Bowl had to agree to move to the newer stadium in the suburbs.³¹ The FedEx manager of sports and event marketing, Nancy Alternburg, stated that if the Orange Bowl had not won a spot in the new national championship rotation, "it would have affected our deal—there's no doubt."³²

These features associated with corporate sponsorship of college football bowl games are found in other sponsorship arrangements as well. For example, a local soft drink bottling company agreed to sponsor an arts and crafts fair in return for the exclusive right to display a banner at the event and to sell its brand of soft drink and allied products exclusively at the concession stands.³³ Several universities have entered arrangements with soft drink companies to give that company the exclusive right to sell their product on campus in exchange for a sizable payment.³⁴ Georgia

29. *Orange Bowl Stadium Sees Glory Slipping Away*, N. Y. TIMES, Jan. 1, 1995, at A36.

30. *Id.* This new system is being run by the newly-created Bowl Alliance, which will reportedly receive approximately \$100 million over six years from corporate sponsors and broadcast rights.

31. According to *The New York Times* (January 1, 1995): "Mr. Williamson, the Orange Bowl Committee's president, said the college representatives had made it clear that if the game was not moved to a modern stadium, 'we'd be out of the running.'" Four cities were competing for the three spots in the national championship bowl rotation.

32. *Id.*, which also quotes the CBS vice president for sports programming as saying that the payment for broadcast rights had also depended on the Orange Bowl's selection for the Bowl Alliance's national championship rotation.

33. Tech. Adv. Mem. 92-17-001 (Sept. 30, 1991). The Service ruled that the payment was not unrelated business income to the recipient organization because the fair was a qualified public entertainment activity under I.R.C. § 513(d)(2)(C). See *infra* at text accompanying notes 222-23.

34. For a discussion of these developments, see Paul Streckfus, *Georgia Tech Takes Corporate Sponsorship to a New Level*, 66 TAX NOTES 1061 (February 13, 1995). See also, Roger Thurow, *Shoe Companies, Tongues Out, Buy Up College Teams Wholesale*, Wall St. J., Nov. 17, 1995 at B9.

Tech has agreed to paint the Golden Arches of McDonalds at the center of its basketball court, to include "McDonalds" in the name of its entire athletic complex, and to give McDonalds an exclusive franchise on campus.³⁵ A more innovative approach was taken by Chrysler, which made a payment to a museum in exchange for the right to park one of its current vehicles in the museum.³⁶ A Chrysler spokesman is quoted as saying that "What we want is our cars exposed to the right type of people."³⁷

The specificity of the obligations of the bowl committee gives at least the initial appearance of an exchange. The ultimate question is whether the corporate sponsor would have given the same amount of money or any money at all in the absence of some or all of these conditions. Statements from some corporate sponsors support the exchange characterization of the corporate sponsorship transaction.³⁸ For example, an executive of John Hancock Financial Services estimated that the company received advertising worth \$5.2 million from its \$1.1 million payment to the Sun Bowl Committee.³⁹ Similarly, a Harvard Business School study, which appears to have been based on the agreement between John Hancock Financial Services and the Sun Bowl concluded that the company received a significant benefit.⁴⁰ Fundraisers also emphasize the importance of providing some return benefit to potential corporate contributors. A hospital development director estimated that only 10 percent of corporate contributors expect no quid pro quo and that 10 percent do not give at all.⁴¹ Of the remaining 80 percent, this development director remarked:

35. *Id.* McDonald's famous logo will also appear on all tickets and game programs and McDonald's will have the exclusive right to operate concessions at the university's coliseum.

36. WALL ST. J., Nov. 26, 1993 at B12.

37. *Id.*, which indicates that "the yuppie demographic" constituted "the right type of people" for this purpose.

38. See Nathan Wirschafer, *Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Game*, 27 LOY. L.A. L. REV. 1465 (1994), reprinted in 64 TAX NOTES 1455 (Sept. 12, 1994).

39. Congressional Research Service, *supra* note 10, at 7.

40. This case study was widely read within the Service, and its impact on the Service's initial position that the corporate sponsorship payment was taxable to the organization as unrelated business income from the sale of advertising has been described as "pivotal." See remarks of Beth Purcell, Office of Chief Counsel (EP/EO) to the American Bar Association Exempt Organizations Committee, reprinted in 6 EXEMPT ORG. TAX REV. 388, 391-92 (Aug. 1992).

41. Comment by John Hyde of the Dallas Methodist Hospitals Foundation on the Service's proposed audit guidelines (available electronically at 92 TNT 110-68)(all electronic citations are to the Tax Notes Today file of the Federal Tax library on Lexis).

Their employees and directors regularly remind one another of their fiduciary responsibilities to the corporation and its owners. Volunteers and employees of non-profit organizations must persuade the corporation's employees and directors that supporting their organizations is in the corporation's best interest. Their strongest means of persuasion exist in providing positive exposure for the corporation. Generally speaking, marketing, advertising, and public affairs departments have the largest budgets for corporate sponsorships and contributions. When a marketing staff person receives little justification (little or no promotion or exposure) the answer to a charitable request is no. More active enforcement of more restrictive guidelines will not cause such corporations to be more altruistic and philanthropic in their giving. These corporations will only channel their sponsorship dollars into non-charitable corporate promotional programs.⁴² In the same vein, the Coconut Grove Arts Festival commented that

The proposed guidelines reflect a remarkable naivete about the relationship between corporate donors and tax exempt events. For profit corporations do not part with their earnings easily. Although most tax exempt events do not provide their sponsors with benefits the value of which can be measured dollar for dollar to be commensurate with the amount of the contribution, corporate sponsors expect to obtain some real value for their contributions. Indeed, the sort of completely disinterested corporate generosity apparently assumed by the proposed guidelines rarely, if ever, exists.⁴³

The festival organizers told the Service that they acknowledge their corporate sponsor's contributions in several ways, depending on the amount of the contribution.⁴⁴ For example, a corporate sponsor might receive one or more booths at which to display products, it might be given an exclusive right to display a particular type of product, a corporate sponsor's name and logo might appear in festival advertising, including print advertisements, radio or television advertisements, and street banners, special parking permits and invitations to special social events during the festival, or a full-page advertisement in the festival souvenir program.⁴⁵ The Toledo Zoo also stated that, although corporate sponsorship of events accounted for less than 1 percent of their gross revenue in

42. *Id.*

43. Comment of the Coconut Grove Arts Festival on the proposed audit guidelines (available electronically at 92 TNT 116-67).

44. *Id.*

45. *Id.*

1991, “[w]e do offer exposure of a sponsor’s name and logo and have, in some instances, linked the amount of payment to the amount of the exposure.”⁴⁶ The Miami Festival Association told the Service that “corporations must be able to justify their investment in non-direct business related activities in terms of obtaining some real value for their contributions.”⁴⁷ The American Association of Museums stated that it provides special events for the employees of institutional supporters as a way of “bringing the sponsor into additional contact with the museum.”⁴⁸

These statements are, of course, not definitive, and the statements of one corporate sponsor do not address the intent of any other corporate sponsor. Nevertheless, they raise at least a threshold question of whether the corporate sponsorship transaction involves the kind of quid pro quo characteristic of an unrelated business transaction but not of a charitable contribution transaction or an exempt function transaction.⁴⁹ The next three sections of the article address this question by analyzing corporate sponsorship in terms of the tax law requirements applicable to each of the three core transactions of the transactional model of exempt organization operations.

III. CHARITABLE CONTRIBUTION TRANSACTIONS

In order to treat the corporate sponsorship transaction as a charitable contribution transaction, the corporate sponsor must act with the intent to benefit the organization’s charitable class and the organization must provide benefits to the charitable class

46. Comment by the Toledo Zoo on the proposed audit guidelines (available electronically at 92 TNT 110-76).

47. Comment of the Miami Festivals Association on the proposed audit guidelines (available electronically at 92 TNT 140-50).

48. Comment of the American Association of Museums on proposed audit guidelines (available electronically at 92 TNT 163-74). The comment suggested that these perquisites should be distinguished from the “luxuries and perquisites which are far removed from the tax-exempt purpose of the donee institution” like chauffeur-driven limousines and hospitality suites at bowl games but did not offer a rationale for the distinction.

49. For a study of diverse social structures in terms of the nature of the nature of exchange transactions characteristics of the various types, see MARCEL MAUSS, *THE GIFT: FORMS AND FUNCTIONS OF EXCHANGE IN ARCHAIC SOCIETIES*. Mauss writes of his approach:

We intend in this book to isolate one important set of phenomena: namely, prestations which are in theory voluntary, disinterested and spontaneous, but are in fact obligatory and interested. The form usually taken is that of a gift generously offered; but the accompanying behavior is formal pretence and social deception, while the transaction itself is based on obligations and economic self-interest.

and not to the corporate sponsor. There can be no quid pro quo benefit to the contributor. Thus, the recipient organization may acknowledge the contribution but may not provide the contributor anything of value.⁵⁰

A. Contributions and Gifts

Section 170(a) provides that a "charitable contribution" is deductible for the taxable year in which it is made.⁵¹ Section 170(c) defines a charitable contribution as "a contribution or gift" to an eligible recipient organization.⁵² The legislative history does not indicate why the statute refers to both contributions and gifts, but courts have looked to the leading cases on gift treatment in determining whether a particular transfer qualifies as a charitable contribution.⁵³

The Supreme Court has defined a gift for purposes of section 102 as a transfer motivated by "detached and disinterested generosity."⁵⁴ In this case, Duberstein received a new Cadillac from an acquaintance to whom Duberstein had referred potential customers.⁵⁵ The Court held that Duberstein must include the value of the Cadillac in his gross income because it was not an excludable gift and no other exclusion applied. The Court held that "the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift."⁵⁶ Instead, the Court looked to the transferor's intent as determined by "an objective inquiry."⁵⁷ The Court rejected any test based on presumptions about human behavior and held instead that decisions "must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts

50. See *infra* at text accompanying notes 82-92 for a discussion of the acknowledgement of charitable contributions.

51. I.R.C. § 170(b) provides certain limitations on deductions by both individuals and corporations, but I.R.C. § 170(d) provides that excess charitable contributions may be carried forward for five succeeding taxable years.

52. I.R.C. § 170(c)(1)-(5) lists eligible recipient organizations.

53. See, e.g., *Hernandez v. Commissioner*, 490 U.S. 680, 687 (1989); *DeJong v. Commissioner*, 36 T.C. 896, 899 (1961), *aff'd*, 309 F. 2d 373 (9th Cir. 1962). Commentators have also taken the position that the law applicable to gifts applies to charitable contributions. See James W. Colliton, *The Meaning of "Contribution or Gift" for Charitable Contribution Deduction Purposes*, 41 OHIO ST. L.J. 973 (1980).

54. *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), (quoting *Commissioner v. LoBue*, 351 U.S. 243, 246 (1956)(stock options from employer not gift to employee)).

55. *Id.* at 281-82.

56. *Id.* at 285.

57. *Id.* at 286.

of each case.”⁵⁸ With respect to Duberstein’s Cadillac, the Court held that “despite the characterization of the transfer of the Cadillac by the parties and the absence of any obligation, even of a moral nature, to make it, it was at bottom a recompense for Duberstein’s past services, or an inducement for him to be of further service in the future.”⁵⁹ The Court thus took a transactional approach to the determination of whether an amount is properly treated as a gift by a recipient.

Section 170 looks at a “gift or contribution” from the perspective of the deductibility by the payor, not inclusion by the recipient. However, the same transactional approach provides the conceptual basis for section 170. The legislative history provides that a transaction in which the payor receives something of value does not qualify as a charitable contribution deductible by the payor.⁶⁰ Consistent with this legislative history, the Supreme Court has held that “[t]he sine qua non of a charitable contribution is a transfer of money or property without adequate consideration.”⁶¹ The Court also held that a charitable contribution must be made intentionally, stating that “[t]he taxpayer must, therefore, at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return.”⁶² The failure to demonstrate such a conscious intent formed the basis of the Court’s holding that the taxpayer had not made a charitable contribution.

The Supreme Court applied a transactional analysis in denying charitable contribution deductions for amount paid to the Church of Scientology for “auditing” sessions with a church auditor.⁶³ The church published a price list and never offered dis-

58. *Id.* at 289.

59. *Id.* at 291-92.

60. The legislative history states that “[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return.” S. REP. NO. 1622, 83d Cong., 2d Sess. 196 (1954); H.R. REP. NO. 1337, 83d Cong., 2d Sess. A44 (1954). The same legislative history defines a gift as a payment “made with no expectation of a financial return commensurate with the amount of the gift.” *Id.* The legislative history provides an example of a payment to a hospital and states that such payment would be deductible “only if there were no expectation of any *quid pro quo* from the hospital.” *Id.*

61. *American Bar Endowment v. United States*, 477 U.S. 105, 118 (1986).

62. *Id.*

63. *Hernandez v. Commissioner*, 490 U.S. 680 (1989), *aff’g*. *Graham v. Commissioner*, 822 F. 2d 844 (9th Cir. 1987); *Allen v. United States*, 541 F. 2d 786 (9th Cir. 1976); *Stubbs v. United States*, 428 F. 2d 885 (9th Cir. 1970).

counts or free auditing sessions.⁶⁴ Fees from auditing sessions were the church's main source of income.⁶⁵ The Court held that the auditing session constituted payment for a service, and that this quid pro quo was inconsistent with deduction of the fee as a charitable contribution.⁶⁶ In so holding, the Court looked to the transferor's intent in making the transfer as evidenced by "the external features of the transaction in question."⁶⁷ The Court set forth its transactional analysis as follows:

As the Tax Court found, these payments were part of a quintessential quid pro quo exchange: in return for their money, petitioners received an identifiable benefit, namely, auditing and training sessions. The Church established fixed price schedules for auditing and training sessions in each branch church; it calibrated particular prices to auditing or training sessions of particular lengths and levels of sophistication; it returned a refund if auditing and training services went unperformed; it distributed "account cards" on which persons who had paid money to the Church could monitor what prepaid services they had not yet claimed; and it categorically barred provision of auditing or training sessions for free. Each of these practices reveals the inherently reciprocal nature of the exchange.⁶⁸

In her dissent, Justice O'Connor took the position that the person who paid for auditing did receive something of value but that the value was a Constitutionally protected religious value to which the Service had historically not applied a quid pro quo analysis.⁶⁹ The dissent thus accepted a transactional analysis as the basic framework for determining whether a transfer qualified as a deductible charitable contribution.

The transactional analysis of charitable contributions has also been applied to cases in which part of the transferred amount is exchanged for something of value and the excess amount quali-

64. Such mandatory fixed charges are based on the "doctrine of exchange," which requires that a person give something back whenever he or she has received something. 490 U.S. at 685.

65. *Id.*

66. *Id.* at 688.

67. *Id.* at 690-91.

68. *Id.* at 691-92.

69. *Id.* at 704-13. I.R.C. § 6115, which was added to the Code in 1993, excludes from the definition of a *quid pro quo* contribution "any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context." I.R.C. §6115(b).

fies as a deductible charitable contribution.⁷⁰ This issue has arisen most commonly in the context of fundraising events such as performances or auctions when the payment amount exceeds the value of the ticket or the item purchased. In this case, the Service has long taken the position that only the excess amount is properly deductible as a charitable contribution.⁷¹

A special application of the general principles of partial gifts occurred with respect to payments made to athletic scholarship programs when the payment gave the payor the right to purchase season tickets for desirable seats. The development of this charitable contributions issue parallels the development of the corporate sponsorship issue. The Service initially ruled that the entire payment was nondeductible because it was a payment for a valuable right, the right to purchase desirable seats at their regular price.⁷² No tickets in the preferred area between the forty yard lines were available to persons who did not make a payment to the athletic scholarship program. There was a waiting list for the right to make the payment and then to purchase the preferred seats. The Service ruled that no part of the payment to the scholarship program was deductible as a charitable contribution because the payor had received a substantial benefit.⁷³

Rev. Rul. 84-132 was issued in July 1984 and was "suspended" in October 1984 in the face of substantial opposition.⁷⁴ The suspension was effective pending a "public session on the implications of Rev. Rul. 84-132 upon the varied athletic scholarship programs in existence throughout the country."⁷⁵ The Ser-

70. Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Proc. 90-12, 1990-1 C.B. 471; Rev. Rul. 68-432, 1968-2 C.B. 104; *Murphy v. Commissioner*, 54 T.C. 249 (1970)(fee paid to exempt adoption agency in connection with adoption of a child not a deductible charitable contribution).

71. Rev. Rul. 67-246, 1967-2 C.B. 104.

72. Rev. Rul. 84-132, 1984-2 C.B. 55. This ruling did not deal with the regular price of the ticket since this is nondeductible by the payor as an exempt function payment, discussed *infra* at Part IV.

73. *Id.* The Service reasoned that

the taxpayer here can purchase a season ticket between the 40 yard lines only by contributing \$300 to the athletic scholarship fund. The fact that there is a waiting list for membership in the program further indicates that this preferred seating has significant value. In view of this, the value of the benefit received as a result of the payment is considered to be commensurate with the amount of the payment made, and therefore no part of the payment constitutes a gift.

The ruling relied on Rev. Rul. 67-246, 1967-2 C.B. 104.

74. The suspension was first announced in New Release IR-84-111 (October 19, 1984), which was followed by Ann. 84-101, 1984-45 I.R.B. 21 (November 5, 1984).

75. Ann. 84-101, 1984-45 I.R.B. 21.

vice also stated that "the suspension has no effect on existing law."⁷⁶ The Service said of the suspension:

The IRS has a longstanding position that where consideration, in the form of admissions or other privileges or benefits, is received in connection with payments by patrons of fundraising affairs, the presumption is that no gift has been made for charitable contribution purposes. The burden is on the taxpayer to establish that the amount paid is not the purchase price of the privileges or benefits and that part of the payment, in fact, does qualify as a gift.⁷⁷

In April 1986 the Service issued Rev. Rul. 86-63, which "clarified, distinguished, and superseded" Rev. Rul. 84-132.⁷⁸ The revised ruling still rested on the substantial benefit test but more clearly illustrated the facts and circumstances nature of the determination of the existence of a substantial benefit. In this ruling a substantial benefit exists only when the preferred seats would not have been readily available without making the payment to the athletic scholarship program. However, a payment in excess of the required payment to the athletic scholarship program would be deductible to the extent it exceeded the amount required to gain the right to purchase the preferred seats. If, however, seats in the same section would have been readily available to persons not making any payment to the athletic scholarship program, the entire payment would be a deductible charitable contribution. The ruling also advised the organization receiving the payment to notify participants in the program what part, if any, of the payment might be deductible.⁷⁹

Not satisfied with this result, Congress amended Section 170 by adding Section 170(l), which removed the issue from an analysis based on the general principles of Section 170. Under Section 170(l) 80 percent of a payment to a college or university is deductible if "such amount would be allowable as a deduction under this section but for the fact that the taxpayer receives (directly or indirectly) as a result of paying such amount the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution."⁸⁰ Amounts paid for tickets do not qualify for

76. *Id.*

77. *Id.*

78. Rev. Rul. 86-63, 1986-1 C.B. 88.

79. The Service provided guidance to organizations providing such notice in Rev. Proc. 90-12, 1990-1 C.B. 471.

80. I.R.C. § 170(l)(2)(B).

this special treatment.⁸¹ Section 170(l) provides one instance of resolving an issue legislatively by enacting a special rule that is inconsistent with the general principles of the statute.

B. Acknowledgement by the Recipient Organization

An acknowledgment remains the accepted and acceptable organizational response to receipt of a deductible charitable contribution. The question, of course, is what constitutes an acknowledgement. Current law deals with this issue in the context of the unrelated business income tax,⁸² the determination of whether an organization is a public charity or a private foundation,⁸³ and the self-dealing rules applicable to private foundations.⁸⁴ In each of these areas the issue is whether the recipient organization has provided to the payor something of sufficient value to constitute a quid pro quo.

An acknowledgement is not itself valuable. The most common acknowledgement is a public statement that an individual or corporation provided support.⁸⁵ Variations on this public statement have also been treated as acknowledgements. For example,

81. I.R.C. § 170(l)(2).

82. The unrelated business income tax issue is whether the exempt organization is acknowledging a contribution or selling advertising. See *infra* at Part V(A)(4) for a discussion of advertising.

83. I.R.C. § 509 provides tests for determining whether the organization is publicly supported, and thus, whether it qualifies as a public charity that is not subject to the special rules applicable to private foundations. One test of public charity status is whether at least one third of the organization's total receipts come in the form of gifts or contributions. I.R.C. § 509(a)(2)(A)(i). Treas. Reg. § 1.509(a)-3(f)(1) provides that a gift or contribution has the same meaning for purposes of this provision as it does for purposes of I.R.C. § 170 and states that "any payment of money or transfer of property without adequate consideration shall be considered a 'gift' or 'contribution.'" Treas. Reg. § 1.509(a)-3(f)(3) provides an example of local businesspersons who provide cash or merchandise for prizes awarded at the annual fair to members of a young farmers' organization who win prizes. The name of the businessperson supplying the prize is generally announced publicly when the prize is awarded. The amounts donated will be treated as contributions because, under the facts of this example, "[t]he recognition given to donors is merely incidental to the making of the award to worthy youngsters." *Id.*

84. I.R.C. § 4941(d)(1)(E) provides that a benefit provided by a private foundation to a disqualified persons constitutes impermissible self-dealing. Treas. Reg. § 53.4941(d)-2(f)(2) provides that public recognition of the contributions of a substantial contributor, who is included among disqualified persons for purposes of the self-dealing rules, will ordinarily not constitute self-dealing because the benefit is ordinarily incidental or tenuous. Treas. Reg. § 53.4941(d)-2(f)(4), Example (4) states that naming a recreation center in honor of the person who donated the land for it does not constitute self-dealing because the benefit is incidental or tenuous.

85. For example, in Priv. Ltr. Rul. 94-31-029 (May 9, 1994) the Service ruled that issuing a press release about a lunch for scholarship recipients that mentioned

the Service has ruled that naming a building after a contributor or including the contributor's name in the name of an event are acknowledgements.⁸⁶ Of course, these rulings are based on factual determinations that under the facts of the particular case, these acknowledgements did not convey any value to the contributor. The test is not based on a search for essential attributes of an acknowledgement but on the presence or absence of a quid pro quo.

In one of the more controversial rulings on acknowledgements, the Service took the position that naming a replica of a historic village after the corporate sponsor and permitting the corporation to refer to the village in its own advertising constituted a mere acknowledgment.⁸⁷ The Service reasoned that

Although the corporation benefits by having the village named after it, by having its name associated with the village in conjunction with its own advertising program, and by having its name mentioned in each publication of the organization that it finances, such benefits are merely incidental to the benefits flowing to the general public from access to the village and its historic structures.⁸⁸

The Service has also ruled that including the logo of a major corporate supporter into the logo of an organization constitutes an acknowledgement and not advertising even when the logo appears prominently in a broad publicity campaign with respect to the organization and its work.⁸⁹

In the area of acknowledgements on public broadcast stations the Service has looked to the Federal Communications Commission ("FCC") rules on acknowledgements on noncommercial stations.⁹⁰ The Service has found this appropriate because the FCC requires that broadcast stations identify sponsors of particular programs. Thus, the Service reasoned that the contributor could not anticipate any benefit and an acknowledgment that complies with FCC requirements will be treated as an acknowledgment for

the name of the person funding the scholarships was an acknowledgment that did not provide a substantial return benefit.

86. Rev. Rul. 77-367, 1977-2 C.B. 192 (contributor's name on facility); News Release IR-92-4, discussed *infra* at text accompanying notes 250-53.

87. Rev. Rul. 77-367, 1977-2 C.B. 193.

88. *Id.*

89. Priv. Ltr. Rul. 95-35-044 (June 5, 1995) (organization's logo incorporates logo of sole corporate supporter); Priv. Ltr. Rul. 92-35-062 (June 5, 1992) (organization's logo incorporates corporate supporter's logo and corporate supporter funds a broad effort to publicize the organization and its programs).

90. See, e.g., Tech. Adv. Mem. 86-44-003 (July 23, 1986).

federal income tax purposes.⁹¹ The Service has refused to extend its reliance on FCC positions outside the public broadcast context to contexts in which the regulatory requirement that sponsors be identified does not apply.⁹²

Even these somewhat controversial rulings have been based on a transactional analysis to determine whether the recipient organization has provided an acknowledgment or something of value. Describing the benefits to the corporate payor as "incidental" to the benefits to the charitable class creates some ambiguity over whether incidental means of small value or whether it means arising from but not necessarily small in value. This ambiguity permitted some critics of the Service's initial position on corporate sponsorship to argue that an acknowledgement could be something of substantial value as long as it arose incidentally to providing a benefit to the charitable class.⁹³ This ambiguity was resolved in 1993 when Congress amended Section 170 to require that a recipient organization inform the transferor of the value it has provided to the transferor. These quid pro quo rules focused explicitly on the extent of the value provided to the payor.

C. *Quid Pro Quo Contributions*

In 1993, Congress amended section 170 by adding section 170(f)(8), which denies a charitable contribution deduction for any contribution of \$250 or more for which the donor has not received a contemporaneous acknowledgement from the recipient organization stating what, if any, goods or services the donor received in connection with the contribution. In addition, the 1993 Act added section 6115, which requires that an organization provide the donor of a quid pro quo contribution with a written statement that informs the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization⁹⁴ and "provides the donor

91. *Id.*

92. Tech. Adv. Mem. 92-34-002 (Feb. 19, 1992)(rejects FCC analogy with respect to print advertisement in the souvenir program of an annual festival).

93. See the Comment of the ABA on the audit guidelines, discussed *infra* at text accompanying notes 286-95.

94. I.R.C. § 6115(a)(1).

with a good faith estimate of the value of such goods or services.⁹⁵ These disclosure and valuation requirements apply only to a “quid pro quo contribution,” which is defined as “a payment made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization.”⁹⁶ Thus, the section 6115 disclosure and valuation requirements do not apply to purely commercial transactions. The Service has ruled that an organization which includes an amount in its unrelated business income is not required to provide section 6115 disclosure to the payor of the amount.⁹⁷ In addition, an amount paid as a fee for provision of a service that provides the basis of the organization’s exemption is not included in the quid pro quo disclosure rule.⁹⁸ In this case, although the organization does not include any amount in its unrelated business income, the payor is not entitled to a deduction because it received a benefit commensurate to the amount of its payment.

The quid pro quo rules commonly apply to fundraising activities when the payor bids at an auction or purchases a ticket for an event for an amount in excess of the value of the item or when a contributor receives a “premium” for making a contribution. In most if not all of these situations, the organization will not be subject to the unrelated business income tax on the amount for which a deduction has been denied. While a transactional analysis would point toward a different result, most of the core situations of quid pro quo contributions trigger application of exceptions to inclusion. For example, most charity auctions involve donated items, for which a specific exception is provided.⁹⁹ Many fundraising events are operated by volunteers, thereby coming within the volunteer exception.¹⁰⁰ The existence of these exceptions helps explain why the OBRA ‘93 contained no explicit provisions with respect to the treatment of a quid pro quo contribution by the recipient organization.

95. I.R.C. § 6115(a)(2). Under Prop. Treas. Reg. § 1.6115-1(a)(1) a good faith estimate can be based on “any reasonable methodology” that an organization “applies in good faith.”

96. I.R.C. § 6115(b). This definition does not apply to “any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.”

97. Tech. Adv. Mem. 95-21-004 (June 5, 1995).

98. *Id.*

99. For a discussion of the contributed property exception of I.R.C. § 513(a)(3), see *infra* at text accompanying notes 213-14.

100. For a discussion of the volunteer exception of I.R.C. § 513(a)(1), see *infra* at text accompanying notes 209-12.

D. Corporate Sponsorship as Charitable Contribution

A transactional analysis strongly suggests that corporate sponsorship transactions of the type characteristic of the college football games are not charitable contributions by the contributor or acknowledgements by the recipient organizations. While no definitive determination can be made with respect to particular cases, a policy determination can be made that the law applicable to charitable contributions and acknowledgements does not provide any basis for determining that most corporate sponsorship transactions can be treated as contributions by the corporation and acknowledgements by the recipient organization. This conclusion is reinforced by the enactment of the quid pro quo provisions in 1993. Thus, the Service's attempt to enforce the quid pro quo provisions while treating the college bowl games as examples of acknowledgements produces a level of statutory dissonance that requires a reconsideration of at least one of the provisions involved.

IV. EXEMPT FUNCTION TRANSACTIONS

To fit the model of an exempt function transaction, the corporate sponsor would have to receive a benefit of the type that is consistent with the organization's exempt purpose. This model transaction departs from the symmetry of the model charitable contribution deduction by denying a Section 170 deduction but not taxing the income to the recipient organization.¹⁰¹

The legal basis for the exempt function transaction derives from the unrelated business income definition that excludes income from an activity that is substantially related to the organization's exempt purpose. In the context of the type of event to which corporate sponsorship is generally thought to apply, exempt function income is income from ticket sales, payments received for attending the game or the concert or the play that the organization has been granted exemption to present.¹⁰² The Service has

101. Rev. Rul. 83-104, 1983-2 C.B. 46 (private school tuition not deductible).

102. The legislative history of the Revenue Act of 1950, Ch. 994, 64 Stat. 906, which added the unrelated business income tax provisions to the Code stated that "income of an educational organization from charges for admissions to football games would not be deemed to be income from an unrelated business, since its athletic activities are substantially related to its educational programs." H.R. REP. No. 2319, 81st Cong., 2d Sess. 37, 109 (1950), 1950-2 C.B. 380, 458. For an example showing that Congress did not intend that ticket revenue from a basketball tournament be included in unrelated business income, see S. Rep. No. 2375, 81st Cong., 2d Sess. 29 (1950).

applied this general statutory principle to several types of exempt function income, including income from the sale of broadcast rights to college athletic events.¹⁰³

Corporate sponsorship transactions do not involve exchanges of a payment for provision of the type of services that provide the basis for the recipient organization's exemption. Corporate sponsors have not argued that they have made substantial payments so that they can provide event tickets to their employees or customers or shareholders. While corporate sponsorship agreements may provide that employees or others receive an agreed upon number of tickets, the value represented by these tickets as a percentage of the total corporate sponsorship payment has been small enough that corporate sponsors have not suggested that they be permitted to allocate an amount of the payment to these tickets and treat that amount as an exempt function payment that they could not deduct and the organization would not have to include in its unrelated business income. The corporate sponsors receive more favorable tax treatment if they can deduct their payments as charitable contributions or as ordinary and necessary business expenses. The recipient organizations have also focused on defining rules that exclude the entire payment from their unrelated business income rather than seeking to disaggregate the pay-

103. Rev. Rul. 80-296, 1980-2 C.B. 195; Rev. Rul. 80-295, 1980-2 C.B. 194; Rev. Rul. 80-294, 1980-2 C.B. 187; and Tech. Adv. Mem. 78-51-004 (Aug. 21, 1978). In some circumstances, corporate sponsorship payments become difficult to distinguish from broadcast revenues. The United States Gymnastics Federation describes this fact pattern as follows:

Instead of paying large sums for events (such as amateur gymnastics competitions) and then selling advertising time to cover that cost, broadcasters generally began to offer the owner of broadcast rights dramatically reduced fees or no fees at all, or they required that the event owners buy the air time in order to get the events broadcast. In most cases the broadcaster also required that the event owner pay for the equipment, technicians, and announcers needed to produce the broadcast. Consistent with this shift in financial risk associated with broadcasting amateur athletic events, broadcasters began to give event owners the opportunity to offset these new costs by selling advertising time during broadcasts (within Federal Communications Commission ("FCC") and other limits. Thus NGBs [national governing bodies] increasingly have been forced to sell advertising spots during the broadcast of events to defray either or both the cost of producing the events for broadcast . . . , or the cost of buying air time directly from broadcasters To apply UBIT [unrelated business income tax] to an NGB's corporate sponsorship revenues simply because it receives some payments directly from corporate sponsors, rather than through an intermediary (such as a broadcast network), is placing form over substance.

ments according to the transactions producing the specific revenue and potentially resulting in different tax treatment.

V. UNRELATED BUSINESS INCOME TRANSACTION

The corporate sponsorship transaction comports most closely with the unrelated business income transaction. Both involve a direct two-party quid pro quo that provides no benefits to a charitable class and does not give the payor the kind of benefit that the organization was granted exemption to provide.

The statutory structure of the unrelated business income tax reflects the quid pro quo nature of the transaction in the general principles defining unrelated business income. At the same time, the statute contains numerous modifications and exceptions enacted by Congress to resolve particular cases. These modifications obscure the transactional basis of the general statutory principles but, at the same time, preserve the structure by resolving special cases without modifying the generally applicable principles.¹⁰⁴ This tension between general principles and special rules is an important element in understanding both the unrelated business income tax provisions and the debate over corporate sponsorship.

A. *Statutory Definition of Unrelated Business Income*

An unrelated trade or business is a trade or business that is regularly carried on and that is not substantially related to the organization's exempt purpose.¹⁰⁵ This definition is based not on the use of the income earned from the activity, as it had been under the destination of income test of prior law, but from the relationship between the activity and the organization's exempt purpose.¹⁰⁶

104. VICTOR TURNER, *THE RITUAL PROCESS: STRUCTURE AND ANTI-STRUCTURE* (1969). ROBERT B. EDGERTON, *RULES, EXCEPTIONS, AND SOCIAL ORDER* (1985).

105. I.R.C. § 512(a) and I.R.C. § 513(a), and Treas. Reg. § 1.513-1(a) (1994).

106. For a discussion of the destination of income test of prior law, see Hill and Kirschten *supra* note 17 at ¶10.01[1]. The 1913 Tarriff Act, 38 Stat. 171, 172 (Oct. 3, 1913) provided an exception to the corporate income tax for any corporation "organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual." The Supreme Court interpreted this provision as exempting from income taxation the revenue used for such purposes. *Trinidad v. Sagrada Orden*, 263 U.S. 578, 582 (1924)(religious order conducting missionary activities in the Philippines not taxable on the income from the sale of wine and chocolate or on income from investments in real estate and corporate securities because such income was used in the organization's missionary work). I.R.C. § 502

1. Trade or Business

A trade or business is defined for this purpose in terms of the concept of a trade or business applicable for purposes of a business deduction under Section 162.¹⁰⁷ The courts have defined a trade or business in terms of an intent to make a profit, whether or not the organization in fact earned a profit.¹⁰⁸ The Supreme Court applied this test in the case of an organization that received so-called experience dividends in exchange for serving as the policy holder of a group insurance policy.¹⁰⁹ The Court referred to a profit motive as “[t]he standard test for the existence of a trade or business for purposes of §162.”¹¹⁰ In so holding, the Supreme Court reversed the Federal Circuit, which had based its opinion on the manner in which the activities had been conducted and on the absence of competition with commercial entities.¹¹¹

ABE’s activity is both the “sale of goods” and “the performance of services,” and possesses the general characteristics of a trade or business. Certainly the assembling of a group of better-than-average insurance risks, negotiating on their behalf with insurance companies, and administering a group policy are activities that can be—and are—provided by pri-

rejects the destination of income test by denying exempt status to “feeder organizations.”

107. Treas. Reg. § 1.513-1(b) provides that “for purposes of section 513 the term ‘trade or business’ has the same meaning it has in section 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.” Section 162 does not define trade or business. See F. Ladson Boyle, *What Is a Trade or Business?* 39 TAX LAW 737 (1986).

108. Treas. Reg. § 1.513-1(b) provides that “where an activity carried on for the production of income constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.” *Id.*

109. *United States v. American Bar Endowment*, 477 U.S. 105 (1986). The sole issue in this case was whether the activities in question constituted a trade or business since the parties had stipulated that the activities were regularly carried on and not substantially related to the organization’s exempt purpose.

110. *Id.* at 110 n. 1.

111. 761 F.2d 1573 (Fed. Cir. 1985). The Federal Circuit explicitly rejected the profit motive test, stating:

Unlike what some other courts may do, this court does not find ‘profits,’ or the maximization of revenue to be the controlling basis for a determination of whether the unrelated business tax provisions apply. We consider not only the amount of money the charitable organization receives, but the source and character of those funds A charity should not be subject to taxation merely because its charitable solicitations are successful.

vate commercial entities in order to make a profits. ABE itself earns considerable income from its program.¹¹²

An actual profit is strong evidence of a profit motive. In *American Postal Workers*, the District of Columbia Circuit pointed to the large profits earned by enrolling “associate members” who participated in the union’s insurance program but not in any other union activities.¹¹³ The court discounted the testimony of union officials that they had not operated the insurance program or made it available to associate members with the intention of earning a profit.¹¹⁴

Both the courts and the Service have also looked to the manner in which an activity is conducted for evidence of a profit motive and thus as evidence that an activity constitutes a trade or business. In examining the manner in which an activity is conducted, the courts have considered both the scale of the activity and its similarity to commercial undertakings. In *American Bar Endowment*, the Supreme Court held that indirect competition with commercial enterprises was evidence of a profit motive.¹¹⁵

112. 477 U.S. at 110-11. The court also found that “ABE has a unique asset—its access to the ABE’s members and their highly favorable mortality and morbidity rates—and it has chosen to appropriate for itself all of the profit possible from that asset, rather than sharing any with its members.” *Id.* at 113.

113. *American Postal Workers Union, AFL-CIO v. United States*, 925 F. 2d 480 (D.C. Cir. 1991), *rev’g* 90-1 USTC ¶50,013 (DDC 1989). The issue of whether associate member dues are unrelated business income to the organization has proved controversial as the Service has taken this position in rulings with respect to other organizations. See Hill and Kirschten, *supra* note 17 at ¶ S10.02[3][b][vi].

114. *Id.* at 464-485. The court observed in discounting the testimony of union officials:

In the face of overwhelming evidence of substantial net profits, the union points to the testimony of its employees and agents that the prospect of earning profits had never appealed—or even occurred—to anyone. Apparently we are invited to believe that the profit received was, as has been said of the British Empire, merely picked up in moments of absentmindedness. Given the traditional view that parties intend the obvious consequences of their acts, we join the other courts that have highly discounted such self-serving testimony.

Id.

115. 477 U.S. at 114-15. The Court stated:

This case presents an example of precisely the sort of unfair competition that Congress intended to prevent. If ABE’s members may deduct part of their premium payments as a charitable contribution, the effective cost of ABE’s insurance will be lower than the cost of competing policies that do not offer tax benefits. Similarly, if ABE may escape taxes on its earnings, it need not be as profitable as its commercial counterparts in order to receive the same return on its investment. Should a commercial company attempt to displace ABE as the group policyholder, therefore, it would be at a decided disadvantage.

The Tax Court held that a large-scale farm of 1600 acres with a feedlot for 500 head of cattle operated with modern equipment and according to current agricultural technology was a trade or business even though it was operated by members of a religious order.¹¹⁶ The Service has ruled that heavily-promoted rock concerts held in the university's multi-purpose facility constituted unrelated business income for the university.¹¹⁷

The model corporate sponsorship transaction appears to satisfy the test of a trade or business because the organizations in question appear to be operating with a profit motive.¹¹⁸ The use of the funds to support the organization's exempt purpose does not defeat a finding of a profit motive.¹¹⁹ The Cotton Bowl Committee argued unsuccessfully that its corporate sponsorship agreement with Mobil should not be treated as a trade or business because the agreement involved very little additional effort by the Committee.¹²⁰ However, the extent of activity is only one factor that may or may not indicate a profit motive. Whether the factual assumption underlying the Cotton Bowl Committee's position would apply to most other cases remains unclear. Finally, arguments based on the nature of the activity involved in entering corporate sponsorship agreements offer a narrow scope for a solution, both because the activities seem to be those undertaken by taxable persons with a profit motive and because the inherent nature

Id.

116. *St. Joseph's Farms of Indiana v. Commissioner*, 85 T.C. 9 (1985).

117. Tech. Adv. Mem. 91-47-008 (Aug. 19, 1991). See also Gen. Coun. Mem. 39863 (Nov. 26, 1991). This ruling has been controversial because it seemed to suggest that the Service's position was based not simply on the manner in which the university conducted the rock concert, itself a controversial analytical approach under the substantially related test, but also on the nature of the activity. In effect, the ruling could be read as positing that a rock concert is "inherently commercial" while a chamber music concert, for example, might be inherently educational. This would be inconsistent with the substantially related test. See *infra* at Part V(A)(3).

118. When considering actual corporate sponsorship arrangements, this determination requires analysis of the facts and circumstances of each case. No *per se* rule applies to corporate sponsorship or any other transaction.

119. In comments on the Service's initial position on corporate sponsorship, several bowl committees emphasized their contributions to local charities in the cities in which the bowl game is played. See Comment of National Collegiate Athletic Association (available electronically at 92 TNT 163-77); Comment of the Fiesta Bowl (available electronically at 92 TNT 160-46); Comment of the Sugar Bowl (available electronically at 92 TNT 159-50). While laudatory, such contributions have no relevance to the issues raised by corporate sponsorship. They bespeak a nostalgia for the destination of income test of prior law, now explicitly disallowed under the I.R.C. § 502 feeder organization rules. For a discussion of the destination of income test of prior law, see Hill and Kirschten *supra* note 17 at ¶10.01[1].

120. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991).

of the activities is not determinative. Thus, the model corporate sponsorship transaction will be treated as a trade or business under the general rules.

The definition of a trade or business is so inclusive that exempt organizations are rarely successful in arguing that their income-producing activities are not a trade or business. Instead, organizations more commonly argue that their trade or business activities are not regularly carried on or that the activities in question are substantially related to achievement of their exempt purpose.

2. Regularly Carried On

A trade or business will not produce taxable unrelated business income unless it is "regularly carried on" by the exempt organization.¹²¹ The conceptual rationale of this requirement is obscure. Neither the courts nor the Service has offered any principled reason why an organization should not be taxed on income from an unrelated trade or business that it conducts only once. If the purpose of the unrelated business income tax is to prevent unfair competition between exempt and taxable entities, then the frequency of a trade or business should be conceptually irrelevant. The frequency of such activity is arguably a factor bearing on whether it is, in fact, a trade or business, but this interpretation would mean that frequency would be weighed against, and thus could be offset by, other factors within the trade or business test. As an independent element in the definition of unrelated business income, the requirement that a trade or business be regularly carried on significantly limits the scope of the unrelated business income tax.

The regulations provide that in determining whether an activity is regularly carried on, "regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued."¹²² Based on these principles, the regulations provide that a trade or business will be regularly carried on if the activities "manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of non-exempt organizations."¹²³

121. I.R.C. § 512(a)(1).

122. Treas. Reg. § 1.513-1(c)(1).

123. *Id.*, which states that these rules are to be applied in light of the general purpose of the unrelated business income tax "to place exempt organization business

If activities are intermittent, the regulations then place greater relative weight on the manner in which the activities are conducted.¹²⁴ However, activities may be so infrequent that the manner in which they are conducted becomes irrelevant. This rule applies to fundraising events.¹²⁵ The regulations provide that for purposes of this special rule "income producing or fund raising activities lasting only a short period of time will not be treated as regularly carried on if they recur only occasionally or sporadically."¹²⁶ Holding such an event every year will not cause the event to be treated as regularly carried on.¹²⁷ The Service has limited the application of this provision to activities directly connected with an identifiable event.¹²⁸

The relevant period for measuring the duration of activities is the subject of significant dispute between the Service and at least one court. This dispute involves the National Collegiate Athletic Association ("NCAA") Men's Basketball Final Four, specifically, the sale of advertising in the Final Four program.¹²⁹ This case turned exclusively on whether the advertising activity was regularly carried; the NCAA had conceded that the sale of advertising is a trade or business not substantially related to its exempt purpose.¹³⁰ The NCAA based its case primarily on the argument that the three-week tournament was a limited period that did not con-

activities upon the same tax basis as the nonexempt business endeavors with which they compete." Most events that attract corporate sponsorship have no direct commercial analogue. However, the proper focus is on the sale and solicitation of advertising and the legally relevant comparison is between such sale and solicitation activities with respect to the sponsored event and other intermittent events that are taxable. The commercial analogue is not the event itself but the solicitation and sale of advertising with respect to such an event.

124. Treas. Reg. § 1.513-1(c)(2)(ii) provides that "[i]n general, exempt organization business activities which are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors."

125. Treas. Reg. § 1.513-1(c)(2)(iii).

126. Treas. Reg. § 1.513-1(c)(2)(iii) states that "[c]ertain intermittent income producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as a trade or business regularly carried on."

127. Treas. Reg. § 1.513-1(c)(2)(iii) states that such events "will not be regarded as regularly carried on merely because they are conducted on an annually recurrent basis." See, *Suffolk County Patrolmen's Benevolent Ass'n. v. Commissioner*, 77 T.C. 1314 (1981) (annual vaudeville show presented by professional entertainers for the benefit of the association was not regularly carried on).

128. Tech. Adv. Mem. 93-04-001 (Sept. 29, 1992) (yearbook distributed at an event was not directly connected with the event).

129. *National Collegiate Athletic Ass'n. v. Commissioner*, 914 F. 2d 1417 (10th Cir. 1990), *rev'g* 92 T.C. 456 (1989).

130. 92 T.C. at 464-65.

stitute regular conduct.¹³¹ The Tax Court held that the relevant period was the period during which the NCAA, directly or through its agent, solicited and sold advertising, not simply the period of the tournament when the program containing the advertisements was sold to the public.¹³² Under the Tax Court approach, advertising involves two transactions, one between the advertiser and the publisher, and the other between the publisher and the public. The publisher is not selling advertising to the public; rather, the publisher is making the advertising available to the public pursuant to the terms of its agreement with the advertiser.

The Tenth Circuit reversed the Tax Court, holding that the relevant period for consideration was the three-week period of the tournament.¹³³ The court treated the period during which the NCAA solicited and sold advertising as mere "preparatory time." Under this analysis, there was only one relevant transaction: that between the NCAA as publisher of the program and the segments of the public who view the program. However, the Tenth Circuit found that "to determine the normal time span of the activity in this case, we should consider the business of *selling advertising space*, since that is the business the Commissioner contends is generating unrelated business income."¹³⁴ The court then compared the sale of advertising in sports magazines with the NCAA's sale of advertising for its Final Four programs, and concluded that the NCAA's sales were intermittent and not regularly carried on. This reasoning raises the important question of what activities are comparable for purposes of the intermittent activity regulations.¹³⁵ It would seem that the sale of advertising in such programs as the Superbowl, the World Series, the NBA Championship, or the Stanley Cup playoffs would be more appropriate comparisons than the sale of advertising in sports magazines published throughout the year.

131. The NCAA also argued that it was only passively involved in the sale of advertising because it contracted with a commercial agent to contact potential advertisers. Neither court accepted this argument because the contract in question gave the NCAA the right to control the actions of the commercial agent. See 92 T.C. at 464-68

132. *Id.* at 466.

133. 914 F. 2d at 1422-1423.

134. *Id.* at 1422 (emphasis in original).

135. The Service has issued no guidance on comparables for this purpose. The regulations under I.R.C. § 482 might provide some useful insights, but the Service has not applied these principles in any ruling involving the question of appropriate comparables in the unrelated business income context.

The Service issued a nonacquiescence in the Tenth Circuit's opinion, but concluded that, in the absence of a split in the circuits, it would not file a petition for certiorari.¹³⁶ The Service questioned the factual basis and legal reasoning of the opinion, focusing particularly on the court's determination that the three-week period during which tournament games were played defined the duration of the unrelated trade or business of selling advertising. The Service announced that it would continue to litigate this issue.¹³⁷

The uncertainty in the standard for determining whether an activity is regularly carried on offers one avenue for a technical resolution of the corporate sponsorship issue.¹³⁸ Any such solution would, however, be inconsistent with the Service's current interpretation of the Code and regulations. Attempting to reconcile the corporate sponsorship transactions, at least those characteristic of the bowl games, with the existing rules would undermine the rule. The result would be that very little trade or business activity that is not substantially related to an organization's exempt purpose would be subject to the unrelated business income tax. In effect, the Code would be amended for all organizations and activities as a byproduct of solving a problem for a subset of organizations engaging in a particular type of activity.

3. Not Substantially Related to Exempt Purpose

The final element in the definition of an unrelated trade or business is that the activity is not substantially related to the organization's exempt purpose.¹³⁹ This means that the trade or business activity must make an important causal contribution to the organization's performance of its exempt purpose apart from

136. *NCAA v. Commissioner*, 92 T.C. 456, *rev'd* 914 F. 2d 1417 (10th Cir. 1990), *action on decision*, 1991-015 (July 3, 1991).

137. *See, e.g.*, Tech. Adv. Mem. 92-34-002 (Feb. 19, 1992), where the Service stated with respect to the 10th Circuit's opinion in *NCAA* that it "disagrees with this decision and will continue to litigate the issue in appropriate cases." *See also*, Tech. Adv. Mem. 95-09-002, Issues 4(a) and 6(a).

138. The legislative solution enacted by Congress and pocket vetoed by President Bush in 1992 took this approach by linking corporate sponsorship to a "public entertainment event." *See infra* text accompanying notes 301-14.

139. I.R.C. § 513(a). Treas. Reg. § 1.513-1(d)(1) states that a trade or business activity that is regularly carried on will be subject to the unrelated business income tax only if it is "not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function consisting of the basis of its exemption." Treas. Reg. § 1.513-1(d)(2) provides that the relationship between the activity and the exempt purpose must be causal.

providing funding for such purpose.¹⁴⁰ The existence and importance of such a causal contribution is to be determined based on all the facts and circumstances of each particular case.¹⁴¹

The substantially related test is thus not based on the inherent nature of the activity but on its relationship to performance of the organization's exempt purpose. For example, the Service has long taken the position that sale of pharmaceutical products by a hospital pharmacy to the hospital's patients is substantially related to the hospital's exempt purpose¹⁴² but that such sales to persons who are not patients of the hospital are not substantially related.¹⁴³

However, the distinctions are not always conceptually clear. While the foregoing example suggests that sales to the general public produce unrelated business income, the Service has also ruled that a museum selling greeting card reproductions of recognized works of art to members of the general public does not earn unrelated business income, even if the cards are personalized, because the reproduction of art work and the brief statement on the back of the card identifying the work and the artist are treated as substantially related to the museum's exempt educational purpose.¹⁴⁴ This ruling raises the question of why the sale of pharmaceutical products or medical devices to members of the public is not treated as contributing importantly to a hospital's exempt purpose.¹⁴⁵ The same question arises with respect to the ruling that sales of herb products by a section 501(c)(3) educational organization were substantially related only if the sales were made to the organization's members.¹⁴⁶

One reason for the lack of conceptual clarity is that the substantially related test serves to some degree as a proxy for an unstated variable: whether engaging in the activity causes the exempt organization to compete with a taxable entity providing the same goods or services. Eliminating so-called "unfair competition" was the impetus for the introduction of the unrelated busi-

140. Treas. Reg. §1.513-1(d)(2).

141. *Id.*

142. Rev. Rul. 78-435, 1978-2 C.B. 181 (hospital's sale of hearing aids to patients not taxable).

143. Rev. Rul. 68-374, 1968-2 C.B. 242.

144. Rev. Rul. 73-104, 1973-1 C.B. 263.

145. Rev. Rul. 68-374, 1968-2 C.B. 242.

146. Tech. Adv. Mem. 94-36-002. This ruling appears to convert the convenience exception into an element of the substantially related test.

ness income tax.¹⁴⁷ The most famous instance of what was considered unfair competition was the creation of a company to hold all the stock of C. F. Mueller Company and donate all the pasta profits to the New York University Law School, thereby, under the law as then in effect, avoiding taxation on such profits. The Service litigated this case and lost,¹⁴⁸ but Congress subsequently amended the Code.¹⁴⁹

While preventing unfair competition with taxable entities is the articulated policy purpose of the unrelated business income tax provisions, evidence of such actual competition in each particular case is not one of the required elements in the definition of unrelated business income.¹⁵⁰ Bowl committees have no taxable competitors in the presentation of college football postseason games, but this fact, even if established, would not in itself be sufficient to exclude corporate sponsorship payments from unrelated business income.¹⁵¹ Colleges, bowl committees, and other sports associations are at least potentially competing with professional sports franchises for corporate sponsorship revenue, although corporate sponsors currently seem to find both professions and college teams sound investments.¹⁵²

147. See S. Rep. No. 2375, 81st Cong., 2d Sess. 28-29 (1950), which states that "[t]he problem at which the tax on UBI [unrelated business income] is directed is primarily that of unfair competition." Treas. Reg. § 1.513-1(b) follows the legislative history in providing that "[t]he primary objective of the unrelated business income tax was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations upon the same tax basis as the nonexempt business endeavors with which they compete."

148. *Mueller Co. v. Commissioner*, 190 F. 2d 120 (3d Cir. 1951), *rev'g* 14 T.C. 922 (1950). Many other universities had similar arrangements involving assets as diverse as a cotton gin and an airport. See Richard L. Kaplan, *Intercollegiate Athletics and the Unrelated Business Income Tax*, 80 COLUM. L. REV. 1430, 1432-34 (1980).

149. Revenue Act of 1950, Ch. 994, 64 Stat. 906. For a discussion of the process leading to the replacement of the destination of income test with the unrelated business income provisions, see Kenneth C. Elliasberg, *Charity and Commerce: Section 501(c)(3)—How Much Unrelated Business Activity*, 21 TAX L. REV. 53, 74-76 (1965).

150. Treas. Reg. § 1.513-1(b) supports this view by providing:

in general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute a trade or business within the meaning of section 162—and which, in addition, is not substantially related to the performance of exempt functions—presents sufficient likelihood of unfair competition to be within the policy of the tax.

151. Comments by several bowl committees on the Service's initial position on corporate sponsorship emphasized the absence of taxable competitors. See Comment of the Southwest Conference (available electronically at 92 TNT 149-46).

152. The most controversial arrangement is the agreement between Texas Stadium and Nike, which has resulted in litigation between National Football League

Conceptually, the policy concern with unfair competition invites consideration of what activities are "commercial" in nature so that they in fact compete with the business activities of taxable entities. While the definition of unrelated trade or business provides that activities may be a trade or business but will not be subject to tax unless they are not substantially related to the organization's performance of its exempt purpose, nevertheless, questions of the commercial character of particular activities recur in the analysis of the unrelated business income tax. As was discussed above, the regularly carried on element of the definition explicitly includes consideration of the manner in which the activity is conducted.¹⁵³ The commerciality inquiry goes even further by suggesting that certain activities are "inherently commercial" and, by virtue of their inherently commercial nature, can never satisfy the substantially related requirement. This line of reasoning attempts to use an essentialist argument to satisfy a relational test. While this is not the reasoning formally adopted in the substantially related test, this essentialist element remains a subtext of many unrelated business income analyses.¹⁵⁴

("NFL"), through its licensing arm, NFL Properties, and Texas Stadium, the Dallas Cowboys, and Cowboys owner, Jerry Jones. For the story thus far, see, Richard Sandomir, *Pro Football; Now Jerry Jones Must Prove How Smart Nike Deal Is*, N.Y. Times, Sept. 7, 1995, at B23; Leonard Shapiro, *Nike's Exposure Is All Day, All Knight*, Wash. Post, Sept. 12, 1995, at E3; Christine Brennan, *The Head Cowboy Tries To Ride Alone; Dallas's Jerry Jones Bucks NFL Owners To Cut His Own Deals*, Wash. Post, Sept. 17, 1995, at A1; Christine Brennan, *NFL Group Sues Cowboys, Owner Jones; Licensing Arm Cites Nike, Pepsi Deals*, Wash. Post, Sept 19, 1995, at A1; Richard Hoffer, *Cowboys for Sale; The NFL Is Not Amused by Maverick Owner Jerry Jones*, Sports Illustrated, Sept. 18, 1995, at 60; Richard Sandomir, *N.F.L. Sues Jones To Stop 'Ambush' Deals*, N.Y. Times, Sept. 19, 1995, at B11; Richard Sandomir, *Cowboys' Jones Is Yielding No Ground*, N.Y. Times, Sept. 20, 1995, at B13. Nike subsequently entered a licensing agreement with the NFL. See, Robert McAllister, *Nike Hits Paydirt with Team Sports; Contract with National Football League*, 51 Footwear News 1 (Oct. 16, 1995); Dan Bickley, *Sneaker Attack; Nike's Growing Clout Feared*, Chicago Sun-Times, Sept. 21, 1995 at 102. Jerry Jones and his critics have confronted each other in the broadcast media. See, ABC News Nightline, Sept. 11, 1995 (transcript # 3731); National Public Radio Morning Edition, Sept. 15, 1995 (transcript # 1695-5).

In *American Bar Endowment v. United States*, 477 U.S. 105, 114-115 (1986), the Supreme Court took the position that competition might be indirect or potential. See *supra* at note 115.

153. See *supra* at Part V(A)(2).

154. The Subcommittee on Oversight, Press Release 16, March 31, 1988 (available electronically at 88 TNT 73-10), discussed a possible reform of the substantially related test that would have developed specific statutory provisions with respect to certain activities "whose nature and scope are inherently commercial, rather than charitable." The Draft UBIT Report of June 23, 1988 (available electronically at 88 TNT 132-5), prepared by the Subcommittee Chair, J.J. Pickle (D-Tx.) and ranking minority member Richard Schulze (R-Pa.) adopted this approach of

As the following discussion of advertising illustrates, there is little scope for arguing that entering into a corporate sponsorship arrangement is substantially related to an organization's exempt purpose.

4. Advertising as an Unrelated Trade or Business

The Service has analyzed advertising within the general principles of the unrelated business income tax.¹⁵⁵ Advertising raises three issues that are also at the core of the corporate sponsorship debate. First, what factors distinguish advertising from the acknowledgement of a contribution? Second, is the message in the purported advertisement substantially related to the organization's exempt purpose? Third, is the purported advertising activity regularly carried on?

The first issue, whether a display constitutes advertising, has arisen most commonly in the context of the sale of advertising space in journals published by an exempt organization. In its initial ruling on this issue, the Service took the position that listings of business names and addresses constituted advertising, reasoning that

The fact that the message published may not be commercial in nature may not be determinative. There are many forms of institutional messages designed for the promotion of good will which do not directly refer to any commercial product or service, but merely identify the particular enterprise or institution involved. The controlling factor in this case is that the activities giving rise to the income in question constitute the sale and performance of a valuable service on the part of the publisher, and the purchase of that service on the part of the other party to the transaction.¹⁵⁶

However, not all displays of the name of a contributor have been treated as advertising. Some displays have, in effect, been treated as acknowledgements. For example, a list of contributors, with sixty names appearing on each page, in a limited circulation journal of a section 501(c)(3) organization magazine was not treated as advertising.¹⁵⁷ With respect to such listings, the Service reasoned:

listing certain activities that would in all cases be taxable while retaining the substantially related test. *Id.*

155. See Treas. Reg. § 1.513-1(d)(4)(iv), Examples (6) and (7).

156. Rev. Rul. 74-38, 1974-1 C.B. 144.

157. Rev. Rul. 76093, 1976-1 C.B. 170, clarifying Rev. Rul. 74-38, 1974-1 C.B.

144.

the purchaser of a listing neither expects nor receives more than an inconsequential benefit therefrom. Any commercial benefit that could reasonably be expected to be derived from the appearance of the commercial name along with at least 59 others on a single page cannot be considered as other than negligible and inconsequential in view of the type of publication that the organization's journal is and the nature of the solicitation that resulted in the payments associated therewith.¹⁵⁸

However, full-page or half-page displays, or displays in blocked-in spaces were treated as advertising.¹⁵⁹ The Service reasoned with respect to these displays that the businesses identified in these displays reasonably expect and receive some consequential amount of commercial benefit from their payments to the organization. Although some of these firms may have been motivated, in part, by charitable purposes in making their payments, the overall appearance and setting of their distinctly located notices clearly tend to give such notices a definite business aspect and thus provide a logical basis for concluding that the firms identified therein expect to receive more than an inconsequential amount of commercial benefit therefrom.¹⁶⁰

In sum, the Service has looked to the facts and circumstances of each case to determine whether the organization has provided a benefit in the form of business promotion in exchange for a payment. While the identification of a business creates a presumption that the payment was made in exchange for a benefit in the form of advertising, others factors beyond the mere identification of the payor must be considered. These factors include "the manner in which the publication under consideration is normally circulated; the territorial scope of such circulation; the extent to which its readers, promoters, or the like could reasonably be expected to further the commercial interests of the advertisers by either direct or indirect means; the eligibility or noneligibility of the publishing organization for the receipt of tax deductible contributions; and the commercial or noncommercial flavor of the methods used to solicit the advertising patronage in question."¹⁶¹

158. Rev. Rul. 76-93, 1976-1 C.B. 170 (such listings were solicited from companies' chief executive officers or community relations officers and not from the advertising departments).

159. *Id.*

160. *Id.*

161. *Id.*

Ultimately, no one factor relating to the manner in which a contributor is identified is determinative.

Addressing the second factor, whether activity associated with displays that are not treated as acknowledgements can escape the unrelated business income tax by satisfying the substantially related test, the Service has consistently taken the position that advertising is not substantially related to organizations' exempt purposes. The Service treats this situation as one example of the appropriate application of the "fragmentation rule" of section 513(c), which provides that an unrelated trade or business can be disaggregated from associated activities that may be substantially related to an organization's exempt purpose.¹⁶²

The regulations on the substantially related test contain two examples based on such advertising in a periodical, the editorial content of which was substantially related to the organization's exempt purpose.¹⁶³ In the first example, a section 501(c)(6) organization¹⁶⁴ publishes a monthly journal "containing articles and

162. I.R.C. § 513(c) states

For purposes of this section, the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose [its] identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit.

In addition to advertising, the fragmentation rule is commonly applied to sales by university bookstores and gift shops in museums and hospitals. *See, e.g.*, Rev. Rul. 85-110, 1985-2 C.B. 166 (laboratory services for private patients of staff physicians not substantially related to hospital's exempt purpose); Rev. Rul. 81-62, 1981-1 C.B. 355 (beauty shop substantially related to exempt purpose of senior citizens center but sale of heavy appliances such as stoves and refrigerators was not); Rev. Rul. 80-297, 1980-2 C.B. 196 (summer tennis camp operated by school's employees not substantially related to school's exempt purpose); Rev. Rul. 80-298, 1980-2 C.B. 197 (lease of university's football stadium to professional team and the provision of substantial services to the team was not substantially related to university's exempt purpose); Rev. Rul. 78-98, 1987-1 C.B. 167 (fees from public for use of school's ski facility unrelated business income); Rev. Rul. 73-587, 1973-2 C.B. 192 (pet grooming and boarding services not substantially related to humane society's exempt purpose); Rev. Rul. 73-105, 1973-1 C.B. 264 (sale of art books substantially related to exempt purpose of museum but sale of souvenirs of city in which museum located not substantially related). *See Examination Guidelines for Colleges and Universities*, Ann. 94-112, 1994-37 I.R. B. 1 at § 342.(13), for the very limited application of the fragmentation rule to college bookstores in light of the generally controlling convenience exception.

163. Treas. Reg. § 1.513-1(d)(4)(iv), Examples (6) and (7).

164. I.R.C. § 501(c)(6) deals with business leagues, trade associations, and professional associations. *See Hill and Kirschten supra* note 17 at Chap. 7. The

other editorial material which contribute importantly to the accomplishment of purposes for which exempt is granted the organization."¹⁶⁵ Consequently, income from the sale of subscriptions to members and others is not treated as unrelated business income.¹⁶⁶ The example provides that the trade association "also derives income from the regular sale of space and services for general consumer advertising, including advertising of such products as soft drinks, automobiles, articles of apparel, and home appliances."¹⁶⁷ The regulation takes the position that the advertising activity is not substantially related to the accomplishment of the organization's exempt purpose, and, consequently, the advertising income is taxable.¹⁶⁸

The second example raises the more difficult issue where the content of the advertising is more closely tailored to the editorial content of the magazine and thus to the exempt purpose of the organization.¹⁶⁹ In this example, a section 501(c)(6) organization limits advertising in its journal to "products which are within the general area of professional interest of its members."¹⁷⁰ The example further states:

Following a practice common among taxable magazines which publish advertising, [the organization] requires its advertising to comply with certain general standards of taste, fairness, and accuracy; but within those limits the form, content, and manner of presentation of the advertising

Service and the courts apply the general requirements of the unrelated business income tax to all organizations. However, the substantially related test requires that the determination be linked to an analysis of each organization's exempt purpose. Nevertheless, the substantially related test has not supported distinctions among types of exempt organizations with respect to advertising.

165. Treas. Reg. § 1.513-1(d)(4)(iv), Example (6).

166. The fragmentation rule does not require allocation of part of the subscription income to advertising such as on the basis of the percentage of pages or lines devoted to advertising and the percentage devoted to editorial content. Similarly, application of the fragmentation rule to corporate sponsorship does not require that ticket income or even the broadcast revenue received by the event organizers be allocated in part to the presence of advertising.

167. Treas. Reg. § 1.513-1(d)(4)(iv), Example 6.

168. *Id.* The regulation concludes

Neither the publication of such advertisements nor the performance of services for such commercial advertisers contributes importantly to the accomplishment of any purpose for which exemption is granted. Therefore, notwithstanding the fact that the production of income from advertising utilizes the circulation developed and maintained in performance of exempt functions, such income is gross income from unrelated trade or business.

169. Treas. Reg. § 1.513-1(d)(4)(iv), Example (7).

170. *Id.*

messages are governed by the basic objective of the advertisers to promote the sale of the advertised products. While the advertisements contain certain information, the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products and differs in no essential respect from the informational function of any commercial advertising. Like taxable publishers of advertising, [the organization] accepts advertising only from those who are willing to pay its prescribed rates. Although continuing education of its members in matters pertaining to their profession is one of the purposes for which [the organization] is granted exemption, the publication of advertising designed and selected in the manner of ordinary commercial advertising is not an educational activity of the kind contemplated by the exemption statute; it differs fundamentally from such an activity both in its governing objective and in its method. Accordingly, [the organization's] publication of advertising does not contribute importantly to the accomplishment of its exempt purposes; and the income which it derives from advertising constitutes gross income from unrelated trade or business.¹⁷¹

In *American College of Physicians*, the Supreme Court decided a case based on essentially similar facts.¹⁷² The American College of Physicians ("ACP") was exempt under section 501(c)(3). It published a monthly professional journal, *The Annals of Internal Medicine* (the "Annals"), each issue of which contained "advertisements for pharmaceuticals, medical supplies, and equipment useful in the practice of internal medicine," which appeared in two clusters, one at the beginning and the other at the end of the magazine.¹⁷³ The Court noted that the ACP had "a longstanding policy of accepting only advertisements containing information about the use of medical products, and screens proffered advertisements for accuracy and relevance to internal medicine."¹⁷⁴ In holding that the advertising was not substantially related to ACP's exempt purpose, the Court relied on *Treas. Reg. §1.513-1(d)(4)(iv), Example (7)* and section 513(c).¹⁷⁵

171. *Id.*

172. *United States v. American College of Physicians*, 475 U.S. 834 (1986).

173. *Id.* at 836.

174. *Id.*

175. The Court noted that section 513(c) was enacted in 1969 in response to the controversy that had surrounded promulgation of the regulation in 1967. The Court treated this subsequent action by Congress as legislative approval of the approach taken in the regulation. *Id.* at 839-40. See *supra* note 163 for other applications of the fragmentation rule.

The central controversy in *American College of Physicians* was whether the regulation created a *per se* rule that all advertising is an unrelated trade or business, or whether this determination was to be made on the facts and circumstances of each particular case. In resolving this question, the Court found the interpretative difficulty of Example 7 arises primarily from its failure to distinguish clearly between the statements intended to provide hypothetical facts and those designed to posit the necessary legal consequence of those facts. Just at the point in the lengthy Example at which the facts would appear to end and the analysis to begin, a pivotal statement appears: "the informational function of the advertising is incidental to the controlling aim of stimulating demand for the advertised products." The Government's position depends upon reading this statement as a general proposition of law, while respondent would read it as a statement of fact that may be true by hypothesis of "Z" [the organization in the regulation] and its journal, but is not true of Annals.¹⁷⁶ The Court also found the legislative history of the 1969 Act inconclusive on the question of a *per se* rule, although not inconclusive on the question of the validity of the regulation in question.¹⁷⁷ It also found that the Service had relied on case-by-case determinations with respect to advertising income.¹⁷⁸ The Court thus rejected the Service's claim that the regulation created a permissible *per se* rule.¹⁷⁹

However, in considering the facts and circumstances of the advertising in the ACP's journal, the Annals, the Court held that the advertisements were not substantially related to the organization's exempt purposes; consequently, the advertising income was subject to the unrelated business income tax.¹⁸⁰ The Court did observe, consistent with its holding that each case was to be analyzed on its own facts

This is not to say that the College could not control its publication of advertisements in such a way as to reflect an intention to contribute importantly to its educational functions. By coordinating the content of the advertisements with the editorial content of the issue, or by publishing only advertisements reflecting new developments in the pharmaceutical market, for example, perhaps the College could satisfy

176. *Id.* at 843.

177. *Id.* at 846-47.

178. *Id.*

179. *Id.* at 847.

180. *Id.* at 849.

the stringent standards erected by Congress and the Treasury.¹⁸¹

Consistent with its previous positions and the Court's holding, the Service has applied the facts and circumstance approach mandated by the Court in its subsequent rulings.¹⁸² None of these rulings has treated listings providing any greater identification than the mere listing of a company's name as an acknowledgment rather than as advertising.¹⁸³ The proposed regulations on corporate sponsorship thus represent a marked departure from its ruling position with respect to print advertising in exempt organization journals.¹⁸⁴

The third factor, whether the activity was regularly carried on, has provided the basis for excluding income from certain types of advertising from unrelated business income. For example, the Service has ruled that advertisements sold by an exempt organization's regular paid staff during the four months preceding the eight-month concert season and appearing in a weekly concert program during the season was regularly carried on.¹⁸⁵ Similarly, the solicitation of advertising for an exempt organization's yearbook was treated as regularly carried on when the solicitation was conducted throughout the year by a commercial firm and the yearbook itself was distributed throughout the year.¹⁸⁶ However, solicitations by volunteers for advertisements in an organization's annual yearbook, which was distributed at the organization's annual dinner dance, was not regularly carried on.¹⁸⁷ These rulings suggest that the Service will treat advertising as not regularly carried on only if the solicitation is not commercial in

181. *Id.* at 849-50. This statement seemed to address the concerns expressed in the concurring opinion by then Chief Justice Burger and then Justice Powell.

182. *See, e.g.*, Tech. Adv. Mem. 91-37-002 (Apr. 29, 1991) and Gen. Couns. Mem. 39,860 (Sept. 26, 1991) (advertising in football programs); Tech. Adv. Mem. 91-48-054 (Mar. 6, 1991) (advertising in local bar association journal not include legal notices); Priv. Ltr. Rul. 92-05-037 (Nov. 6, 1991) (advertising in advertising industry journal not substantially related); Tech. Adv. Mem. 92-34-002 (Feb. 19, 1992) ("message" notice are advertising); Tech. Adv. Mem. 93-04-001 (Sept. 29, 1992) ("clustering" of some notices does not make them mere listings).

183. *See, e.g.*, Tech. Adv. Mem. 93-45-004 (July 27, 1993), in which the Service ruled that a "yellow pages" listing was advertising because it contained the fax number, telephone number, and name of the company sales representative for each company listed.

184. *See infra* at Part VII(B) for a discussion of the proposed regulations.

185. Rev. Rul. 75-200, 1975-1 C.B. 163.

186. Rev. Rul. 73-424, 1973-2 C.B. 190.

187. Rev. Rul. 75-201, 1975-1 C.B. 164. It appears that the income would not be includable in any case due to the volunteer exception of I.R.C. § 513(a).

manner, relatively short in duration, and the advertising appears in a program that is distributed at an event that is also of short duration.

Based on these precedents, the Service took the position that income from the advertising appearing in the program for the NCAA Men's Final Four was unrelated business income.¹⁸⁸ While the Tax Court held that the Service was correct, the Court of Appeals reversed.¹⁸⁹ The Tenth Circuit's NCAA decision and the Service's nonacquiescence have left the law in this area unresolved.¹⁹⁰

For purposes of computing the amount of unrelated business taxable income, advertising in exempt organization journals is subject to the favorable rules applicable to activities that exploit an exempt function.¹⁹¹ These provisions are an exception to the general requirement that any amount deducted from unrelated business income must be directly connected with the unrelated business activities producing the income.¹⁹² The concept of an unrelated business activity that exploits an exempt function permits an exempt organization to deduct from unrelated business income any amount of its exempt function expenses in excess of its exempt function income.¹⁹³ This concept has been applied exclusively in the case of advertising in exempt function journals where certain expenses associated with the production of the editorial content of the magazine may be deducted from the advertising revenue, thereby reducing the amount of unrelated business taxable income.¹⁹⁴

188. *National Collegiate Athletic Association v. Commissioner*, 92 T.C. 456 (1989).

189. *National Collegiate Athletic Association v. Commissioner*, 914 F. 2d 1417 (10th Cir. 1990). See Hill and Kirschten *supra* note 17 at ¶10.02[2] for a critique of the court's reasoning in this case.

190. AOD 1991-015 (July 3, 1991). See also Tech. Adv. Mem. 92-34-002 (Feb. 19, 1992)(Service states that it "will continue to litigate the issue in appropriate cases"). See Hill and Kirschten *supra* note 17 at ¶10.02[2] for a discussion of the current state of the regularly carried on test.

191. Treas. Reg. § 1.512(a)-1(d).

192. I.R.C. § 512(a)(1) and Treas. Reg. § 1.512(a)-1(a).

193. Treas. Reg. § 1.512(a)-1(d)(2).

194. Treas. Reg. § 1.512(a)-1(f). For a discussion of these rules applied to print advertising, see Hill and Kirschten *supra* note 17 at ¶10.07[3].

B. Special Exceptions to the Definition of Unrelated Business Income

The three-part statutory test discussed above is subject to two broad categories of statutory modifications and exceptions. The first category consists of statutory modifications under section 512(b). These modifications apply to types of income that, under many common fact patterns, do not constitute unrelated business income. However, under other fact patterns, such income would be unrelated business income within the general rules. The statutory modifications are intended to define the situations in which the general rules are not likely to apply while not foreclosing their application under other facts. These modifications are generally expressed in provisions drafted as broad principles, not as specific rules. The second category consists of statutory exceptions set forth in section 513 that apply to types of income that clearly fall within the statutory definition of unrelated business income. The statutory exceptions simply provide that such types of income will not be subject to tax. These provisions tend to be drafted as much more narrowly-crafted and fully-specified rules. The following discussion of these special statutory exceptions highlights the limitations of the general rules and invites consideration of the tension between general principles and particular cases in the statutory structure of the unrelated business income tax.

1. Statutory Modifications

The statutory modifications of section 512(b) in several instances resolve disputes that could be resolved within the general definition of unrelated business income. These modifications are thus more matters of efficiency of tax administration and certainty for exempt organization taxpayers than of departures from the general principles.

Several of these modifications extend the principle that income from passive investment activities is not unrelated business income. For example, the Service has generally taken the position that investment activities of exempt organizations are not a trade or business activity, and this is clarified in section 512(b)(1), which excludes interest, dividends and certain other forms of investment income.

Similarly, by extension of the distinction between a trade or business and the passive receipt of investment income, the receipt of royalty income from licensing agreements is considered not to be a trade or business because the organization plays a passive

role.¹⁹⁵ What arrangements qualify as royalties rather than as the provision of goods or services are currently in dispute, especially with respect to affinity credit cards and the provision of mailing lists.¹⁹⁶

The Cotton Bowl Committee attempted to argue that it had not sold advertising to Mobil, but that Mobil had instead paid the Committee a royalty for the use of the Cotton Bowl name and logo in its advertising.¹⁹⁷ This approach contains elements of plausibility but ultimately fails. This royalty argument, in effect, reverses the transaction so that Mobil is no longer purchasing the right to display its name and logo, but is instead purchasing the right to use the Cotton Bowl's name and logo. To the extent that Mobil purchased, in the corporate sponsorship agreement, the right to use the Cotton Bowl logo as it saw fit, this analysis is consistent with the Mobil Cotton Bowl agreement. However, even in this case, Mobil purchased more than the right to use the logo; it purchased the right to display its name and logo in a particular setting at a particular event with specified forms of broadcast coverage. The Cotton Bowl did not simply agree to allow Mobil to use its logo but actively participated in the Mobil display of its logo at the game itself and in the associated publicity and game programs. This kind of active involvement of the Cotton Bowl Committee takes the corporate sponsorship transaction, at least in the football bowl game setting, out of the passive licensing arrangements to which royalty analysis properly applies. The question here is whether the corporate sponsor would purchase the right to display the bowl game logo if it did not also have the right to display its own logo at the game.¹⁹⁸ One approach might be to bifur-

195. I.R.C. § 512(b)(2). What constitutes a royalty is a matter of intense contemporary dispute. See Hill and Kirschten *supra* note 17 at ¶10.04[1].

196. *Sierra Club, Inc. v. Commissioner*, 103 T.C. 307 (1994). For the Service's position, see Tech. Adv. Mem. 93-21-005 (Feb. 23, 1993) (affinity credit card).

197. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991).

198. The Olympic Games' licensing of its name and logo for use by sponsors in their own advertisements might seem to offer a case for royalty treatment. However, in its comments to the Service on the proposed audit guidelines on corporate sponsorship, the United States Olympic Committee discussed the linkage between the use of its logo by sponsors and payments it receives from the same sponsors to display their names and logos at Olympic events (comment available electronically at 92 TNT 163-81). For discussions of similar linkages between the display of the organization's name or logo by the corporate sponsor and the organization's display of the corporate sponsor's name and logo, see the Comment on the proposed audit guidelines by the United States Gymnastics Federation, which is a National Governing Body recognized by the United States Olympic Committee under the Amateur Sports Act of 1978, 36 U.S.C. secs. 391(a) and 392 (comment available

cate corporate sponsorship payments into a royalty element that is not taxable and an advertising component that is subject to the unrelated business income tax. This approach would raise significant allocation issues.

Receipt of income from the rental of real property is also excluded from unrelated business income, largely on grounds that it is not a trade or business because it is passive and akin to investment income.¹⁹⁹ However, the income from the rental of personal property does not fall within this exception unless it is rented in connection with the rental of real property.²⁰⁰ The rental income rules are set forth with the level of detail more characteristic of the exclusion provisions of section 513 than with the statutory modifications of section 512(b). This reflects the more tenuous grounding of the exception in the general principles of the unrelated business income tax.

Gain or loss on the sale of property is also excluded.²⁰¹ This exception does not apply to sale of stock in trade or other property properly includable in inventory²⁰² or to the sale of "property held primarily for the sale to customers in the ordinary course of the trade or business."²⁰³ This modification is akin to the regularly carried on requirement and has elements of an argument that the sale of property is not a trade or business.

The exclusion of research income from unrelated business income rests on the educational aspects of research. The three exceptions do not apply to applied research, which is treated as a trade or business. Section 512(b) contains three distinct exceptions for research income. The first exception applies to income from any research performed by a college, university, or hospital.²⁰⁴ The second exception applies to income from research performed for the United States government, its agencies and instrumentalities, or for any state or its political subdivisions by any exempt organization.²⁰⁵ The third exception applies to income from research performed by an exempt organization "oper-

electronically at 92 TNT 163-78) and the Comment on the proposed audit guidelines of the PGA Tour, Inc. (comment available electronically at 92 TNT 163-58).

199. I.R.C. § 512(b)(3).

200. I.R.C. § 512(b)(3)(A)(i). However, a limited amount of rental income from personal property rented with real property can be excluded from unrelated business income under I.R.C. § 512(b)(3)(A)(ii).

201. I.R.C. § 512(b)(5).

202. I.R.C. § 512(b)(5)(A) and Treas. Reg. § 1.512(b)-1(d)(1).

203. I.R.C. § 512(b)(5)(B) and Treas. Reg. § 1.512(b)-1(d)(1).

204. I.R.C. § 512(b)(8).

205. I.R.C. § 512(b)(7).

ated primarily for purposes of carrying on fundamental research."²⁰⁶ To qualify for this exception, the results of the research must be "freely available to the general public."²⁰⁷ These exceptions for research income derive from the general principle that research is not a trade or business. The exceptions for research performed by colleges, universities, or hospitals and for research performed for federal or state governments are also based on claims that the research in question fulfills the organization's exempt purpose, including relieving the burdens of government.

Apart from the royalty provision discussed above, none of the statutory modifications applies to corporate sponsorship. This is not surprising since these modifications generally clarify the application of the general statutory principles, under which corporate sponsorship payments are likely to be treated as unrelated business income to the recipient organizations, rather than departing from such principles.

2. Statutory Exceptions

The statutory exceptions all appear in section 513 and apply to very specific situations that would result in unrelated business income under the general rules.²⁰⁸ The exceptions are the volunteer exception, the contributed property exception, the convenience exception, the low-cost items exception, the bingo exception, the public entertainment exception, and the trade show exception. While each of these exceptions can find some basis in extension of the general definitional principles of the unrelated business income tax, application of these general principles would, in most cases, have resulted in treating the activities as unrelated trade or business activities. Thus, the Section 513 exceptions do not so much extend the general principles as reverse the effect of their application to very particularized fact patterns. Each of these statutory exceptions is discussed below.

The volunteer exception provides that an activity will not be treated as an unrelated trade or business if "substantially all of the work in carrying on such trade or business is performed for the organization without compensation."²⁰⁹ The Service has applied the volunteer exception to income from the operation of

206. I.R.C. § 512(b)(9).

207. *Id.*

208. See Hill and Kirschten *supra* note 17 at ¶10.03.

209. I.R.C. § 513(a)(1) and Treas. Reg. § 1.513-1(e)(1).

thrift shops or gift shops operated by volunteers.²¹⁰ The Service has interpreted the volunteer exception strictly in refusing to apply it if volunteer labor “is not a material income-producing factor.”²¹¹ However, minimal amounts of work by an organization’s paid staff members will not preclude application of the volunteer exception.²¹²

The contributed property exception provides that income from the sale of merchandise, “substantially all of which has been received by the organization as gifts or contributions,” is not subject to the unrelated business income tax.²¹³ This exception has been applied to thrift shops selling donated merchandise and to auctions of donated items at fundraising events.²¹⁴

The convenience exception applies to a trade or business carried on “primarily for the convenience of its members, students, patients, officers or employees.”²¹⁵ Examples include hospital pharmacies selling items used primarily by patients²¹⁶ and college bookstores.²¹⁷

Certain low-cost items distributed in connection with fundraising efforts are not treated as having been sold to generate revenue under the low-cost items exception.²¹⁸ The regulations treat the distribution of such low-cost items as not a trade or business.²¹⁹

Income from operating bingo games is not taxable as unrelated business income if the games are not operated in a commercial manner and do not violate any state or local law.²²⁰ Certain religious organizations historically raised funds by operating bingo games, and the bingo exception responded to assertions that these church-related social and fundraising activities should not

210. Treas. Reg. § 1.513-1(e). See also Rev. Rul. 80-106, 1980-1 C.B. 113.

211. Rev. Rul. 78-144, 1978-1 C.B. 168 (heavy equipment leasing).

212. Tech. Adv. Mem. 82-11-002 (n.d.).

213. I.R.C. § 513(a)(3) and Treas. Reg. § 1.513-1(e)(3).

214. Treas. Reg. § 1.513-1(e).

215. I.R.C. § 513(a)(2) and Treas. Reg. § 1.513-1(e)(2).

216. Rev. Rul. 68-374, 1968-2 C.B. 242.

217. Rev. Rul. 58-194, 1958-1 C.B. 240.

218. I.R.C. § 513(h).

219. Treas. Reg. § 1.513-1(b) states

where an activity does not possess the characteristics of a trade or business within the meaning of section 162, such as when an organization sends out low cost articles incidental to the solicitation of charitable contributions, the unrelated business income tax does not apply since the organizations is not in competition with taxable organizations.

220. I.R.C. § 513(f) and Treas. Reg. § 1.513-5.

be taxed. No other games of chance fall within this bingo exception.²²¹

The public entertainment exception applies to events at state or county fairs.²²² Events such as horse races, auto races, or musical entertainment might not be substantially related to the educational or civic purposes of the section 501(c)(3) or section 501(c)(4) organizations that organize such fairs. The public entertainment exception does not attempt to establish that such events are substantially related to the exempt purposes of the main body of fair activities, such as agricultural education or civic betterment, but instead simply provides that income from such events is not subject to the unrelated business income tax. The statute invokes the tradition and custom of presenting such events at exempt fairs.²²³

The trade show exception is also based on a reference to the types of activities traditionally carried on at trade shows.²²⁴ Again, the exception is not based on the assertion that the activities themselves are educational, but that they are traditional and attract persons to the trade show at which other activities will be educational.

These statutory exceptions are all drafted to apply to narrowly-defined fact patterns. Thus, none of these exceptions applies to corporate sponsorship in their current form. The closest analogue is the Section 513(d)(2) public entertainment exception. However, these statutory exceptions provide a model for a narrowly-drafted statutory exception for corporate sponsorship.

221. Treas. Reg. § 1.513-5(d) defines "bingo games" for this purpose. See Tech. Adv. Mem. 86-02-001 (Feb. 27, 1985) (pulltabs are not covered by the bingo exception).

222. I.R.C. § 513(d)(2).

223. I.R.C. § 513(d)(2)(A) defines a public entertainment activity as

any entertainment or recreational activity of a kind traditionally conducted at fairs or expositions promoting agricultural or educational purposes, including, but not limited to, any activity one of the purposes of which is to attract the public to fairs or expositions or to promote the breeding of animals or the development of products or equipment.

224. I.R.C. § 513(d)(3)(A) defines convention or trade show activity as

any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows, including, but not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of displaying industry products or to stimulate interest in, and demand for, industry products or services, or to educate persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

C. *Unrelated Business Income and Exempt Status*

Unrelated business income can jeopardize an organization's exempt status even if the organization pays the full amount of the unrelated business income tax. Exempt status is jeopardized not by nonpayment of tax, but by the organization's not operating "exclusively" for an exempt purpose.²²⁵ This is a potentially significant problem for the bowl committees, which appear to earn a significant share of their revenue from corporate sponsorship payments. Museums, universities, and other organizations that receive corporate sponsorship payments are less likely to face this problem because they generally receive a lesser share of their total revenue from corporate sponsorship payments. However, the issue is potentially not limited to the bowl committees. For example, the Guthrie Theater of Minneapolis, received approximately one-sixth of its 1991 budget from business, although it is not clear what share of that might be considered a corporate sponsorship payment.²²⁶ The Boston Symphony Orchestra raised approximately 7.5 percent of its \$38 million operating budget from corporate underwriting of individual concerts and tours.²²⁷ The Princeton University Art Museum reported at it must finance all of its exhibitions and programs from sources outside the university.²²⁸ Approximately one-sixth of the annual operating budget of a community arts program offered by the University of California at Davis is provided by corporations.²²⁹

The regulations set forth inconsistent requirements. The regulations under section 501(c)(3) provide that such organizations must be "organized and operated exclusively" for one or more exempt purposes,²³⁰ but defines "exclusively" as primarily,²³¹ and "primarily" as all but an insubstantial part.²³² These formula-

225. Treas. Reg. § 1.501(c)(3)-1(a)(1) requires that an I.R.C. § 501(c)(3) organization be "both organized and operated exclusively" for an exempt purpose.

226. Comment by the Guthrie Theater on the proposed audit guidelines (available electronically at 92 TNT 163-87).

227. Comments of the Boston Symphony Orchestra on proposed audit guidelines (available electronically at 92 TNT 163-64).

228. Comments of the Art Museum of Princeton University on proposed audit guidelines (available electronically at 92 TNT 149-66).

229. University of California at Davis comments on proposed audit guidelines (available electronically at 92 TNT 149-34).

230. Treas. Reg. § 1.501(c)(3)-1(a)(1).

231. Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that "an organization will be regarded as 'operated exclusively' for one or more exempt purpose only if it engages primarily in activities which accomplish one or more of such exempt purposes."

232. Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will not be regarded as operated "primarily" for one or more exempt purposes "if more than an

tions are far from precise, but are generally taken to mean that only an insubstantial part of the activities of a section 501(c)(3) organization can be for nonexempt purposes, including unrelated trade or business activities.

The unrelated business income tax regulations simply provide that an organization may not be operated "primarily" for an unrelated business purpose.²³³ The regulations do not limit primarily to only an insubstantial part.²³⁴ Thus, the language of the regulation referring specifically to the unrelated business activities of section 501(c)(3) organizations might be read as permitting an exempt organization to engage in unrelated business activity that is substantial but not primary, which is to say does not account for more than half of the organization's activities or income or both.

The Service has not clarified this issue. In Revenue Ruling 64-182, the Service ruled that an organization's exempt activities must be "commensurate in scope with its financial resources."²³⁵ While the Service stated that this would serve as interim guidance, it has since issued no additional precedential guidance.²³⁶ The Service has reiterated its position that whether exempt activities are commensurate in scope is a factual question.²³⁷

The courts have rarely considered this issue and in the few decided cases have read the reference to "primarily" in the unrelated business regulations as consistent with the reference in the general operational requirements for exemption, so that exempt organizations may not engage in more than an insubstantial

insubstantial part of its activities is not in furtherance of an exempt purpose." Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)(b) provides that an organization will be treated as organized for exempt purposes if "an insubstantial part of its activities" are unrelated to its exempt purpose.

233. Treas. Reg. § 1.501(c)(3)-1(e) provides that an organization will satisfy the requirements of section 501(c)(3) "if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513."

234. Treas. Reg. § 1.501(c)(3)-1(e)(1) states with respect to unrelated business activities: "In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes."

235. Rev. Rul. 64-182, 1964-2 C.B. 186.

236. Gen. Couns. Mem. 34682 (Nov. 17, 1971).

237. Gen. Couns. Mem. 34682 (Nov. 17, 1971)(advising against issuing a revenue ruling). *See also*, Gen. Couns. Mem. 38742 (June 3, 1981)(the commensurate in scope test applied to fundraising events).

amount of unrelated business activity.²³⁸ They have not provided further guidance on the commensurate in scope standard.

The danger that corporate sponsorship payment might jeopardize exempt status is a significant factor fueling the effort to exclude corporate sponsorship payments from taxation as unrelated business income.

VI. CORPORATE SPONSORSHIP PAYMENTS AS UNRELATED BUSINESS INCOME: APPLYING THE GENERAL PRINCIPLES

As the foregoing analysis based on the transactional model suggests, the most straightforward approach to corporate sponsorship arrangements is to determine whether, based on the facts and circumstances of each case, the organization was engaged in an unrelated trade or business that it regularly carried on. This was the approach the Service took in its initial ruling on corporate sponsorship.

The controversy over corporate sponsorship began in earnest when the Service ruled that payments made by Mobil Oil to the Cotton Bowl Committee constituted the purchase of advertising and that, consequently, the Cotton Bowl Committee was taxable on the payment from Mobil because it had been received in exchange for the sale of advertising.²³⁹ Although heavily redacted, the ruling turned on a contract with most of the elements discussed above in describing a generic corporate sponsorship agreement. The ruling states that the contract "recites the mutual receipt of valuable, good and sufficient consideration."²⁴⁰ The ruling turned on whether the Cotton Bowl provided Mobil with a quid pro quo for its contribution. While the Service agreed with the bowl committee that Mobil's intent is not determinative, it nevertheless looked to the payor's expectation of a "substantial

238. See, e.g., *Orange County Agric. Soc., Inc. v. Commissioner*, 893 F. 2d 529 (2d Cir. 1990), *aff'd* 55 T.C.M. 1602 (1988). The Second Circuit held that 29 percent to 35 percent of a fair association's revenue derived from auto races held outside of the fair's operation was not an "insubstantial" amount of unrelated business income for purposes of Treas. Reg. § 1.501(c)(3)-1(c). 893 F. 2d at 531, 533-34. Neither court referred to Treas. Reg. § 1.501(c)(3)-1(e). The Second Circuit held that the public entertainment activity exception of I.R.C. §513(d)(2) applied only to the auto races held in direct connection with the county fair. 893 F. 2d at 532-33.

239. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991). While the ruling was made public by the Service in a severely redacted form and while all published rulings are redacted to protect the identity of the taxpayer to which it was issued, Mobil and its attorneys have made the full ruling public and the ruling is commonly referred to as "the Cotton Bowl ruling."

240. *Id.*

return benefit" to determine whether there was a quid pro quo or a mere acknowledgement.²⁴¹

The bowl committee argued that the benefits received by Mobil were "mere recognition of a donor's generosity" and not a "substantial return benefit" because providing the benefits provided in the contract involved relatively little extra time or effort by the bowl committee.²⁴² The Service rejected a test based on incremental effort and looked instead to whether the value of the benefit was "commensurate in value" with the payment.²⁴³ It also found that "the benefits provided in this case are significantly different from the types of donor recognition previously recognized by the Service as insignificant."²⁴⁴

The bowl committee also argued that unrelated business income arose only where an exempt organization competed with a taxable entity.²⁴⁵ Arguing that it was not competing with any taxable entity, the bowl committee took the position that unrelated business income tax was improper in this case. The Service rejected both prongs of this position. The Service stated flatly that "there is no requirement that unfair competition be present in order to tax the proceeds from an activity."²⁴⁶ Alternatively, the Service argued that the bowl committee was competing unfairly

241. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991) states

The Organization argues that the * * * payment is a gift or contribution that was made with no expectation of a return in the way of goods or services. The Organization also argues that the donative intent or lack thereof on the part of * * * is not determinative of the treatment to be accorded the payments by the Organization. Accordingly, we agree with the Organization that regardless of the subject intent of * * * which we do not know, and regardless of how * * * treated the payment on its federal income tax return, which we also do not know, the question to be resolved here is whether the payment was in exchange for goods and/or services provided by the Organization. In other words, did the Organization provide a quid pro quo in exchange for the payment from * * *. The appropriate way to answer this question is to look at all the facts and circumstances to see if the payment was made with an expectation of receiving from the Organization a substantial return benefit.

Id.

242. *Id.* In effect, the Cotton Bowl Committee attempted to base the determination of whether it was conducting a trade or business on the amount of activity and not on the profit motive test adopted by the courts and the Service. See *supra* at Part V(A)(1).

243. *Id.*

244. *Id.*

245. *Id.*

246. Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991) (citing Treas. Reg. § 1.513-1(b), states that "there is no necessity to determine that the Organization actually competes with other advertisers").

with taxable entities that might wish to attract corporate advertising.²⁴⁷

The ruling also addresses the question of whether the activity was regularly carried on. The Service refused to follow the NCAA decision and ruled that the activity was regularly carried on.²⁴⁸

Publication of the Mobil Cotton Bowl Ruling caused immediate controversy.²⁴⁹ The Service responded to the furor by issuing a News Release stating that the corporate sponsorship ruling did not represent a change in the law.²⁵⁰ In the News Release the Service stated that recognition of a contribution did not result in unrelated business income. It offered as examples of permissible forms of recognition a university's naming a professorship, building, or scholarship after the contributor, a public broadcast station's acknowledging a contribution on the air or in its broadcast schedule, or a performing arts group's acknowledging a contributor in the program for a performance.²⁵¹ The News Release also

247. Tech. Adv. Mem. 91-47-007 states

The Service maintains that the presence of unfair competition is neither the sole nor the primary criterion to be considered in determining whether an activity is an unrelated trade or business. However, even if it were true that there must be a finding of unfair competition, it is important to recognize the broad reach of the term 'unfair competition.' For-profit entities that offer * * * and other services might find it is difficult to compete for the business of the * * * which might otherwise be inclined to purchase the services of these for-profit entities.

Tech. Adv. Mem. 91-47-007 (Aug. 16, 1991). The Service relied on the American Bar Endowment case, which is discussed *supra* at text accompanying notes 109-11.

248. *Id.* For a discussion of the NCAA decision, see *supra* at text accompanying notes 129-36.

249. The Service has described the ensuing events as follows

As soon as TAM 91-47-007 became public, the exempt community erupted with outrage and concern. Coalitions began forming in an all out effort to stop this perceived full-scale assault by the IRS on vital fundraising activities of exempt organizations. Many organizations felt that their very existence was threatened. The heavily redacted version of the TAM fueled rather than assuaged their worst fears.

RUSSLYN GURITZ AND CHARLES BARRETT, *Corporate Sponsorship Income*, INTERNAL REVENUE SERVICE EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM TEXTBOOK (1992) ("1992 CPE Text") (available electronically at 94 TNT 70-20).

250. IR-92-4, 1992 IRB Lexis 63 states

Under current law, donations a charitable organization receives are considered tax exempt contribution income if the organization does not, in return, provide a valuable benefit or service to the donor. Mere recognition of a contributor as a benefactor normally is of little or no value to the donor and is incidental to the contribution.

Unrelated business income is earned by "organizations that go beyond recognition and extensively promote the donor." *Id.*

251. News Release IR-92-4.

stated that “[a]ssociating the name of the sponsor with the name of the exempt organization’s event is not, by itself, advertising.”²⁵² The News Release offered the following noninclusive list of indicators of unrelated business activity:

- providing exposure of the sponsor’s name, logo or corporate message according to negotiated terms of a contract or other agreement,
- agreeing to verbally or visually maximize donor name or logo exposure in the media during the sponsored activity,
- linking the amount of payment to the amount of exposure that the donor’s name or logo receives, or
- agreeing that payment is contingent upon the organization securing television or other marketing contracts to provide the sponsor’s name widespread exposure.²⁵³

These factors are all consistent with a quid pro quo analysis and treatment of the corporate sponsorship transaction as an unrelated business income transaction.

The Service extended its quid pro quo approach in Announcement 92-15, which set forth Proposed Examination Guidelines Regarding the Treatment of Corporate Sponsorship Income (the “Guidelines”).²⁵⁴ The proposed guidelines emphasized the existence of a quid pro quo, stating

Payments an exempt organization receives from donors are nontaxable contributions if there is no expectation that the organization will provide a substantial return benefit. Mere acknowledgment or recognition of a corporate contributor as a benefactor normally is incidental to the receipt of a contribution is not of sufficient benefit to give rise to unrelated trade or business income. However, where an exempt organization performs valuable advertising, marketing, and similar services, on a quid pro quo basis, for the corporate sponsor, payments made to an exempt organization are not contributions to the exempt organization, and questions of unrelated business income arise.²⁵⁵

The Guidelines followed a transactional approach based on a quid pro quo, stating:

A determination of whether a substantial return benefit is present should include an analysis of: the value of the service provided in exchange for the payment; the terms under

252. News Release IR-92-4.

253. News Release IR-92-4.

254. Ann. 92-15, 1992-5 I.R.B. 51.

255. *Id.*

which payments and services are rendered; the amount of control that the sponsor exercises over the event; and whether the extent of the organization's exposure of the donor's name constitutes significant promotion.²⁵⁶

The Guidelines then listed factors that might bear on the question of whether there was a substantial return benefit. With respect to the corporate sponsor's name or logo, the Guidelines direct attention to inclusion in the official event title, whether they are "prominently placed throughout the stadium, arena or other site where the event is held," whether they are displayed on participants' uniforms, whether they are displayed on materials relating to the event.²⁵⁷ The Guidelines also direct attention to the corporate sponsor's reference to its sponsorship in its advertisements, the possible role of event participants in endorsing the sponsor's products or making personal appearances on behalf of the sponsor, and such benefits as special seating, accommodations, transportation, and hospitality for the corporate sponsor's executives or clients. The Guidelines also raise specific questions about broadcast of the sponsored event, including whether the payment is contingent on broadcast giving the sponsor's name or logo widespread exposure, whether the payment is contingent on television ratings of the event, whether extensions or renews of the corporate sponsorship depend on the extent of the public exposure, and "[w]hether the segment of the public expected to see the identifying sponsorship information can reasonably be expected to purchase the sponsor's goods or services."²⁵⁸ These factors are similar to the factors examined in determining whether the display of a payor's name or logo in print in an organization's journal constitutes an acknowledgement or an advertisement.²⁵⁹

The Guidelines also provided a form of safe harbor for certain groups, stating

As a matter of audit tolerance, the Service will not apply these guidelines to organizations that are of a purely local nature, that receive relatively insignificant gross revenue from corporate sponsors and generally operate with significant amounts of volunteer labor. Generally, included among these are youth athletic organizations such as little league

256. *Id.*

257. *Id.*

258. *Id.*

259. *See supra* at Part V(A)(4).

baseball and soccer teams, and local theaters and youth orchestras.²⁶⁰

While this safe harbor was intended to limit the scope of the Guideline's application, it may have instead unintentionally fueled concern among a broad range of organizations that they would be subject to the corporate sponsorship Guidelines and that the Guidelines created a new legal standard for distinguishing an acknowledgement of a contribution from a taxable sale of advertising and that this new standard would include in taxable advertising a far greater range of displays previously treated as acknowledgments. Paradoxically, this result may have been due in part to the lack of a definition of corporate sponsorship in the regulations. A definition of corporate sponsorship would have limited the application of the Guidelines to a knowable range of transactions, thereby limiting the public concern to those organizations engaging in the defined transaction. While the inclusion of such a definition seems, from this perspective, prudent, it would have been inconsistent with the entire logic of the Service's position in the Guidelines, which simply apply the Service's interpretation of current law to any transactions that may fit within it. Presentation of a limiting definition of corporate sponsorship without specific statutory authority would have resulted in administrative amendment of current law. In the ensuing debate over corporate sponsorship, many of the comments read more like an attack on current law than simply expressions of disagreement with the corporate sponsorship Guidelines. Opposition to the corporate sponsorship Guidelines became an opportunity to enlarge the concept of an acknowledgment while limiting the concept of advertising. This became the heart of the debate, couched in the extra-statutory term of corporate sponsorship.

The Guidelines announced public hearings would be held and invited public comments. The Service received over 300 comments, most of which called for fundamental changes in the Service's approach.²⁶¹ Comments came from a very diverse group of

260. *Id.* This safe harbor suggests that the Service did not find such activities "inherently commercial," perhaps in part because they fulfilled most if not all of the elements of certain exceptions from unrelated business income tax, such as the volunteer exception. See *supra* at text accompanying notes 151-52 for a discussion of the "commerciality" subtext in statutory definition of unrelated business income.

261. 1992 CPE Text *supra* note 249 states of the public comments

In general, many of the organizations feel that the guidelines are too broad and vague, and leave too much discretion in the hands of examiners. Essential terms, such as "substantial return benefits" and "purely local in nature," need definition. Citing lack of definition, clarity

exempt organizations, all of which emphasized the importance of corporate contributions, in whatever form, to their continued operations. Commentators ranged from the National Collegiate Athletic Association²⁶² to the Boston Symphony²⁶³ to the Santa Barbara Civic Opera²⁶⁴ to the Connecticut Food Bank.²⁶⁵

The heart of the substantive comments was an attack on the transactional approach of the Guidelines. Even though the Guidelines stated that the corporate sponsor's treatment of the payment for federal income tax purposes "is not determinative" of the treatment of the payment by the recipient organization,²⁶⁶ numerous comments focused on what they saw as the unfairness of looking at the sponsor's intentions or expectations in determining whether the recipient organization had unrelated business income from the sale of advertising. The most consistent expression of this point of view appears in identical words in the comments of six college football bowl organizations, which wrote

The proposed guidelines incorrectly focus on the benefit received by the sponsor. The sponsor's motive is irrelevant. The IRS should be focusing only on the activities in which the exempt organization is engaged that would not be performed without the sponsorship funds. Many of the activities identified in the proposed guidelines are activities an exempt organization already performs and activities which further the organization's exempt purpose.²⁶⁷

and scope, few found the audit tolerance provision helpful. The guideline, it is argued, fail to provide adequate guidance so that an organization could determine prospectively with reasonable certainty what is sponsorship recognition and what is advertising. For example, some commentators express serious concern that identifying product and/or service lines or slogans are listed as indicators of advertising rather than donor recognition. Others urge that incidental benefits, such as tickets, VIP dinners and hospitality suites, given to donors should not taint the contribution All in all, not one provision contained in the proposed guidelines escaped the ire of commentators, who urged substantial revisions to, if not complete withdrawal of, the guidelines. While most accepted that clearly advertising income was taxable, these organizations also urged a very restrictive definition of what is advertising in the context of fundraising and donor recognition practices.

262. Comments available at 92 TNT 163-77.

263. Comment available at 92 TNT 163-64.

264. Comment available at 92 TNT 165-103.

265. Comment available at 92 TNT 163-75.

266. Ann. 92-15, 1992-5 I.R.B. 51.

267. Comment by the John Hancock Bowl (92 TNT 163-57); comment by the Mobil Cotton Bowl Classic (92 TNT 149-70); comment by the Fiesta Bowl (92 TNT 160-46); comment by the Copper Bowl (92 TNT 159-49); comment by the Sugar Bowl

In the same vein, the Southwest Conference criticized the Guidelines for concentrating on "the subjective intent of the donor," but its subsequent comments indicate that it objected to the focus on whether the recipient organization provided a benefit to the corporate sponsor.²⁶⁸

This position, of course, ignores the long-established legal standard based on the organization's provision of a benefit to the payor,²⁶⁹ referring instead simply to the sponsor's motive in making the payment and suggesting that the organization provides a benefit to the sponsor only if it engages in activities that it would not otherwise undertake. This argument rejects a transactional analysis of exempt organization operations and suggests instead that some activities are inherently exempt.

The athletic organizations also argued that the corporate sponsorship payments should not be subject to the unrelated business income tax because the money was used for exempt activities. They pointed not only to their own exempt activities in presenting the bowl games or other tournaments, but also to their support of other exempt organizations, including the universities participating in the sponsored events and other exempt organizations in the communities where the events are held. This position was developed most fully by the NCAA, which commented

Historically, the use of the proceeds from a UBI [unrelated business income] activity has no relevance on whether the activity is taxable. Maybe it would be beneficial to see that

(92 TNT 159-50); and comment by the Blue-Gray All Star Football Classic (92 TNT 160-48).

268. Comment of the Southwest Conference (92 TNT 149-46). The comment expressed concern that the bowl games or other athletic events were being unfairly singled out and quite correctly observed that acknowledgements in other settings might also benefit the corporate payor, stating

Some dangerous assumptions are made when delving into the psychology of giving. It is not at all clear, for example, that attaching the name of a corporate benefactor to an exempt facility, for example, a building that plays host to some 250 events per year (a large majority of which are regularly covered by the media) and, moreover, is readily visible from the nearby interstate (as the name tastefully yet significantly displayed), is of any less "commercial" value than the one-day events now in question. Yet, the proposed guidelines would have you believe otherwise. Likewise, upon studied consideration of targeted audience demographics and "appropriate presentation," it is highly likely that acknowledgement of a corporate underwriter's support in bringing the consumer the fall season of Masterpiece Theater is as effective a commercial message as a logo sewn on the side of a football jersey.

Id.

269. See *supra* at Part III.

colleges and universities utilize sponsorship income to fund those sports that are not self supporting such as golf, track, soccer, tennis, swimming among many others for both men and women. This income assists in providing opportunities for men and women who otherwise may not have the avenue to pursue a college education. At a time when gender equity, graduation rates, and the poor financial condition of colleges and universities are at the forefront it would appear that strong support is needed to protect the revenue stream of these exempt organizations from taxation. Otherwise, not only are opportunities lost, but already financially crippled institutions will be forced to subsidize their athletic programs. Therefore, a better analysis would be whether the income is derived as a result of a tax exempt related activity (i.e., athletic events), and if the revenue is utilized for activities that are part of the organization's exempt purpose.²⁷⁰

In effect, the NCAA wishes to add elements of the destination of income test to the current unrelated business income tax provisions.²⁷¹ While there is no reason not to discuss this policy option, it would constitute a fundamental change in current law by requiring the repeal of the Section 502 feeder organization provisions as well as of the substantially related test.

The athletic organizations also emphasized that they were not competing with taxable entities and argued that the absence of unfair competition meant that the unrelated business income tax provisions did not apply to them. For example, the Southwest Conference chided the Service for "abandoning reference to the competitive impact of the income producing activity of exempt organizations—upon which the unrelated business income tax is based—and focusing instead on some visceral and, all too often, antiquated notion of what a charitable contribution should look like."²⁷² While it is true that there are no direct taxable competitors presenting bowl games, this observation takes a narrow view of the facts and an unduly expansive view of the importance of competition as an element in an unrelated business income analysis. It ignores the success of professional sports teams in attracting corporate sponsorship²⁷³ and fails to appreciate that current law does not make competition with taxable entities an

270. Comment of the National Collegiate Athletic Association (92 TNT 163-77).

271. See Hill and Kirschten *supra* note 17 at ¶ 10.01[1] for a discussion of the destination of income test.

272. Comment of the Southwest Conference (92 TNT 149-46).

273. See *supra* note 152 for a discussion of corporate sponsorship in professional football.

independent element of the definition of an unrelated trade or business.²⁷⁴ The Ladies Professional Golf Association ("LPGA") asked the Service to clarify the volunteer exception in the context of LPGA tournaments.²⁷⁵

Numerous arts and cultural organizations also commented adversely on the Guidelines. Generally, the arts organizations sought clarification of the line between acknowledgements and advertising but did not reject the quid pro quo analysis as inconsistent with current law. Many of the arts organizations, using essentially similar language, took the position that

[t]he guidelines should make a clear distinction between sponsorship recognition which merely provides an indirect benefit to the sponsor in the nature of goodwill or other intangible benefits and recognition designed to promote actively a specific service or product of the sponsor in a manner similar to commercially available advertising.²⁷⁶

Several organizations devoted to research on particular diseases also expressed concern that the Guidelines would limit the use of fund raising events to support research. The American Heart Association ("AHA") stated that "a small but significant portion of out total revenues is derived from corporate sponsorships" and expressed a general concern about the consequences to research on heart disease if it were taxed on these corporate payments.²⁷⁷ The AHA rejected a quid pro quo analysis and called instead called for "a test that focuses on the essential nature of a sponsorship communication."²⁷⁸ The proposed test would be based on such factors as whether the message benefitted the cor-

274. See *supra* at text accompanying note 115.

275. Comment of Ladies Professional Golf Association (92 TNT 163-62) (comment prepared by former Internal Revenue Service Commissioner Donald C. Alexander).

276. Comments of the Boston Symphony Orchestra on proposed audit guidelines (available electronically at 92 TNT 163-64). For a discussion of print advertising, see *supra* at Part V(A)(4).

277. Comment available at 92 TNT 116-60.

278. *Id.* Asserting that corporate payers should be expected to seek a benefit in return for their payments, the AHA stated

By their very nature, corporate activities are expected to yield substantial return benefits. It is, in fact, this characteristic that distinguishes corporations from not-for-profit organizations. To impose a new tax burden on the nonprofit community simply because corporate donors derive some benefit from their contributions serves merely to punish the nonprofit community for tapping into the natural inclinations of another community. *Id.*

This comment rejects any examination of what an exempt organization in fact provides, and thus, rejects a transactional analysis of exempt organizations' operations.

porate sponsor or the exempt organization, whether the target audience is potential customers of the corporate sponsor or potential participants in or supporters of the exempt organization, or whether the exempt organization or the corporate sponsor controlled the delivery of the message.²⁷⁹ While these factors might be considered under current law in distinguishing advertising from an acknowledgement, this approach seeks to minimize attention to the benefits the exempt organization provides to the corporate sponsor.

Several civic organizations also submitted comments. The Buffalo Common Council passed an ordinance opposing the Guidelines.²⁸⁰ These comments generally focused on the adverse impact on local economies predicted to follow the chill to corporate giving thought to arise from the Guidelines.²⁸¹

Comments from such a diverse array of exempt organizations effectively alerted the Service to the extent of the disaffection with the Guidelines even though many of the comments demonstrated a lack of understanding of current law or of the Guidelines.²⁸² These comments played a crucial role in the total lobbying effort by creating a climate of disaffection among those most directly affected by the Guidelines. Stated more precisely, the mobilization of a large number of very diverse organizations helped mask the nature of the interests directly at issue while creating a climate of concern and opposition.

The final element in the lobbying effort was to offer the Service a technical solution to the corporate sponsorship issue. Both the American Bar Association Section of Taxation Committee on

279. *Id.*

280. Comment of the City of Buffalo on proposed audit guidelines (available electronically at 92 TNT 116-63). The ordinance stated

This Common council is opposed to any IRS regulation that inhibits corporate donations to not-for-profit organizations that provide funding for cultural events that might otherwise not be offered to the community and requests that some latitude be given that would allow the corporate donors name on signage and any other form of advertising used to promote the event.

Id.

281. See, e.g., the comment on the proposed audit guidelines of the International Association of Auditorium Managers (available electronically at 92 TNT 126-110), which suggested that the financial viability of some 800 public assembly facilities in the United States depended on permitting displays of the names and logos of corporate sponsors at sponsored events.

282. Many of the comments in effect called for a fundamental reform of the unrelated business income tax that would virtually eliminate tax on the trade or business activities of exempt organizations by broadening the not regularly carried on exemption and eliminating the substantially related test.

Exempt Organizations (the "ABA Committee")²⁸³ and Independent Sector,²⁸⁴ an umbrella organization of exempt organizations, presented solutions that contained common elements but with important differences in approach. Both of these organizations accepted the quid pro quo analysis at the heart of current law but each sought to redefine it in fundamental ways.

The ABA Committee's approach rested on an attempt to redefine the concept of a benefit that should be taken into account in a quid pro quo analysis, asserting that "recognition benefits" should not be considered a substantial benefit but that "return benefits" should be considered a substantial benefit. This distinction did not rest on the relative value of either type of benefit but on the nature of the benefit. Following Justice O'Connor's reasoning in her dissent in *Hernandez*,²⁸⁵ the ABA Committee analogized what it called "recognition benefits" to religious benefits, neither of which should be taken into account. The basis for this analogy remained unspecified in the absence of any analogue to the Constitutional protections provided religion. The analogy seemed to rest on assertions regarding customary practices of exempt organizations, with references to the legal basis of acknowledgements. Applied to corporation sponsorship arrangements, the concept of a "recognition benefit" permitted the ABA Committee to offer the following analysis

The essential feature of a corporate sponsorship arrangement is the charity's agreement to provide to the sponsor in exchange for the contribution some kind of public association with a charitable program or event. Although the manner in which the association is announced or established will vary from one sponsorship arrangement to another, what is characteristic of contributions in the sponsorship context is that they are made with the expectation of a benefit that is important to the sponsor.

We think it important the Examination Guidelines explicitly recognize that contribution treatment does not depend on a finding that the benefit derived by a corporate sponsor is in any quantitative sense "incidental" or "insubstantial." The benefit that is provided is typically significant' it is typically negotiated for' and it is sometimes of

283. Comment of the American Bar Association Section of Taxation Committee on Exempt Organizations ("1992 ABA Comment") (available electronically at 92 TNT 151-37).

284. Comment of Independent Sector on proposed audit guidelines ("1992 Independent Sector Comment") (available electronically at 92 TNT 160-53).

285. See *supra* at text accompanying note 69.

quite substantial public relations value. What distinguishes a contribution from a receipt in the sponsorship context is that the benefit received in exchange for a sponsorship contribution is a benefit of a nature or in a category that the tax law has traditionally accepted as consistent with the contribution definition—typically, in the case of a sponsorship contribution, the category of Recognition Benefits.²⁸⁶

To make the category of “recognition benefits” serve its ends, the ABA Committee attempted to separate the *Duberstein* standard of “disinterested generosity” which the Supreme Court applied in *Hernandez* from the operative standard for a deductible charitable contribution under Section 170.²⁸⁷ This position is necessary to detach the concept of “recognition benefit” from a value test. Then, the ABA Committee confronted the question of the form that permissible recognition might take. Here, the ABA Committee argued that “acknowledgement formalities” should be treated as “recognition benefits” rather than as “return benefits.” These “acknowledgement formalities” were described as “some occasion for an event or ceremony or for some set of courtesies that will serve to express in a public way the charity’s gratitude for the sponsor’s support.”²⁸⁸ The ABA Committee offered examples of a reception at a museum or a dinner in honor of a contributor who endowed a university chair or a special concert for the sponsor of a symphony series, and concluded that “[w]hat distinguishes an Acknowledgement Formality from a Return Benefit is that an Acknowledgement Formality fits in the tradition of ceremonies or events honoring major donors to charity, and that it is proportional to the gift received.”²⁸⁹ The ABA Committee also urged that “in the specific context of an event arranged by an exempt organization to honor a major corporate sponsor, there need be no limit on the extent to which the business of the sponsor is emphasized” because an Acknowledgement Formality “is by definition

286. 1992 ABA Comment.

287. *Id.* This argument was bolstered by suggestions that corporate contributors could not make charitable contributions based on disinterested generosity. If this were an accurate statement of current law, which it is not, it would not explain why a corporate contributor would be compelled by its duty to its shareholders to receive in exchange a benefit in the nature of advertising rather than a benefit in the nature of goodwill that is consistent with current law concepts of acknowledgements. See Knauer, *supra* note 2 for a discussion of corporate law issues. See *supra* at text accompanying notes 54-70 for a discussion of the “disinterested generosity” test.

288. *Id.*

289. *Id.*

not a public event.”²⁹⁰ The ABA Committee did not, however, limit reference to a corporate sponsor’s business or products to such private events, but urged that “references to products and product lines for purposes of sponsor identification may be consistent with treatment of the benefit as a Recognition Benefit.”²⁹¹

The ABA Committee would treat as a Return Benefit only references to the corporate sponsor’s product or product line that constituted “actual product promotion.”²⁹² Thus, according to the ABA Committee the recipient organization of a corporate sponsorship payment would be treated as having sold advertising only if the message contained information on price or product availability or “any detailed description or any explicit evaluation of the sponsor’s products, or any comparison to competing products.”²⁹³ While the ABA Committee argued that linking the corporate sponsorship payment to arrangements for media exposure, including television coverage, was consistent with treatment as an Acknowledgement Benefit, it suggested that tying the payment to ratings might indicate that the corporate sponsorship arrangement constituted advertising.²⁹⁴ However, the ABA Committee also suggested that in some cases constant repetition of the corporate sponsor’s name could produce a “saturation effect” that constituted advertising.²⁹⁵

The ABA Committee provided the Service one way of appearing to maintain its transactional approach while so redefining it that most corporate sponsorship arrangements would not be taxable to the recipient organizations. The analytical weakness was also the most aggressive assertion and the greatest departure

290. *Id.*

291. *Id.*

292. *Id.*

293. *Id.* Under this approach much of the advertising on television and in the print media would not be treated as advertising.

294. *Id.*

295. *Id.* The comment states

The most troublesome question in the application of the Return Benefit analysis involves what in a few cases is a kind of saturation effect. Even if a charity avoids product promotion or any of the other obvious elements of normal advertising in connection with a sponsored event, we believe that the Examination Guidelines must recognize that there can be cases in which the charity so repeatedly, obviously, and visibly emphasizes the sponsor’s association with the sponsored event that even if none of the usual Return Benefit factors are present, the pure saturation effect is so great that the event as a whole should emphasize that these cases are likely to be rare, and that in most situations the agent should focus on the kind of analysis described above.

Id.

from current law, namely, the attempt to argue that the extent of the benefit to the corporate sponsor had no legal significance.

Independent Sector, in comments prepared by a leading Washington, D.C. law firm, provided a more subtle approach that also both accepted and redefined a quid pro quo analysis.²⁹⁶ This approach shifted attention from the benefit provided by the recipient of a corporate sponsorship payment and looked instead at the activities performed by the recipient organization. Based on this approach, Independent Sector urged the Service to include the following statement in revised Guidelines on corporate sponsorship

Contributors to charities frequently make their gifts because of a desire for the public recognition and improved reputation though to accompany such gifts. In particular, businesses normally make charitable contributions only where they conclude that doing so will serve a business purpose, including improved community standing and public awareness of the business that will flow from publicity concerning the gift. Such benefits may be of considerable commercial value. It is fully consistent with a true gift that the business donor is motivated primarily by desire for the reputational and image benefits to the business that will flow from the gift, or that the donee, in soliciting a gift, stresses such benefits. What distinguishes advertising from recognition is not motive, or consciousness of business benefit, but provision by the organization receiving the payment of advertising services in exchange for the payment. Only where the donee goes beyond normal identification and recognition of donors and provides advertising, marketing, or similar services are the amounts received potentially unrelated business income rather than contributions.²⁹⁷

This approach draws on the language of a royalty analysis, which turns on whether the organization provided the kind of services that are inconsistent with a pure licensing agreement, to redefine the trade or business definition based on a profit motive, not on the nature or extent of activities. Thus, Independent Sector draws on the language of a modification of the definition of a trade or business to take many if not most corporate sponsorship arrangement out of the definition of an unrelated trade or business. However, this approach also depends upon shifting the analysis from the exempt organization's solicitation of corporate sponsorship payments to the nature of activities the organization must under-

296. 1992 Independent Sector Comment.

297. *Id.*

take to provide these benefits.²⁹⁸ The Independent Sector comment characterized these activities by listing factors indicating that the organization was simply acknowledging a contribution, neutral factors, and factors tending to indicate that the organization was providing advertising services. The following factors support characterization as an acknowledgement: publicity is directed primarily at audiences chosen for reasons related to the recipient organization's exempt purposes; the payment exceeds the cost of equivalent advertising; the sponsor agrees to publicize the recipient organization's exempt activities; there are multiple business sponsors; satisfying Federal Communication standards applied to the ban on advertising on public radio and television stations. Independent Sector identifies the following as neutral factors: written agreements; participation by outside professional advisors; exclusive sponsorships; termination for breach; likelihood that the segment of the public likely to see the sponsorship information will patronize the sponsor; use of sponsor logos; identification of the sponsor on uniforms; use of sponsor name or logo on material relating to the event; provision of sponsor products as prizes or premiums and their identification as having been given by the sponsor; assurances that the recipient organization will acknowledge the sponsor's support in its communications with its members and supporter; and "brief identifying references to products or services, or use of a sponsor slogan."²⁹⁹ The following factors indicate advertising: requiring personnel of the recipient organization or participants in the organization's events to participate in selling the sponsor's products; "descriptions of sponsor products or service beyond brief listings appropriate for identifica-

298. *Id.* This subtle, but essential, shift parallels the shift in the NCAA case from the time during which the NCAA solicited advertising to the time during which the program in which the advertising appeared was sold during the tournament. See *supra* at text accompanying notes 129-36 for a discussion of this case.

299. *Id.* In language similar to that used by the ABA Committee in taking the same position, the Independent Sector comment stated

The proposed guidelines make any reference to sponsor products or services in the acknowledgement an indicator of advertising. Sec. 178.3(3)(c)2. While it is appropriate to treat extensive descriptions of products or services as such an indicator, this blanket rule goes too far. Corporate sponsors have a legitimate interest in being recognized for their generosity, and, in many cases, meaningful recognition requires some brief description of the business, products, or services. Such identifying material does not suffice to transform an acknowledgement into advertising. Moreover, a strict rule against slogans or product descriptions would discriminate against businesses whose name are not particularly descriptive or well known.

Id.

tion"; references to prices, sales, or comparison to competitor products; and making the amount of the corporate sponsorship payment contingent on securing media coverage.³⁰⁰ By directing attention to the activities of the recipient organization, the Independent Sector comment avoided the ABA Committee's problem of directly defending return benefits of substantial value. While the two positions are essentially similar, Independent Sector avoided the difficult task of redefining a charitable contribution and chose instead to attempt to redefine a trade or business.

A third approach was taken by the public broadcast stations, which argued forcefully that the Federal Communications Commission ("FCC") standard for compliance with the advertising ban should apply. This approach shifted the debate from the Code to what could be made to appear to be largely a procedural issue of coordinating the Code with other applicable law. Response to the Guidelines by exempt organizations demonstrated the classic lobbying technique of putting forward the more sympathetic groups rather than those at the heart of the controversy who may account for the greatest amount of foregone revenue. These are classic lobbying techniques because they tend to be successful, and this case was no exception. However, the success at the regulatory level derived in substantial part from success on the legislative front.

VII. LEGISLATIVE AND REGULATORY EFFORTS TO DEFINE A SPECIAL RULE FOR CORPORATE SPONSORSHIP

A. *The Congressional Response*

At the same time that the Service was issuing nonprecedential guidance treating corporate sponsorship payments as unrelated business income, Congress passed legislation that would have created a statutory exception for most corporate sponsorship arrangements.³⁰¹ The legislation would have added a new subsection (i) to section 513, the section of the Code containing the other narrowly-targeted statutory exceptions to the general statutory definitions of unrelated business income.³⁰² This legislation provided an exception from the unrelated business income tax for "qualified sponsorship payments" that are received in connection

300. *Id.*

301. Sec. 7303 of the Revenue Act of 1992, H.R. 11, 102d Cong., 2d Sess. (1992).

302. *See supra* at Part V(B)(2) for a discussion of these statutory exceptions.

with a "qualified public event."³⁰³ A qualified public event was an event conducted by certain types of exempt organizations³⁰⁴ that satisfied one of two tests. First, a qualified public event was any "public event the conduct of which is substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exempt purposes of the organization conducting such event."³⁰⁵ Second, a public entertainment event is any event that does not satisfy the first test provided that "such event is the only event of that type conducted by such organization during a calendar year and such event does not exceed 30 consecutive days."³⁰⁶

This approach is consistent with Congressional enactment of the statutory modifications and exceptions discussed above.³⁰⁷ There can be no question that Congress was acting within its proper authority. It is not a particularly telling critique of such special rules simply to point out that they alter the result arrived at by applying the general principles. That is, after all, the reason for enacting special rules. Showing that certain members of Congress or of the tax-writing committees are football fans intent on protecting home-state bowl games is largely irrelevant without a theory of why this approach is inconsistent with a legitimate concept of representation.³⁰⁸ Some critics opposed the legislation not on tax grounds but on the grounds of its implications for college athletics, seeing the non-taxation of corporate sponsorship payments as contributing to an undesirable commercialization of col-

303. The language and the structure of this exception are akin to the language and structure of the exceptions for public entertainment events and trade show activities. See *supra* at text accompanying notes 222-24.

304. I.R.C. §§ 501(c)(3), (4), (5), (6) organizations and those state colleges or universities described in I.R.C. § 511(a)(2)(B) that perform activities consistent with I.R.C. § 501(c)(3) purposes. The subsection as enacted granted the Service specific regulatory authority to ensure that these limitations on permissible recipients of nontaxable payments would not be circumvented by the use of complex structures of related organizations. For an analysis of complex structures, see Hill and Kirschten *supra* note 17 at Chapter 9.

305. Sec. 7303 of H.R. 11. The language rejects a destination of income rationale evoked by several of the comments on the Guidelines. See *supra* at Part VI.

306. *Id.* The subsection as enacted did not define what was meant by an event "of that type." *Id.* A restrictive meaning would have treated all public events as one category.

307. See *supra* at Part V.B.

308. Paul Streckfus, *IRs's Pre-Inaugural Gift for Charities*, 7 EXEMPT ORG. TAX REV. 179 (1993) refers to the remarks of a lawyer who observed that the Cotton Bowl would never be taxable, as long as there were Texans on the House of Representatives Ways and Means Committee, the tax-writing committee of the House.

lege sports.³⁰⁹ The most surprising critic of the proposed legislation was the Service, which took the position that Congress was protecting only the college football games and not other exempt organizations.³¹⁰ In effect, the Service asserted that Congress was not protecting the public interest and was transgressing the norms of fairness that are generally thought to be fundamental criteria of appropriate tax policy.³¹¹

A more meaningful critique would show that a particular special rule or a structure of special rules undermines the purposes of the statute. This is not the same as showing that it simply produces a different result. In the context of tax legislation this critique requires a showing that the fairness and efficiency and simplicity of the statute have been undermined by the special rules. None of the critics of Congress and the subsequent Service position have attempted to do this. Indeed, it is possible to argue that narrowly targeted special rules that resolve special cases that become, for whatever reason, points of policy contention, preserve the integrity of the statute. If the general principles apply to most

309. See the remarks of Rep. Michael A. Andrews (D-Tex.), who argued that the college bowl games have changed over the past decade and have "gone way beyond any bounds of what is appropriate for education." 138 Cong. Rec. H 6638 (July 27, 1992).

310. See James J. McGovern, *Service's McGovern Explains Proposed Corporate Sponsorship Regulations*, 58 Tax Notes 795 (Feb. 8, 1993). See also, Gioia Ligos and Russlyn Guritz, *Corporate Sponsorship Income*, 1993 CPE Text (available electronically at 94 TNT 71-50). While this critique fairly applied to certain earlier legislative proposals, it did not apply to H.R. 11, which incorporated the language of H.R. 5645. For the comments of Rep. Ed Jenkins (D-Ga.), one of the sponsors of H.R. 5645, on the decision to broaden earlier bills to encompass most exempt organizations, see 138 Cong. Rec. H 6636-37 (July 27, 1992).

311. Rep. Beryl Anthony (D-Ark.) rejected this assertion by the Service, asserting: "As members of Congress it is our duty to define the law and determine how it will impact our constituents." 138 Cong. Rec. H6639 (July 27, 1992). Some critics of the Service's subsequent change in position argued that the Service had ignored the public interest and had itself been captured by special interests. See, Paul Streckfus, *IRs' Pre-Inaugural Gift for Charities*, 58 Tax Notes 384 (Jan. 25, 1993); Lee A. Sheppard, *The Goldberg Variations, or Giving Away the Store*, 58 Tax Notes 530 (Feb. 1, 1993); Paul Streckfus, *Corporate Sponsorship Sellout Puts IRS At Risk*, 60 Tax Notes 1641 (Sept. 20, 1993). These critiques of both the substance of the proposed regulations and the process by which they were produced elicited thoughtful letters to Tax Notes regarding the proper roles of Congress and the Service in formulating tax policy. See, Milton Cerny, *Sheppard Variations*, 58 Tax Notes 981 (Feb. 15, 1993)(defending the role played by the Service and Treasury during the corporate sponsorship debates); James P. Holden, *Lee Sheppard's Grumpy Attack*, 58 Tax Notes 1130 (Feb. 22, 1993)(defending the integrity of the Service but also suggesting broader role for Congress); George Yin, *The Tax Administrator's Duty To Take Pro-Government Positions*, 58 Tax Notes 1387 (March 8, 1993)(suggesting that Congress relies on private interests or Treasury to initiate tax legislation and may not effectively play the role Holden suggests).

cases in a manner that is fair and efficient and simple, then special exceptions provide a necessary element of anti-structure.³¹²

This legislation was part of a larger tax package that was pocket vetoed by President Bush in November 1992. However, Congress had signalled its intentions with respect to corporate sponsorship of college football bowl games. This legislative victory strengthened the interests that were also lobbying the Service, which subsequently issued proposed regulations attempting to find a statutory basis under current law for regulations permitting corporate sponsorship payments to be excluded from the recipient organization's unrelated business income.³¹³ This task is far more problematic for a regulatory agency that must find a basis for the revised position in current law than it is for a legislative body that is not required to provide a basis in current law for its current enactments.

Despite these considerations, the organizations interested in changing the Service's treatment of corporate sponsorship income preferred a regulatory solution. In contrast to a legislative change, a regulatory solution did not come at the price of an off-setting revenue-raising provision.³¹⁴

B. The Service's Revised Position on Corporate Sponsorship

In January 1993 the Service issued proposed regulations that dramatically modified its prior position.³¹⁵ The Service abandoned a quid pro quo transactional analysis.³¹⁶ Instead, the proposed regulations rest on a distinction between an acknowledgement, which does not result in taxation, and advertising, which does subject the recipient to taxation. In presenting these definitions, the Service placed primary emphasis on the nature of the activity and de-emphasized the benefit provided by the recipient organization to the corporate sponsor. While the proposed regulations appeared under Section 513, it is far from clear what statutory provision or provisions they are referencing and applying and, thus, what constitutes the statutory basis for

312. VICTOR TURNER, *THE RITUAL PROCESS: STRUCTURE AND ANTI-STRUCTURE* (1969). ROBERT B. EDGERTON, *RULES, EXCEPTIONS, AND SOCIAL ORDER* (1985).

313. See *infra* at Part VII(B).

314. The Budget Act required that all revenue-losing provisions be offset by revenue-raising provisions. The trade-off in the case of corporate sponsorship was income from affinity credit cards. See *supra* note 11.

315. Prop. Treas. Reg. § 1.513-4, 58 Fed. Reg. 5,687 (Jan. 22, 1993).

316. 1993 CPE Text *supra* note 310 states: "The test is not, as was suggested in the guidelines and the earlier rulings, whether there is a quid pro quo. Rather, the test is whether there is advertising or acknowledgement."

the position taken.³¹⁷ The preamble to the proposed regulations states that they “take into consideration both an exempt organization’s need to attract private sector support and the statutory and regulatory requirement that the organization be organized and operated exclusively for exempt purposes.”³¹⁸

The proposed regulations define advertising as any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed in exchange for any remuneration, and which promotes or markets any company, service, facility or product. Advertising includes any activity which promotes or markets any company, service, facility or product.³¹⁹

Advertising does not include “acknowledgments,”³²⁰ which the proposed regulations define as follows:

Acknowledgments are mere recognition of sponsorship payments. Acknowledgments may include the following, provided that the effect is identification of the sponsor rather than promotion of the sponsor’s products, services, or facilities; sponsor logos and slogans that do not contain comparative or qualitative descriptions of the sponsor’s products, services, facilities or company; sponsor locations and telephone numbers; value-neutral descriptions, including displays or visual depictions, of a sponsor’s product-line or services; and sponsor brand or trade names and product or service listings. Logos or slogans that are an established part of a sponsor’s identity are not considered to contain comparative or qualitative descriptions.³²¹

317. The Preamble to the proposed regulations states that “[t]o the extent possible, the proposed regulations are designed to parallel the statutory and regulatory framework of the Federal Communications Commission (FCC) currently in effect.” 58 Fed. Reg. 5687, 5688 (Jan. 22, 1993). The Preamble cites *In the Matter of Commission Policy Concerning the Noncommercial Nature of Educational Broadcasting Stations*, Public Notice FCC 86-16 (April 11, 1986). The Service states in the Preamble to the proposed regulations that “this should not be viewed as ceding, in any way, the Service’s authority to interpret and administer the Internal Revenue Code.” 58 Fed. Reg. 5687, 5688 (Jan. 22, 1993).

318. 58 Fed. Reg. 5687, 5688 (January 22, 1993).

319. Prop. Treas. Reg. § 1.513-4(b).

320. Prop. Treas. Reg. § 1.513-4(b).

321. Prop. Treas. Reg. § 1.513-4(c)(1). In its comments on the proposed regulations, the American Bar Association Section of Taxation Committee on Exempt Organizations (“1993 ABA Comments”)(available electronically at 93 TNT 144-19) expressed concern that reference to whether “the effect is identification of the sponsor rather than promotion of the sponsor’s products, services, or facilities” would require a factual inquiry as to effects and suggested that the language be changed to refer to whether the purpose was identification of the sponsor or promotion of its products. The comment was silent as to how purpose, or intent, was to be determined.

These general definitions are illustrated with several examples. Displaying the latest model automobiles produced by the corporate sponsor in the tournament area does not result in advertising treatment.³²² Permitting restaurants that are corporate sponsors of an arts festival to sell food at the festival or to distribute samples of their food does not make the restaurants' payments advertising income to the organization presenting the festival.³²³ Changing the name of an event to include the name of a corporate sponsor does not result in advertising treatment.³²⁴ Displays of the corporate sponsor's name and logo are approved in several examples.³²⁵ The statutory or empirical bases of these examples remain obscure. The Service itself remarked in the Preamble to the proposed regulations

The principle of administrative simplicity governs the rules defining advertising and acknowledgements in the proposed regulations. As a result, the lines drawn between activities constituting advertising and acknowledgements may not relate to the substance of the activities. For example, distribution of samples of a sponsor's product to the general public at a sponsored event is advertising. However, the proposed regulations provide that distribution of samples of a sponsor's product constitutes an acknowledgement rather than advertising.³²⁶

The proposed regulations include a 'tainting rule' providing that "[i]f any activities, messages, or programming material constitute advertising with respect to a sponsorship payment, then all related activities, messages or programming material that might otherwise be acknowledgments are considered advertising."³²⁷

322. Prop. Treas. Reg. § 1.513-4(g), Example 3.

323. Prop. Treas. Reg. § 1.513-4(g), Example 6. The example does not indicate whether the samples were free, but there is also no basis for treating sales differently than free samples under the proposed regulations. *Id.*

324. Prop. Treas. Reg. § 1.513-4(g), Example 1.

325. Prop. Treas. Reg. § 1.513-4(g), Example 1 (name of corporate sponsor of walkathon and marathon in promotional fliers, newspaper advertisements, and on T-shirts worn by participants); Example 2 (name of corporate sponsor of art exhibition displayed in all publicity materials, including banners, poster, brochures, and public service announcements); Example 3 (name and logo of corporate sponsor of sports tournament displayed on signs, scoreboards, and other printed material); Example 4 (name and logo of corporate sponsor of college football bowl game displayed on playing field, players' helmets and uniforms, scoreboard and stadium signs, on cups for soft drinks at the game, and "on all related printed material distributed in connection with the game"); and Example 5 (corporate sponsor that underwrites the expenses of a team has its name and logo on team uniforms). *Id.*

326. 58 Fed. Reg. 5686, 5688 (January 22, 1993).

327. Prop. Treas. Reg. § 1.513-4(c)(2).

Such tainting elements include “qualitative or comparative language; price information or other indications of savings or value associated with a product or service; a call to action; an endorsement; or an inducement to buy, sell, rent or lease the sponsor’s product or service.”³²⁸

The proposed regulations treat the existence of a contract or the degree of detail are neutral factors.³²⁹ Exclusivity of a sponsorship arrangement does not in itself mean that the payment is advertising income.³³⁰ Similarly, providing benefits such as complimentary tickets to the sponsor or to individuals designated by the sponsor are not relevant in determining whether the sponsorship payment is advertising income.³³¹ The sponsorship payment may be contingent on the event’s taking place or being broadcast without resulting in treating the payment as advertising income, but “[w]here the amount of the sponsorship payment is contin-

328. Prop. Treas. Reg. § 1.513-4(c)(2). The regulations provides that “[d]istribution of a sponsor’s product by the sponsor or the exempt organization to the general public at the sponsored event, whether for free or for remuneration, is not considered an inducement to buy, sell, rent or lease the sponsor’s product for purposes of this regulation.” The only example of a message that constitutes advertising and not an endorsement is Prop. Treas. Reg. § 1.513-4(g), Example 7, in which a noncommercial radio station broadcast the following message: “This program has been underwritten by the Record Shop, where you can find all of your great hit music. The record shop is located at 123 Main Street. Give them a call today at 555-1234. This station is proud to have the Record Shop as a sponsor.” While the example does not provide any guidance on the specific reasons for treating this message as advertising, giving the address and telephone number seems to constitute a call to action.

329. Prop. Treas. Reg. § 1.513-4(d). The proposed regulations state: “The mere existence of a sponsorship contract does not necessarily mean that a sponsorship payment is income from advertising. The terms of the agreement, not its existence or degree of detail, are relevant to the determination.” Prop. Treas. Reg. § 1.513-4(g), Example 4 presents a “detailed contract” treated as an acknowledgement, not advertising.

330. Prop. Treas. Reg. § 1.513-4(d). Prop. Treas. Reg. § 1.513-4(g), Example 4 treats an exclusive sponsorship arrangement as not advertising.

331. Prop. Treas. Reg. § 1.513-4(f) states that

[p]rovision of facilities, services or other privileges by an exempt organization to the sponsor or individuals designated by the sponsor (e.g., complimentary tickets, pro-am playing spots in golf tournaments or receptions for major donors) in connection with the sponsorship payment does not affect the determination of whether a sponsorship payment is advertising income.

In Prop. Treas. Reg. § 1.513-4(g), Example 2 the corporate sponsor of an exhibition at a museum receives a special tour of the exhibition for its employees and the museum hosts a special dinner for the corporate sponsor’s executives without jeopardizing acknowledgment characterization. Similarly, in Prop. Treas. Reg. § 1.513-4(g), Example 3, the corporate sponsor receives admissions passes and pro-am playing spots but the payment is not advertising income to the recipient organization.

gent, by contract or otherwise, upon factors such as attendance at an event or broadcast ratings, the sponsorship payment is considered advertising income.³³²

In addition to limiting the circumstances under which corporate sponsorship payment might be subject to the unrelated business income tax, the proposed regulations also limited the amount of any such income that might be taxable by treating corporate sponsorship as an activity that exploits an exempt function.³³³ Thus, expenses associated with the exempt function in excess of the cost of the exempt function can be deducted from the corporate sponsorship payment and the amount of unrelated business taxable income decreased.³³⁴

The proposed regulations were generally well-received by the policy-shaping community of exempt organizations and their professional advisors.³³⁵ Instead of a broad-based mobilization of local organizations to create a political climate of opposition, several national policy-shaping organizations addressed particular issues in the proposed regulations, but in a general climate of support for the Service, and used the occasion of the public comment period and public hearings to attempt to use the positions taken in the proposed regulations to modify the general principles of the unrelated business income tax on other fronts. These leading policy-shapers were seeking to consolidate one lobbying victory and lay the foundation for others.

The 'tainting rule' occasioned the most consistent criticism. Most comments called for application of the principles of Revenue Ruling 67-246, which treats any amount in excess of the fair market value of the benefit received as a charitable contribution.³³⁶

332. Prop. Treas. Reg. § 1.513-4(e). *See also*, Prop. Treas. Reg. § 1.513-4(g), Example 4.

333. Prop. Treas. Reg. § 1.512(a)-1(e), Examples (2)-(4).

334. It is less certain that this computational benefit addresses potential jeopardy to the organization's exempt status because the Service has never clarified whether the commensurate in scope test is based on net unrelated business taxable income or gross unrelated business income or to what extent, if any, the amount of activity is balanced against the amount of income. *See supra* at Part V.C.

335. *See* 1993 ABA Comment. *See also* the unofficial transcript of the Hearings on the Proposed Regulations on Corporate Sponsorship (available electronically at 93 TNT 147-33).

336. *See, e.g.*, 1993 ABA Comment (93 TNT 144-19); Comment of National Public Radio and Public Television Stations (93 TNT 138-26); Comment of Independent Sector calling for a de minimis rule (93 TNT 134-24); National Society of Fund Raising Executives (93 TNT 138-25); Comment of PGA Tour, Inc. (93 TNT 151-20 calling for no tainting with respect to elements in separate contracts); Comment of American Heart Association calling for respect of separate contracts or allocations in a contract as protection against tainting rule (93 TNT 139-47); Comment of American

Several comments urged that the tainting rule be replaced with its obverse, thereby permitting favorable treatment as corporate sponsorship to apply to numerous "ancillary activities" such as advertising in game programs.³³⁷ This position provides a significant illustration of the use of the proposed regulations on corporate sponsor to liberalize current law. The comment of the public broadcasters illustrates the technique.³³⁸ Noting that the proposed regulations do not define corporate sponsorship, the public broadcasters stated

Since the purpose of the Proposed Regulations is to provide clarity and certainty, it is important to address any significant ambiguities that remain. However, in many cases, sponsorship arrangements cover not just a single event but multiple events and ancillary activities related to them. We are concerned that hinging the application of the regulations on the existence of a "sponsored event" may be unduly restrictive, unless the term is defined broadly to encompass the entire sponsorship arrangement, and not just a particular event or activity.

For example, in public broadcasting, it is common for a corporate underwriting arrangement to cover not only funding for a particular program or series, but also the cost of advertising the program or series in the station's magazines, or a variety of other media. The underwriter may also provide funding for publications, educational guides and other activities that are extensions of the program or series. If a definition of "sponsored event" is added to the Proposed Regulations, it should be broad enough to encompass all ancillary and related activities that are part of the sponsorship arrangement, including (but not limited to) advertisements

Association of Museums (93 TNT 134-25); Comment of Football Bowl Association (93 TNT 133-34); Comment of American Institute of Certified Public Accountants (93 TNT 146-35); Comment of Coopers & Lybrand (93 TNT 147-24). At the Hearings on the proposed regulations, the spokesman for the American Institute of Certified Public Accountants commented that the tainting rule was inconsistent with the fragmentation rule (93 TNT 147-23).

337. 1993 ABA Comment (93 TNT 144-19); Comment of National Public Radio and Public Television Stations (93 TNT 138-26). At the Hearings on the proposed regulations the United States Olympic Committee noted that "corporate sponsorship agreements often provide a package of benefits to the sponsor" and requested further guidance on the circumstances under which these benefits would be treated as related (93 TNT 147-23).

338. Comment of National Public Radio and America's Public Television Stations (93 TNT 138-26).

in station guides or publications, publicity campaigns and ancillary educational activities and programs.³³⁹

This comment artfully raises three related issues—ancillary activities, print advertising, and the regularly carried on requirement. Treating the proposed regulations as a baseline, the comment addresses the issue of ancillary activities and lays the foundation for subsequent efforts to liberalize the treatment of print advertising in periodicals and the regularly carried on requirement.³⁴⁰ The ABA Comment follows the same strategy by seeking to move forward on ancillary activities while raising questions with respect to print advertising in periodicals and the regularly carried on requirement.³⁴¹ Arguing that a distinction between displays that are treated as acknowledgements under the proposed regulations and displays in the event program “would be arbitrary and inappropriate,” the ABA Comment urges that “the term ‘corporate sponsorship’ should be defined so as to include payments made with respect to programs, catalogs, or other printed materials that are distributed in connection with events or occasions that would themselves be included in the definition of a sponsorship event.”³⁴² While the ABA Comment did not call on the Service to change the treatment of advertising in periodicals, it skillfully raised the issue by identifying the distinction between its position on advertising in event programs and in periodicals.³⁴³

339. *Id.*

340. These are closely related issues because a periodical is defined in Prop. Treas. Reg. § 1.513-4(a) as “regularly scheduled and printed material that is not related to and primarily distributed in connection with a specific sponsored event.”

341. 1993 ABA Comment (93 TNT 144-19).

342. *Id.*

343. In a statement that could serve as a model of identifying a future issue while avoiding overreaching, the ABA Comment stated after urging that print displays in event programs be treated as acknowledgements under the proposed regulations. This, of course, in turn creates a distinction between ads in a program or catalog that is related to a sponsored event and ads in a regular exempt organization periodical. Although the ads could in some cases be identical as to size, design and content, the periodical ads, without the benefit of the corporate sponsorship rules, will be treated under general UBIT rules as giving rise to unrelated business income. Distinctions of some kind are unavoidable when regulations carve out a class of arrangements or transactions and apply to such arrangements a rule of administrative simplicity designed to avoid complications in the law that would otherwise be applicable. If the corporate sponsorship rules are to be applied to a limited class of arrangements defined by the regulations, there will inevitably be points around the margins of that defined class where seemingly similar situations are treated in dissimilar ways. Assuming that such a result is unavoidable, it seems better to draw the line between periodicals (subject to general UBIT rules) and materials published in connection with sponsored occasions (subject to the corporate sponsorship rules), rather than to let the distinction fall between printed

Certain other organizations expressed concern about the example that seemed to suggest that revenue from the sale of logo items is unrelated business income.³⁴⁴ Public broadcasters, while expressing satisfaction at the Service reliance on FCC positions, called for the Service to make such reliance permanent by adding to the final regulations a provision representing that it would defer on an ongoing basis to FCC positions.³⁴⁵

Several organizations raised the fundamental question of the scope of the proposed regulations. Is there a distinction between a corporate sponsorship payment and a charitable contribution by a corporate contributor? If corporate sponsorship applies to only a subset of corporate contributions, then the distinction will necessarily be somewhat arbitrary. This difficult issue was addressed most directly and insightfully by the ABA, which reached no consensus on this issue, in its testimony at the 1993 Hearings.³⁴⁶ The ABA testimony noted that the most difficult issue involved corporate support for a continuing program. The lawyer presenting the ABA testimony stated that her own solution was to treat these payments as corporate sponsorship payments but to treat corporate contributions for facilities, such as a university building, as subject to the less liberal return benefit test and not the more lib-

acknowledgments and acknowledgments in other forms where both are made in connection with a sponsored event. *Id.* This comment skillfully treats the proposed regulations as an accepted baseline and then treats current law as the source of an indefensible distinction that violates norms of horizontal equity. *Id.*

344. Comment of the Football Bowl Association (93 TNT 133-34). The 1993 ABA Comment called for clarification that all current exceptions to the unrelated business income tax apply in the corporate sponsorship context (93 TNT 144-19).

345. The Comment of National Public Radio and America's Public Television Stations (93 TNT 138-26) called upon the Service to replace Example 4 of the proposed regulations, which referred to a sponsor announcement on a public broadcasting station with "an announcement that has been found objectionable by the FCC in one of its public orders or opinions." The Comment made it clear such deference to the FCC was not a matter of resolving a particular issue but a matter of ensuring on a continuing basis that tax law conformed to broadcast regulation. Stating that "it is critical that the IRS rules be applied to public broadcasters in a manner that is consistent with the FCC underwriting credit rules," the Comment urged

To promote such consistency, we recommend that an individual in the National Office be designated to serve as a resource within the IRS on FCC rules; that field agents be advised to consult with such individual concerning the application of the FCC rules to public broadcasters; that such individual be authorized to coordinate with the FCC as necessary on questions of interpretation; and that the IRS defer to FCC interpretations of the application of these rules to public broadcasters.

Id.

346. Transcript of 1993 Hearings (testimony presented by Julie Noel Gilbert).

eral corporate sponsorship rules of the proposed regulations. If the proposed regulations are ever promulgated in final form, this definitional issue remains to be addressed, whether in regulations, audits, or litigation. The uncertainty over the scope of the proposed regulations is one of the consequences of the absence of a statutory basis for an exception for corporate sponsorship arrangements.

These comments seeking modifications of specific provisions in the proposed regulations appeared alongside subtle but potentially important arguments seeking to use the proposed regulations as the basis for more fundamental changes in the general principles of the unrelated business income tax. For example, the ABA Comment called upon the Service to state that a corporate sponsorship payment is not income from a trade or business and also called for clarification of the regularly carried on requirement.³⁴⁷ In effect, these very sophisticated comments treated the proposed regulations as a statement of the Service's current position on the unrelated business income tax rather than as an exception to these principles.³⁴⁸

347. 1993 ABA Comment (available electronically at 93 TNT 144-19) urged the Service to devise a regularly carried on requirement that would encompass a liberal position on corporate sponsorship and reminded the Service of its risks of additional litigation, stating

Finally, as to the "regularly carried on" requirement, a special interpretation of the requirement applicable only in the area of corporate sponsorship does not appear to be necessary. In this respect, it would seem particularly desirable to develop principles of interpretation through a process other than litigation. There would be considerable advantage, therefore, to addressing this issue through a separate rule-making process, with an opportunity for public comment.

348. The lobbying effort by the leading national organizations is an artful example of modern information-based lobbying linked with the participatory legitimacy of more broad-based coalitions including grassroots organizations. See KEVIN HULA, *ROUNDING UP THE USUAL SUSPECTS: FORGING INTEREST GROUP COALITIONS IN WASHINGTON*, in *INTEREST GROUP POLITICS* (Allan J. Cigler and Burdett A. Loomis eds., 4th ed. 1995); JOHN P. HEINZ, ET AL. *THE HOLLOW CORE: PRIVATE INTERESTS IN NATIONAL POLICY MAKING* (1993). The currency of this information-based lobbying is expertise, especially that expertise in drafting and interpreting statutes and regulations particular to lawyers. However, expertise does not mean neutrality. Indeed, most lawyers with the requisite expertise have acquired such expertise representing clients with particular and legitimate interests in the outcome of issue controversies such as corporate sponsorship. Such persons' interests are clear when they identify their clients but may not be clear when the same persons act through a professional association. The problem is not overlapping roles, which would invite a relatively straightforward solution, but instead the broader and more complex issue of how lawyers acquire and use their expertise and the absence of any alternative to the dual role of lawyers. This issue is not confined to expertise-based lobbying on tax issues. See, e.g., Robert E. Scott, *The Politics of Article 9*, 80 VA. L.

Despite the subtlety of this approach, it appears to have fallen short of achieving either its immediate aim of protecting corporate sponsorship payments from taxation or its broader aim of changing certain fundamental principles of the unrelated business income tax. It is uncertain whether the proposed regulations will be promulgated in final form. This situation arises from two related problems with the proposed regulations—they have no basis in the current statute and they create significant issues of statutory dissonance. Both of these problems arise from attempting to create an exception to a statute through regulations. Each of these problems is discussed below.

VIII. REGULATORY EXCEPTIONS AND STATUTORY DISSONANCE

The lack of a statutory basis for the proposed regulations becomes apparent from the placement of the regulations under Section 513. This section provides both the general definition of unrelated business income and delineates the statutory exceptions to it. The proposed regulations attempt the ultimately self-defeating task of defining an exception on the basis of the general principles. As discussed above, none of the specific narrowly-tailored exceptions applies to corporate sponsorship arrangements.³⁴⁹ Consequently, none of these exceptions can be used as the statutory basis for the corporate sponsorship exception. This leaves the Service in the position of attempting to fashion an exception for corporate sponsorship from the general statutory principles defining unrelated business income. However, as the foregoing analysis suggests, these general principles would treat corporate sponsorship as an unrelated business income transaction, not as a charitable contribution transaction or an exempt function transaction. Attempting to avoid this result in the case of corporate sponsorship has led to the second problem with the proposed regulations, statutory dissonance.

REV. 1783 (1994)(Symposium on the Revision of Article 9 of the Uniform Commercial Code). For more general discussions of lawyer's roles in representing clients and shaping the law in particular substantive areas through participation in bar associations or other law reform efforts, see David Luban, *The Noble Oblige Tradition in the Practice of Law*, 41 Vand. L. Rev. 717 (1988)(Brandeis and "progressive professionalism"); Robert W. Gordon, *Corporate Law Practice as a Public Calling*, 49 Md. L. Rev. 255 (1990)(noting example of tax lawyers); Robert W. Gordon, *The Independence of Lawyers*, 68 Boston U. L. Rev. 1 (1988)(tension between norms of professional culture and "capture" of law reform fora by special interests within the bar).

349. See *supra* at Part V.B.

Statutory dissonance is used here to describe conflict in the results and rationales of provisions of one statute.³⁵⁰ It has been suggested here that dissonance in results may have more limited implications than does dissonance in rationales. Not all special provisions create dissonance even in result. Some special rules set forth the implications of the general provisions for particular fact patterns and clarify their treatment under the general principles. The statutory modifications of Section 512(b) are special rules of this type. The exceptions of Section 513 are clearer cases of statutory dissonance. Yet, these are very narrowly-drafted exceptions that simply provide for results that could not be reached under the general principles of the statute but which do not depend on redefining those principles. Congress has the authority to enact such exceptions that provide for nonconforming results without providing a rationale for the exception based on the general principles of the statute. Statutory dissonance with respect to narrowly-defined results does not necessarily undermine the general statutory structure and may well serve to preserve it by obviating the necessity of modifying the general structure and fundamental principles of the statute.

Statutory dissonance arising through regulations interpreting general principles of a statute threaten precisely this broader redefinition of the statute. This is the problem presented by the proposed regulations on corporate sponsorship, which raise issues of statutory dissonance with respect to the definition of a trade or business and the regularly carried on requirement as well as with respect to their application to advertising in exempt organization journals and the quid pro quo provisions under Section 170.

Treating corporate sponsorship arrangements as not a trade or business would not only undermine the profit motive test but also raise the difficult question of a corporate sponsorship arrangement is in terms of the activities performed by the exempt organization.³⁵¹ The transactional model of exempt organization operations suggests that an exempt organization engages in two types of activities—exempt functions consistent with its exempt purposes or trade or business activities. The model further suggests that exempt function activities are the activities pursued by the exempt organization in the charitable contribution transaction and the exempt function transaction, while in the unrelated busi-

350. Statutory coordination here refers to efforts to reconcile the implications of two or more statutes as they apply to a particular legal issue.

351. The trade or business test of current law is discussed *supra* at Part V(A)(1).

ness transaction the exempt organization engages in trade or business activities. The corporate sponsorship proposed regulations do not fit into this model to the extent that they treat a trade or business activity as part of some transaction other than an unrelated business transaction. They diverge from the statutory concept of a trade or business to the extent that they attempt to define corporate sponsorship activities as distinct from trade or business activities.

The statutory dissonance with the regularly carried on concept is even clearer.³⁵² The proposed regulations so blur the already problematic concept of what activities are regularly carried on that the Service would be pressed to withdraw its nonacquiescence to the NCAA decision.³⁵³ The consequence of this change would be a substantial limitation on the application of the unrelated business income tax.

The result reached in the proposed regulations contrasts starkly with the Service's treatment of print advertising in exempt organization journals.³⁵⁴ The proposed regulations simply state that they do not apply to this case. However, the divergent results highlight the statutory dissonance introduced by the corporate sponsorship regulations. If these regulations are based on the general principles of the statute which also apply to print advertising, on what grounds can the Service maintain its position with respect to print advertising? If a corporate sponsor's name and logo on a football field or basketball court in a nationally televised game constitutes a mere acknowledgement, why should a corporate sponsor's name and logo on the page of an organization's journal constitute advertising? Regulations must find a basis for such a distinction in the statute under which they are promulgated, and the unrelated business income tax provisions of the Code provide no statutory basis for such a distinction.

The statutory dissonance between the proposed regulations and the statutory provisions on quid pro quo contributions are equally stark.³⁵⁵ Organizations that must document for contributors the value of a tote bag would be free of any such responsibility with respect to corporate sponsorship payments under the proposed regulations. In effect, a tote bag would be treated as a substantial benefit while exposure for a corporation's name and logo

352. The regularly carried on test of current law is discussed *supra* at Part V(A)(2).

353. See *supra* at text accompanying notes 136-37.

354. See *supra* at Part V(A)(4).

355. See *supra* at Part III(C).

to a stadium crowd and a national television audience would not be a substantial benefit.

The magnitude of the incongruence produced by the statutory dissonance introduced by the proposed regulations has resulted in reconsideration of the proposed regulations themselves. The problem is not that private groups lobbied the Service or that some groups may have had access outside the formal process of the public hearing. Administrative agency lobbying is a long-established method of representing clients' legitimate interests by shaping applicable regulations and agency contacts with the public are not limited in the same way as contacts between bench and bar in a judicial proceeding.³⁵⁶ The problem posed by the proposed regulations arises not from the process by which they were produced but the result they reached and the attempt to define a statutory exception in regulations. The choice is between a different result through regulations or a narrowly-focused statutory exception.

In the context of the unrelated business income tax, Congress has enacted several special exceptions to ensure results that would not otherwise be possible by applying the general principles of the statute.³⁵⁷ This is the role of Congress, subject to review ultimately by the Supreme Court. While every exception raises important questions of fairness, the appropriate debate is over the wisdom of the particular exception, not over Congress' right to enact it.

A special rule dealing with the college bowl games would present anomalies. For example, a corporate sponsor whose name and logo were displayed sixty times during a heavily watched bowl game would be treated as having received nothing of value while the recipient of a tote bag in exchange for a contribution to public broadcasting would be able to deduct only the amount of the contribution in excess of the value of the tote bag. The anomaly become less troubling when these two examples are viewed transactionally. The issue is not the deduction by the contributor. Here, the corporation will be able to deduct the corporate sponsorship payment under either Section 162(a) as an ordinary or necessary business expense or under Section 170 as a charitable contribution, while the corporate or individual contributor to public broadcasting will have only the Section 170 claim. The issue is

356. This is not to suggest that questions of administrative representation do not raise significant issues of professional responsibility and of policy-making in the administrative state but rather to suggest that these questions do not define the core of the debate over corporate sponsorship.

357. See *supra* at Part V(B).

the tax treatment of the payment in the hands of the organization. This treatment depends on whether the organization provided a quid pro quo. There is little reasonable debate over whether the name and logo displays featured at the bowl games are valuable or whether they are exchanged for the corporate sponsorship payment. Similarly, there can be little debate over whether the tote bag is an item of value received in exchange for the contribution, also a quid pro quo. Why, then, is public broadcasting not taxable under current law on the amount of the contribution for which the contributor may not claim a charitable contribution deduction? The answer is found in the statutory exception for income earned from events run by volunteers³⁵⁸ and the exception for income from the sale of contributed property.³⁵⁹ Although this will be a facts and circumstances determination in each particular case, Congress has created an exception that protects recipient organizations from the tax consequences of a quid pro quo analysis. Private school auctions and other fundraisers also benefit from these exceptions.

In this light, enacting another special rule would be neither unprecedented nor unprincipled. This tension between general rules and exceptions, between structure and anti-structure is a fundamental element in all legal systems and social structures. Treating corporate sponsorship as an exception, as an element of anti-structure would preserve the structure of the unrelated business income tax more effectively than the tortuous and ultimately unworkable efforts to accommodate corporate sponsorship within the general rules.

Yet, this legislative resolution of the corporate sponsorship issue would raise again and with particular force the question of when special exceptions have become so numerous or so fundamental that they erode the general statutory structure by posing unanswerable questions of both coherence and fairness. Such larger questions with respect to the unrelated business income tax and the exemption itself are ripe for consideration in terms of the actual operations of contemporary organizations.

358. I.R.C. § 513(a)(1). See *supra* at text accompanying notes 210-12.

359. I.R.C. § 513(a)(3). See *supra* at text accompanying notes 213-14.