

Halos, Billboards, and the Taxation of Charitable Sponsorships

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*Act now, act now, and receive as our gift, our gift to you
They come in all colors, one size fits all
No muss, no fuss, no spills, you're tired of kitchen drudgery
Everything must go, going out of business, going out of business
Going out of business sale
Fifty percent off original retail price, skip the middle man
Don't settle for less.¹*

[S]upport for WSUI comes from Kentucky Fried Chicken, near the corner of Highway 1 West and Riverside Drive in Iowa City, joining others in support of WSUI and KSUI public radio. KFC of Iowa City: family owned since 1960.²

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1. TOM WAITS, *Step Right Up*, on SMALL CHANGE (Elektra/Asylum Records 1976).

2. *Sponsor Acknowledgement, Weekend Edition Saturday* (WSUI radio broadcast Mar. 25, 2006) (on file with author).

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INTRODUCTION

One fine day in 1991, a small band of idealistic IRS auditors and regulators set out to defend the public fisc, the integrity of the tax system, competitive markets, and the soul of the American nonprofit sector by taxing the sponsorship revenues of college football and the Atlanta Olympics. Arrayed against the IRS were the combined lobbying forces of college football, the Atlanta Olympics, the American Heart Association, public broadcasting, and thousands of America's favorite institutions. Guess who won.

This is the standard story of the sponsorship battles in the early 1990s that ended with the exemption of charities'³ commercial sponsorship income from the "unrelated business income tax" (UBIT) that might otherwise apply.⁴ In this story, cynical charities, corrupted by corporate advertising money, deployed unprincipled political muscle to overwhelm the integrity of the tax system and sully American philanthropy with unchecked commercialism. Like many conventional stories, this one contains substantial truth. Frequent repetition, however, hides unanswered questions.

At the center of the controversy was the characterization of payments businesses make to charities on condition of public recognition. Charities characterized these

3. This article uses "charity" as shorthand for organizations exempt from federal income taxation under I.R.C. § 501(c)(3). Some of the rules I discuss also apply to other exempt organizations, but the controversy over sponsorships revolved around organizations exempt under Section 501(c)(3). It is important to emphasize that I intend the word to include all of the activities that we implicitly choose to subsidize with the tax exemption under I.R.C. § 501(c)(3), although many people would not include all of these activities in their colloquial understanding of the word "charity." For further discussion of this disconnect between the extent of Section 501(c)(3) and colloquial understandings of "charity," see *infra* note 6. All references in this article to sections of the "Code" and the "I.R.C." refer to sections of Title 26 of the United States Code (2006), and all references in this article to sections of the "Regulations" or "Treas. Reg." refer to sections of Title 26 of the Code of Federal Regulations.

4. See, e.g., Frances R. Hill, *Corporate Sponsorship in Transactional Perspective: General Principles and Special Cases in the Law of Tax Exempt Organizations*, 13 U. MIAMI ENT. & SPORTS L. REV. 5 (1995); Nancy J. Knauer, *How Charitable Organizations Influence Federal Tax Policy: "Rent-Seeking" Charities or Virtuous Politicians?*, 1996 WIS. L. REV. 971, 1021-31 (1996) [hereinafter Knauer, *Influence*]; Lee A. Sheppard, *The Goldberg Variations, or: Giving Away the Store*, 58 TAX NOTES 530 (1993); Nathan Wirtschafter, *Note and Comment, Fourth Quarter Choke: How the IRS Blew the Corporate Sponsorship Game*, 27 LOY. L.A. L. REV. 1465 (1994).

payments as charitable donations (exempt from tax) for which the donor was simply thanked publicly. The IRS attacked them as barely disguised ad buys, resulting in taxable business income.

Underlying these claims, as well as the legislation that ended the controversy, was an unexamined assumption that there was an important distinction between providing a charitable donor with public recognition and providing a business with advertising services. This assumption was so deeply ingrained that it tempted the IRS into two losing battles and also held the charities back from total victory.

In this article, I examine this assumption critically for the first time, seeking not only to explain what happened in the 1990s, but also to use it to explain the political dynamics of the charitable exemption and the odd tax that protects it. I draw on several decades of academic marketing literature that all sides of the debate have hitherto ignored, to elucidate the conceptual distinction between selling sponsorships and selling advertising—between leasing halos and billboards.

This distinction is the key to understanding the sponsorship controversy, the legislation that ended it, and the instability of that solution. The distinction is important because advertising and sponsor acknowledgement, although both forms of commercial communication, have opposite symbolic meanings in the context of the exemption. Advertising is the kind of uncharitylike activity the UBIT is designed to deter. Sponsor acknowledgement, by contrast, is premised on creating a perception of genuine support for the sponsored event or organization. In the symbolic politics of the exemption, this perception of genuine support is a good substitute for the real thing. Any attempt to deter it with the UBIT, no matter how well-grounded in preexisting doctrine, was destined to political failure. Viewed in light of the distinction between advertising and sponsor acknowledgement, the IRS did not start in the right, nor did it cravenly abandon its post. Rather, it made an early mistake and quickly reconceptualized the problem.

This reconceptualization led to a practical problem: while the conceptual distinction between advertising and sponsor acknowledgement is clear, it is not a practical way to sort real arrangements, all of which contain a mix of both. The end result had to be a legislative rule that would avoid this ambiguity. At the charities' urging, Congress passed a rule that retained only a symbolic tax on advertising. As I will discuss below, this was a politically unstable choice. I discuss the outlines of a more stable safe-harbor rule.

First, a caution. Most writing about the charitable exemption has a strong normative quality. People feel strongly about charities. Those strong feelings are what prompt many authors to write. They want to support institutions they love, to tear the cloak of saintliness from unworthy pretenders, or simply to suggest reforms that might bring the reality of charity closer to authors' high ideals.

I share these emotions and sympathize with the normative goals they inspire. But that is not my project here. I have tried to write not from my emotional perceptions of charities but about those perceptions and their influence on the politics and law of the charitable tax exemption. This is crucial to understanding the charitable tax exemption because, as I have demonstrated elsewhere, the exemption does not reflect instrumental

legislative policy.⁵ The exemption is not a deliberate or even an intuitive attempt to achieve some economic or social goal, such as a horizontally fair tax system or an optimal level of public goods. Rather, it is chiefly an exercise in symbolic politics—a mechanism for expressing and perpetuating cultural perceptions about charities. My project in this article is to describe the possibly unstable place of sponsorship and advertising in this political mechanism. Accordingly, I do not praise or condemn the end result of that mechanism—the broad tax subsidization of charities. For the same reasons, I also do not address whether the exemption covers a broader set of organizations than it should.⁶ Both of these topics are worthy of thought, but they are simply not the issue here.

5. See Ethan G. Stone, *Adhering to the Old Line: Uncovering the History and Political Function of the Unrelated Business Income Tax*, 54 EMORY L.J. 1475, 1480–81 (2005). For further discussion, see *infra* text accompanying note 19.

6. Many observers' discomfort in the 1990s may also have reflected an underlying unhappiness with the scope of the exemption. Many of the critics of the college bowls and the 1993 Regulations seem to have been motivated to a significant degree by a feeling that popular sports events were outside the realm of "good works" properly subsidized by the exemption. See, e.g., Cynthia G. Farbman, *Forced to Be a Fan: An Analysis and History of the IRS's Proposed Regulations Regarding Corporate Sponsorship*, 2 SPORTS L.J. 53, 53 (1995) ("College football has become increasingly commercialized. It is seldom played for the Olympic ideal that sports should be played by amateur athletes for the sheer love of the game. Some athletes might be playing for the love of the game, but it is likely that the schools' motives are less altruistic.") (internal quotations omitted); Amy Forsythe, *Implications of the Cotton Bowl Ruling on the Exempt Status of Intercollegiate Athletic Organizations*, 6 EXEMPT ORG. TAX REV. 933, 933 (1992) (proposing the IRS challenge exempt status of bowl organizations rather than challenging sponsorship revenues under UBIT); Paul Streckfus, *Editor's Notebook*, 9 EXEMPT ORG. TAX REV. 161, 162 (1994) (placing quotation marks around "charities" in referring to the Mobil Cotton Bowl Athletic Association and other college bowl game organizations); Wirtschafter, *supra* note 4, at 1510 ("Ultimately, however, big-time college sports should be classified as for-profit activities."). Questions of the appropriate limits of the exemption are beyond the scope of this article. For an examination of the UBIT's role in suppressing such questions, see Stone, *supra* note 5. It should be noted that, although the commercialism of college sports has grown over the years, its current political resolution is as old as the UBIT itself. See H.R. REP. NO. 81-2319, at 37 (1950) (specifying exemption of college sports revenues as "related" business income). Recently, this political resolution has come under question. On October 2, 2006, William Thomas, then chair of the House Ways and Means Committee, sent a letter to Myles Brand, President of the National College Athletic Association (NCAA). *Thomas Requests Information on Tax Exemption, College Sports*, TAX NOTES TODAY, Oct. 5, 2006, LEXIS, 2006 TNT 193-23. The letter presents a number of specific questions purportedly seeking to determine "whether major intercollegiate athletics further the exempt purpose of the NCAA and, more generally, educational institutions." *Id.* Thomas states that "[c]orporate sponsorships, multimillion dollar television deals, highly paid coaches with no academic duties, and the dedication of inordinate amounts of time by athletes to training lead many to believe that major college football and men's basketball more closely resemble professional sports than amateur sports." *Id.* He then asks the NCAA to report on the effects of I.R.C. § 513(i), which, as discussed below, assured the tax-exempt status of college sport sponsorships. *Id.* For a discussion of I.R.C. § 513(i) and the history of its passage, see *infra* notes 21–60 and accompanying text. There have been other recent media calls for change. See, e.g., Daniel Golden, *Tax Breaks for Skyboxes*, WALL ST. J., Dec. 27, 2006, at B1; George Will,

Part I introduces the current taxation of advertising and sponsorship and describes the controversy over sponsorship revenue. Part II discusses the distinction between advertising and sponsor acknowledgement. This Part also discusses how that distinction differs from the distinction between gratuitous and commercial transactions, and why it is important to the political symbolism of the charitable exemption and the UBIT. Part III uses the distinction set forth in Part II to reexamine the sponsorship controversy of the 1990s and its eventual legislative solution. Part IV considers the political stability of this solution and discusses alternatives.

I. BACKGROUND

A. The Charitable Tax Exemption

Section 501(c)(3) of the Internal Revenue Code⁷ (“Code”) exempts certain “charitable” organizations from the federal income tax. The Code imposes two principal requirements for exemption—nonprofit form and exempt purpose.⁸ The first constraint is that the exempt organization must be organized in nonprofit form, such that its earnings cannot inure to private benefit.⁹ The second requirement for exemption is that the organization must be organized and operated exclusively for a statutorily defined exempt purpose.¹⁰

Time to Rethink the Place of High-Stakes Football in Higher Education?, JEWISH WORLD REV., Oct. 24, 2006, available at <http://jewishworldreview.com/cols/will102406.php3>. Brand’s response to Thomas’s letter extols the educational virtues of college athletics and gives factual answers to Thomas’s questions where unavoidable. The crux of his answer, however, comes in response to Thomas’s question, asking whether federal taxpayers should pay for high-profile sports teams that colleges justify as giving themselves an advantage in competing for student applicants. Thomas notes that “[f]ederal taxpayers have no interest in increasing applicant pools at one school opposed to another.” *Id.* Brand responds that “while federal taxpayers, in the abstract, may have no interest in increasing applicant pools at one school as opposed to another, individual taxpayers surely do. Presumably, this is one of the reasons that taxpayers, including many Members of Congress, support and contribute to their alma maters and to their local schools” *NCAA Answers W&M on Tax-Exemption*, TAX NOTES TODAY, Nov. 17, 2006, LEXIS, 2006 TNT 222-20. In essence, Brand seems to be saying that the fundamental basis for extending a tax exemption to college football and basketball is that they are highly popular with members of Congress and their constituents. This seems to be an accurate analysis of the history of the exemption and is likely an accurate description of the current situation. Senator Charles Grassley, the ranking minority member of the Senate Committee on Finance, has called for hearings on the question. *See* Golden, *supra*. Whether these hearings take place and, if so, whether they result in any change will reveal the current accuracy of Brand’s analysis.

7. For a more detailed discussion of I.R.C. § 501(c)(3), see BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 63–317 (8th ed. 2003).

8. Two additional constraints, not relevant for this article, limit the exemption to organizations “no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.” I.R.C. § 501(c)(3).

9. I.R.C. § 501(c)(3) exempts only organizations “no part of the net earnings of which inures to the benefit of any private shareholder or individual.”

10. I.R.C. § 501(c)(3) exempts only organizations “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals.”

The key word is “charitable.” Courts of equity interpreting the law of charitable trust have generally interpreted the term broadly, looking for purposes “designed to accomplish objects that are beneficial to the community—i.e., to the public or indefinite members thereof—without also serving what amount to private trust purposes.”¹¹ The IRS has long adopted this interpretation of the exempt purposes requirement.¹²

B. The Unrelated Business Income Tax (UBIT)

1. General

Exempt organizations owe a tax—the “unrelated business income tax” (UBIT)—on their “unrelated business taxable income.”¹³ The UBIT applies only if three conditions are met.¹⁴ First, the exempt organization has income from the conduct of a business. Second, the exempt organization regularly carries on that business. Finally, the business is not substantially related (except as a source of funds) to the exempt organization’s performance of its exempt functions. In addition to these restrictions, the UBIT also excludes specified categories of “passive” income, such as dividends and royalties.¹⁵

Accordingly, for UBIT purposes, income is first divided into tax-free “passive” income (income that fits into certain excluded categories) and potentially taxable “active” income (income from all other sources). Active income is further divided into tax-free “related” income (income from the active conduct of a business related to an exempt purpose), and taxable “unrelated” income (income from all other active business endeavors).

New York University’s (NYU) acquisition of the Mueller Noodle Company—the poster case for the UBIT—provides an easy framework to illustrate these distinctions.¹⁶ If NYU earns income by operating the C.F. Mueller pasta factory, that business is regularly carried on and bears no relationship to NYU’s educational purpose. The income is taxable. By contrast, if NYU has a culinary school that teaches students to make pasta, NYU is regularly carrying on a business (education for tuition payments), but the business is related to NYU’s exempt purpose. The UBIT does not apply. If NYU receives dividends on the publicly traded common stock of the American Italian Pasta Company or interest from that company’s bonds, that income fits into the passive

11. RESTATEMENT (THIRD) OF TRUSTS § 28 general cmt. a (1992) (citation omitted).

12. See Treas. Reg. § 1.501(c)(3)-1(d)(1). This regulation was first adopted in 1959. See T.D. 6391, 1959-2 C.B. 139, 144. Subsequent amendments have not changed the basic definition of an exempt purpose.

13. See I.R.C. § 511. Generally speaking, UBIT is adjusted gross income less deductible expenses directly related to an unrelated business. See I.R.C. §§ 512(a), 513(a). The UBIT is levied at either the corporate or trust rates, depending on the nature of the exempt organization. See I.R.C. § 511(a)(1) (corporations); *id.* § 511(b)(1) (trusts).

14. See I.R.C. §§ 512(a), 513(a); Treas. Reg. § 1.513-1(a).

15. See I.R.C. § 512(b); Treas. Reg. § 1.512(b)-1.

16. See *C. F. Mueller Co. v. Comm’r*, 190 F.2d 120 (3d Cir. 1951) for the facts of the actual case. This paragraph merely uses those facts, and variations on them, to illustrate the current rule. Those rules did not apply when the actual transaction took place.

income exceptions to the UBIT. The UBIT does not apply. Finally, if the C.F. Mueller Company donates money to NYU, the donation does not derive from the conduct of a business. The UBIT does not apply.

Because I will be discussing transactions that can be characterized either as donations or quid pro quo payments for services rendered, it is worth emphasizing that the payor's tax treatment of a transaction is a distinct matter. Businesses can deduct most payments to charity either as charitable contributions under Section 170 of the Code or general business expenses under Section 162 of the Code.¹⁷ The business's choice of deduction has no direct bearing on whether the charity must pay UBIT.¹⁸

As I have demonstrated elsewhere, the exemption and the UBIT must be understood primarily in terms of symbolic politics.¹⁹ The charitable exemption's subsidy for charities is not an efficient mechanism for achieving specific policy results. Rather, it is a symbolic expression of public support for the general idea of organizations dedicated to good works. The UBIT serves to protect the exemption politically by protecting the perception that the exemption only subsidizes activities that fit this general idea. The UBIT deters charities from engaging in active business pursuits that do not conform with popular conceptions of charity. By keeping charities away from such activities, it preserves the political symbolism that supports the charitable tax exemption.

2. Advertising/Sponsorship

The paradigmatic unrelated business is a stand-alone operation, such as NYU's noodle business, unrelated to any exempt function. Code Section 513(c) extends the UBIT further to include unrelated businesses carried out within the context of exempt activities. The original impetus for this rule, and one of its main applications, is advertising income.²⁰ An exempt organization could provide stand-alone advertising services, for instance by operating a billboard. Generally, however, exempt organizations provide advertising services in the context of their exempt activities. For example, an educational magazine may sell advertising pages. Either way, the revenue is taxable.

Although advertising revenues are taxable, "qualified sponsorship payments" are not.²¹ Under Section 513(i) of the Code, a "qualified sponsorship payment" is a payment for which the exempt organization gives no "substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of [the payor's] trade or business in connection with the activities of [the recipient]."²² In order to qualify, a "use or acknowledgement" of the payor's name or logo must not

17. The Code limits a corporation's charitable deductions to ten percent of taxable income. See I.R.C. § 170(b)(2). There is no such limit on business deductions.

18. Some of the issues involved are closely analogous. See, e.g., I.R.S. Tech. Adv. Mem. 81-45-020 1981 PLR LEXIS 5860 (July 30, 1981) (explaining that benefits to business from community goodwill and economic development are too remote to justify business expense deduction).

19. The following discussion is based on Stone, *supra* note 5.

20. For a discussion of this history, see *infra* notes 102-107 and accompanying text.

21. I.R.C. § 513(i)(1).

22. *Id.* § 513(i)(2)(A).

include any “advertising [of the payor’s] products or services.”²³ In addition, payments contingent on the amount of public exposure of the message (such as television ratings) do not qualify.²⁴ Finally, acknowledgements in print periodicals and certain convention and trade show activities also do not qualify.²⁵

On its face, Section 513(c) appears to set the general rule—advertising income is taxable—and Section 513(i) appears to define a limited exception for arrangements that do not constitute advertising. This appearance is deceptive. Section 513(i) effectively exempts almost all advertising income, if we understand “advertising” colloquially to mean posting a commercial message for pay. Before I give a technical explanation, consider this practical example.

The 2005 Capital One Bowl²⁶ was organized by Florida Citrus Sports Association, Inc. (FCSA), a tax-exempt nonprofit whose exempt purpose is to “promote and foster an interest in amateur athletics.”²⁷ FCSA acknowledged the game’s chief sponsor—Capital One—by naming the game for it. FCSA likewise acknowledged Capital One by placing the game logo (containing Capital One’s name) on the players’ uniforms and in the center of the field. It also painted Capital One’s name on both sides of the field at each twenty-yard line, ensuring that most television pictures of the game would include Capital One’s name. Capital One’s name was also placed on billboards around the stadium and on screen when the players were introduced.²⁸ It is safe to assume that Capital One secured these acknowledgements as enforceable consideration for a sponsorship payment to FCSA and that FCSA did not pay tax on the payment.

In technical terms, this results from the interaction between the provisions of Section 513(i). First, Section 513(i) emphasizes that income from an acknowledgement transaction can be exempt, even if the transaction is a quid pro quo exchange. This means that the IRS cannot establish taxability merely by demonstrating that the sponsor had little or no donative intent. The only limit is that the charity’s service to the sponsor cannot be “advertising.” Advertising, however, is not defined, other than by a nonexclusive list of examples, all of which describe direct exhortations to buy, rather

23. *Id.*

24. *See id.* § 513(i)(2)(B)(i).

25. *See id.* § 513(i)(2)(B)(ii). Convention and trade show activities are separately excluded under I.R.C. § 513(d). Print periodical advertising was the original impetus for Section 513(c), and the subject of *United States v. American College of Physicians*, 475 U.S. 834 (1986). *See infra* notes 102–107 and accompanying text. Special rules also govern the deduction of the exempt organization’s costs against revenue attributable to an unrelated activity that “exploits” an exempt-purpose activity. *See* Treas. Reg. § 1.512(a)-1(d) (general rules); *id.* § 1.512(a)-1(f) (periodical advertising rules).

26. University of Iowa 30, Louisiana State 25. *See* Randy Peterson, *Great Tate: MVP’s Game-Ending TD Pass Beats LSU in Bowl*, DES MOINES REG., Jan. 2, 2005, at 1C; *see also* <http://www.iowaalum.com/pub/music/iafight.wav>. (last visited Sept. 23, 2006). Go Hawks.

27. *See* Florida Citrus Sports Association, Inc., Return of Organization Exempt from Income Tax, Form 990, Part III & Statement 3 (2003), available at <http://www.guidestar.org/FinDocuments/2004/591/058/2004-591058144-1-9.pdf> (last visited Sept. 23, 2006) [hereinafter Capital One Bowl Form 990].

28. *Capital One Bowl* (ABC television broadcast Jan. 1, 2005).

than more subtle forms of brand promotion.²⁹ Finally, even if the IRS can prove that a charity agreed to provide “advertising” services to its sponsor, the charity owes tax only on the portion of the total payment properly allocated to those services.³⁰

The upshot: the deck is stacked against the IRS except in cases closely matching the statute’s examples. Any attempt by the IRS to define a broader scope for “advertising” faces a built-in defense. Section 513(i) is clear on only one point: commercial sponsorships are usually exempt. Everything else is arguable (and defensible) and tax is due only to the extent the IRS wins the argument.

The IRS finalized regulations under Section 513(i) in 2002.³¹ The final regulations at first appear to add teeth to Section 513(i) by defining “advertising” functionally as any message that “promotes or markets any trade or business, or any service, facility, or product.”³² This language is derived from Federal Communication Commission (FCC) regulations governing sponsorship credits.³³ It is intended to allow charities to identify sponsors, but not promote them. In theory, the IRS might argue that a very aggressive acknowledgement could cross that functional line, even if it did not include overt sales promotion.

Examined more carefully, however, the regulations achieve the same effect as the statute. The functional definition of advertising is qualified by a list of sponsor benefits that never constitute advertising.³⁴ These exceptions effectively swallow the rule and leave “advertising” defined by the statute’s examples. Again, the only clear message is that revenue from quid pro quo deals, in which a sponsor pays a charity to publicize brand-promotion messages, is not necessarily taxable.

C. The Controversy over Sponsorships

I will discuss the sponsorship controversy in greater detail below.³⁵ I begin, however, with this brief summary to situate the reader. As discussed above, when the public controversy over sponsorship revenues began in 1991, Section 513(c) of the Code already applied the UBIT to advertising income. The IRS had also already considered the tax treatment of donor acknowledgements in analogous contexts. It had

29. See I.R.C. § 513(i)(2)(A) (“messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services”).

30. See *id.* § 513(i)(3).

31. See Taxation of Tax-Exempt Organizations’ Income from Corporate Sponsorship, 67 Fed. Reg. 20,433 (Apr. 25, 2002) (codified at 26 C.F.R. pt. 1).

32. Treas. Reg. § 1.513-4(c)(2)(v).

33. Commission Policy Concerning the Noncommercial Nature of Educational Broadcasting Stations, 49 Fed. Reg. 13,534 § 13 (Apr. 5, 1984) (codified at 47 C.F.R. pt. 73) [hereinafter FCC Rules]. As will be discussed below, Section 513(i) itself derives from the FCC Rules. See *infra* notes 53, 136–140 and accompanying text.

34. This list of permitted messages is “exclusive sponsorship arrangements; logos and slogans that do not contain qualitative or comparative descriptions of the payor’s products, services, facilities or company; a list of the payor’s locations, telephone numbers, or Internet address; value-neutral descriptions, including displays or visual depictions, of the payor’s product-line or services; and the payor’s brand or trade names and product or service listings.” Treas. Reg. § 1.513-4(c)(2)(iv).

35. See *infra* notes 114–158 and accompanying text.

concluded that such acknowledgements were not improper self-dealing between the charity and donor, and that they would not prevent donors from deducting the acknowledged contributions as charitable donations.³⁶ In each case, the IRS treated the transaction as a donation, even if the donor bargained for an enforceable right to be acknowledged. The theory was that acknowledgements had only an incidental value to donors. The rule, however, did not seem to depend on the value of particular acknowledgements. The rulings did not consider whether the facts seemed to indicate a quid pro quo deal. Rather, they seemed conclusively to presume that acknowledging a donor, whatever its value, was not the kind of benefit that could transform a donation into an exchange.³⁷

Consequently, it surprised many when the IRS issued two Technical Advice Memoranda (“Bowl TAMs”)³⁸ in 1991, holding that payments to sponsor the Mobile Cotton Bowl and John Hancock Bowl were taxable unrelated business income in the hands of the exempt organizations that presented the games.³⁹ The Bowl TAMs recharacterized the IRS’s prior rulings as holding only “that recognition of a donor’s generosity *can* be an insubstantial return benefit.”⁴⁰ They then held that the recognition provided to the bowl sponsors, unlike the acknowledgements in prior rulings, had

36. See Treas. Reg. § 53-4941(d)-2(f)(9), Example (4) (finding no self-dealing in gift conditioned on naming rights), *adopted in* T.D. 7270, 1973-1 C.B. 473, 483 (as amended in T.D. 8639, 60 Fed. Reg. 65,568 (Dec. 20, 1995)); Rev. Rul. 77-367, 1977-2 C.B. 193 (granting tax exemption to organization operating replica of nineteenth-century village, although village would bear corporate sponsor’s name and corporate sponsor would feature village in its own advertising); Rev. Rul. 73-407, 1973-2 C.B. 383 (holding exempt organization’s agreement to adopt name of a major contributor for at least one hundred years not prohibited self-dealing); Rev. Rul. 68-432, 1968-2 C.B. 104 (holding donations to clubs deductible despite acknowledgement of donors); Rev. Rul. 67-342, 1967-2 C.B. 187 (approving exemption of educational television production company despite on-air acknowledgement of program sponsors, without “mention . . . of products or services sold by the sponsors”).

37. The point of Rev. Rul. 68-432, 1968-2 C.B. 104, for instance, was to emphasize that club dues might be deductible donations or not, depending on the value of membership privileges. In the context of this fact-heavy test, the IRS stated flatly that “[s]uch privileges as being associated with or being known as a benefactor of the organization are not significant return benefits that have a monetary value within the meaning of this Revenue Ruling.”

38. A Technical Advice Memorandum is a form of nonprecedential guidance provided by the IRS national office at the request of field agents.

39. See I.R.S. Tech. Adv. Mem. 92-31-001, 1991 PLR LEXIS 2722 (Oct. 22, 1991) (John Hancock Bowl); I.R.S. Tech. Adv. Mem. 91-47-007, 1991 PLR LEXIS 1778 (Aug. 16, 1991) (Mobile Cotton Bowl) [hereinafter Cotton Bowl TAM, and, together with TAM 92-31-001, the Bowl TAMs]. The IRS is legally required to excise taxpayers’ names and identifying details before releasing TAMs. Nonetheless, the taxpayers’ identities were widely known. See, e.g., *Edited Transcript of Winter EO Committee Meeting: Luncheon Speech—Cotton Bowl Comments*, 5 EXEMPT ORG. TAX REV. 615, 616 (1992) [hereinafter *Winter 1992 Meeting*] (comments of Bruce Bernstein, who represented Cotton Bowl on audit). Some of the terms of the Cotton Bowl’s contract with Mobile likewise leaked. See Paul Streckfus, *A Glimpse of the Mobile Cotton Bowl Contract Provisions*, 55 TAX NOTES 447 (1992).

40. Cotton Bowl TAM, *supra* note 39, at *13 (emphasis added).

substantial value. The IRS began to take the same position in audits of other bowl game organizers and Olympic sports federations.⁴¹

The targeted charities responded on three fronts, by: (1) fighting the audits, (2) enlisting members of Congress to propose legislation, and (3) whipping up concern among charities generally.⁴² The IRS's first reaction was to publish proposed audit guidelines ("Audit Guidelines") to explain its position.⁴³ The Audit Guidelines first noted that "[m]ere acknowledgement or recognition of a corporate contributor as a benefactor normally is incidental to the receipt of a contribution and is not of sufficient benefit to give rise to unrelated trade or business income."⁴⁴ They then told auditors to examine sponsorships for signs of advertising sales and provided a list of suggestive facts.⁴⁵ Finally, the Audit Guidelines instructed auditors that

[a]s 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 baseball and soccer teams, and local theatres and youth orchestras.⁴⁶

Although the Audit Guidelines were formally only a guide to field agents, the IRS saw them as "baby regs" and provided a public comment period and hearings in July 1992.⁴⁷ The result was a flood of negative written comments, followed by angry hearings.⁴⁸

Meanwhile, Congress took up the issue. The first bills reversing the Bowl TAMs appeared several months before the Bowl TAMs themselves.⁴⁹ These bills simply excluded activities related to amateur athletic events (apparently including outright advertising) from the definition of unrelated business. In the fall of 1992, a few months after the IRS's Audit Guidelines hearings, Congress passed the Revenue Act of 1992,

41. See Mike Fish, *IRS Tries to Tax Money Raised by Olympic Sponsorships*, 5 EXEMPT ORG. TAX REV. 458 (1992).

42. For a discussion of the Bowl's position in the audit, see *Winter 1992 Meeting*, *supra* note 39 (comments of Bruce Bernstien, who was representing Cotton Bowl on audit). For a survey of bills introduced from 1991 to 1996, see Keith L. Henderson, *The Tax Treatment of Corporate Sponsorship Payments and the Aftermath of the Cotton Bowl Ruling*, 13 EXEMPT ORG. TAX REV. 789 (1996). For a description of the efforts to spark broader concern, see Gilbert Fuchsberg, *Special Events Organizers Gird To Battle IRS*, WALL ST. J., Dec. 27, 1991, at B1.

43. See I.R.S. Announcement 92-15, 1992-5 I.R.B. 51 [hereinafter Audit Guidelines].

44. *Id.* at 51 (Purpose).

45. See *id.* § 178.3.

46. *Id.* § 178.2.

47. See Paul Streckfus & Julianne MacKinnon, *Non-Profit Tax Conference Updates Charities on the Latest Developments*, 5 EXEMPT ORG. TAX REV. 411, 411 (1992).

48. Paul Streckfus, *IRS's Pre-Inaugural Gift for Charities*, 7 EXEMPT ORG. TAX REV. 179, 179 (1992) [hereinafter Streckfus, *Gift*].

49. See S. 866, 102d Cong. (1991); H.R. 538, 102d Cong. (1991). The bowls had evidently concluded that the IRS would rule adversely. See *Winter 1992 Meeting*, *supra* note 39, at 622 (comments of Ed Knight). For a survey of bills introduced from 1991 to 1996, see Henderson, *supra* note 42.

which would have become law but for a veto (unrelated to the UBIT issue).⁵⁰ It contained a UBIT exemption for event-sponsorship revenues that was even more explicit than the earlier bills in covering advertising revenue for a category of events obviously designed to fit college bowl games, the NCAA's March Madness, and the Olympics.⁵¹

A few months later, the IRS scrapped the Audit Guidelines and instead proposed formal regulations ("1993 Regulations").⁵² The 1993 Regulations were based on the FCC's rules for sponsor acknowledgement.⁵³ The 1993 Regulations allowed exempt organizations to enter into openly commercial sponsorship deals without incurring tax liability. They tried to limit the practice, however, by distinguishing between "advertising" that had the effect of promoting the sponsor's goods or services and "acknowledgements" that did not.⁵⁴ Only the latter enjoyed a safe harbor from the UBIT. The 1993 Regulations also included a "tainting rule": any arrangement that mixed advertising and sponsor acknowledgement would be ineligible for special treatment as a sponsor acknowledgement.⁵⁵

The charities favored the 1993 Regulations, but opposed the tainting rule.⁵⁶ Although they pressured the Treasury to finalize the 1993 Regulations, however, years passed with no sign that it planned to do so.⁵⁷ Eventually, the charities once again

50. See Bennett Minton, *Bush Vetoes Tax Bill*, 92 TAX NOTES TODAY 223-1 (1992).

51. See H.R. 11, 102d Cong. § 7303 (1992); *Conference Report on Tax Bill Passes Senate*, 92 TAX NOTES TODAY 214-97 (1992) (reporting on passage of act). H.R. 11 excluded from UBIT "Qualified Sponsorship Payments" received in conjunction with "Qualified Public Events." "Qualified Sponsorship Payments" included "the use of the name or logo of [a sponsor's] trade or business in connection with any Qualified Public Event under arrangements (including advertising) in connection with such event which acknowledge such person's sponsorship or promote such person's products or services," as well as VIP privileges at the event. "Qualified Public Event" included any event substantially related to the presenting charity's exempt purpose, as well as any event held only once a year for less than thirty days. The Olympics organizers secured a separate provision in the same bill, providing that any payment for which "a substantial part of the consideration" was the right to use the Olympics' trademarks would be considered a royalty for purposes of the UBIT. See H.R. 11 § 7304.

52. See *Taxation of Tax-Exempt Organizations' Income from Corporate Sponsorship*, 58 Fed. Reg. 5,687 (Jan. 22, 1993) (codified at 26 C.F.R. pt. 1) [hereinafter 1993 Regulations].

53. See *id.* at 5,688 (describing origin in FCC Rules); FCC Rules, *supra* note 33, § 13. By 1992, Congress had partially codified the FCC's approach. See 47 U.S.C. §§ 399A-399B (1984).

54. See 1993 Regulations, *supra* note 52, at 5,690.

55. See *id.* Arrangements that did not qualify as acknowledgements might still escape UBIT on more general grounds. For instance, if the charity had not provided a substantial return benefit to the donor, it would be hard to argue that it had received income from a trade or business. Likewise, income might fall into a category of income exempt from UBIT, such as royalties. For a discussion of the requirements of the UBIT, see *supra* notes 13-16 and accompanying text.

56. *Unofficial Transcript of IRS Hearing on Corporate Sponsorship Regs.*, 93 TAX NOTES TODAY 147-23 (1993) [hereinafter 1993 Hearing Transcript].

57. See, e.g., *Nonprofit Advisors Turn to Capitol Hill for Corporate Sponsorship Guidance*, TAX DAY REP. (CCH), at A.2 (May 1, 1995) (citing Treasury explanation that "questions that have come up in the process of working on other projects that involve UBIT issues have, in turn, raised additional concerns with the corporate sponsorship regulations"); Paul Streckfus, *Editor's*

turned to Congress. The current text of Section 513(i) was first passed in the 1995 budget act, which was vetoed for other reasons.⁵⁸ It became law two years later in the Taxpayers Relief Act of 1997.⁵⁹ I have outlined its provisions above.⁶⁰

II. THE DISTINCTION BETWEEN ADVERTISING AND SPONSOR ACKNOWLEDGEMENT

My first task is to tease apart and analyze the confused and unexamined conceptions about advertising and sponsor acknowledgement that undergirded the sponsorship controversy in the 1990s. My thesis is that prior accounts are incomplete for two reasons. First, they have not taken into account the conceptual distinction between advertising and sponsor acknowledgement. Second, they have not differentiated between (1) the advertising/sponsor acknowledgement distinction, and (2) the more familiar conceptual distinction between commercial and gratuitous payments. Understanding these distinctions and the difference between them is important to understanding the sponsorship controversy. The 1993 Regulations and Section 513(i) represent not simply a retreat from the IRS's initial position, but a reconceptualization of the problem.

Accordingly, before analyzing the events of the 1990s, I will first develop the distinction between advertising and sponsorship and then discuss two ways in which that distinction is important for understanding the UBIT's application to sponsorship revenues. Subpart A discusses the conceptual distinction between advertising and sponsor acknowledgement. In Subpart B, I point out that this distinction is not the same as the distinction between commercial and gratuitous transactions, with which it is often confused. In Subpart C, I show that the two distinctions are not only conceptually distinct, but also have different meanings in the context of the symbolic politics that support the charitable exemption and underlie the UBIT.

A. Distinction Between Advertising and Sponsor Acknowledgement

This Subpart distinguishes two types of quid pro quo transaction between charities and third parties: advertising and sponsor acknowledgement. It is worth emphasizing that as I am using these terms, neither involves any element of gratuitous altruism. In each case a business (the advertiser/sponsor) pays a charity to transmit a commercially valuable message (an advertisement or sponsorship acknowledgement). This

Notebook, 11 EXEMPT ORG. TAX REV. 311, 311 (1995) (discussing efforts to finalize the regulations); *Testimony of the American Society of Association (ASAE) Before the Committee on Ways & Means of the U.S. House of Representatives*, 12 EXEMPT ORG. TAX REV. 371, 376 (1995) (complaining about delay); *Treasury Working on Corporate Sponsorship*, 11 EXEMPT ORG. TAX REV. 875 (1995) (February 2, 1995 letter from Leslie B. Samuels, Assistant Secretary for Tax Policy, Department of the Treasury, replying to letter from Senator J. Bennett Johnston).

58. See H.R. 2491, 104th Cong. § 12702 (1995) (as passed by the Senate on October 27, 1995), reprinted in 211 Daily Tax Rep. (BNA), Special Supp., at d39 (Nov. 1, 1995); Ann Devroy & Eric Pianin, *Clinton Vetoes GOP's 7-Year Balanced Budget Plan*, WASH. POST, Dec. 7, 1995, at A1.

59. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 965, 111 Stat. 788, 893-94 (1997) (codified as I.R.C. § 513(i)).

60. See generally *supra* notes 21-34 and accompanying text (discussing Section 513(i) and subsequent regulations).

distinction, while at the center of the sponsorship controversy, has never been clearly separated in the legal literature from the distinction between gifts and sponsorships, although it has been much discussed in academic and professional marketing literature.

The distinction is simple in theory: transactions in which the sponsor pays to be connected to the sponsored organization and transactions in which an advertiser pays for exposure for a commercial message. To illustrate it in the UBIT context, consider what would constitute a “pure” sale of advertisement for UBIT purposes. To qualify, the arrangement could allow no argument that the payor was merely receiving a “thank you” for a gratuitous donation. The only possible description would be a payment for advertising services.

An easy example is a charity-owned billboard, rented on commercial terms.⁶¹ Assume the charity exerts no substantive control over messages posted and that the billboard exhibits no obvious connection to its owner. It is impossible to characterize the leasing of billboard space as a donation and acknowledgement. No viewer could understand the billboard as a communication by the owner, let alone as a “thank you” to the advertiser. The billboard’s value depends solely on its visibility. I call this pure advertising value a “billboard effect.”

Contrast this to a pure paid sponsor acknowledgement, in which the sponsor pays for a “thank you” but cannot be said to have paid for a billboard effect. These are rare in the real world. To give a plausible example, however, assume that a drug maker sponsors rural clinics in an undeveloped country. The sponsor insists on the contractual right to place a large sign with its logo at each clinic entrance. Why? The signs provide no billboard effect. Drug makers aim their commercial communications at patients, prescribing doctors, regulators, and politicians in developed countries, none of whom will see the signs. The signs’ value is the association they make between the drug company and a worthy cause. To realize the value of this association, of course, the drug maker needs to design advertisements (featuring pictures of the clinic) and display them where developed-country consumers, doctors, regulators, and politicians will see them. The transaction with the clinic, however, is valuable and distinct from the ad buys that eventually publicize it. I call this pure association value a “halo effect.”

Scholars of marketing have noted and studied this distinction between billboards and halos for decades. The upshot of the marketing research is that one of the unique benefits of sponsorship is its ability to generate a halo effect—an association between a company or brand and the goodwill of a well-liked organization or event.⁶² Marketing

61. Assume also that the owner provided services beyond simple access to real property, such as workers to paint the billboard, so that the arrangement could not be exempt as rent. See I.R.C. § 512(b)(3).

62. See, e.g., Drew Barrand, *Sizing Up Sponsorship*, *MARKETING*, Aug. 2, 2006, at 17 (quoting an advertising agency executive who states, “[t]here will always be people who equate sponsorship to a media buy because it makes it easier to understand. But this type of thinking removes the principal benefits of using sponsorship—that it can deliver much more for your brand than pure media exposure. Sponsorship is not just about how many times your logo appears on TV.”); Paul N. Bloom et al., *How Social-Cause Marketing Affects Consumer Perceptions*, *MIT SLOAN MGMT. REV.*, Winter 2006, at 49, 51 (“We hypothesize that the primary reason why demonstrating a high degree of affinity can enhance the effectiveness of a promotional initiative is that it increases the likelihood that consumers will treat the initiative itself—or, more generally, the brand’s ‘style of marketing’—as an important and positively

scholars also recognize that a sponsor cannot fully realize this value from the billboard effect of brand exposure at a well-publicized event.⁶³ The impact of such exposure is highly contingent and depends in large part on the strength of the association between the sponsor and the halo of the sponsored organization or event.

Marketing researchers have repeatedly stressed that a perceived fit between the sponsor and the event sponsored tends to make sponsorship more effective. If the fit is wrong, sponsorship can backfire. Viewers perceive that the sponsored organization has sold out. This perception can damage both the sponsor and the sponsored organization.⁶⁴ Genuine supporters of cool things look cool, but obviously false fans

weighted attribute of the brand.”); James Crimmins & Martin Horn, *Sponsorship: From Management Ego Trip to Marketing Success*, J. ADVERTISING RES., July/August 1996, at 11, 12 (“Sponsorship is a means of persuasion that is fundamentally different from traditional advertising . . . Sponsorship improves the perception of a brand by flanking our beliefs about the brand and linking the brand to an event or organization that the target audience already values highly.”); Tony Meenaghan, *Sponsorship—Legitimising the Medium*, 25 EUR. J. MARKETING 5, 8 (1991) [hereinafter, Meenaghan 1991] (noting “goodwill” aspect of sponsorship as principal difference from advertising); Dennis M. Sandler & David Shani, *Olympic Sponsorship vs. “Ambush” Marketing: Who Gets the Gold?*, J. ADVERTISING RES., August/September 1989, at 9, 10 (defining sponsorship as “[t]he provision of resources (e.g. money, people, equipment) by an organization directly to an event or activity in exchange for a direct association to the event or activity.”).

63. An advertising executive, for instance, recently reacted to evidence that advertisers doubt sponsorships affect brand visibility and that viewers do not recall cluttered sponsors’ brands, by noting that “advertisers are still keen to connect with people’s interests and passions. It would be naive to suggest that these advertisers . . . are [pursuing sponsorships] just for broadcast exposure.” Alastair Reid, *Is Sponsorship Really Worth It?*, CAMPAIGN, Feb. 11, 2005, at 10 (quoting Laurence Munday).

64. See Karen L. Becker-Olsen & Carolyn J. Simmons, *When Do Social Sponsorships Enhance or Dilute Equity? Fit, Message Sources, and the Persistence of Effects*, 29 ADVANCES IN CONSUMER RES. 287 (2002); Bloom et al., *supra* note 62; Michel Tuan Pham & Gita Venkataramani Johar, *Market Prominence Biases in Sponsor Identification: Processes and Consequentiality*, 18 PSYCHOL. AND MARKETING 123 (2001) [hereinafter Pham 2001]; Richard Speed & Peter Thompson, *Determinants of Sports Sponsorship Response*, 28 J. OF THE ACAD. OF MARKETING SCI. 227 (2000). Some recent experiments found that social-cause sponsorships, whether high-fit or low-fit, improved consumer perceptions of a beer brand, whereas sponsorships of commercial events degraded perceptions. See Bloom, et al., *supra* note 62. There is also evidence that the combination of a good fit and a high-status event sends a message of insincerity by making the sponsor’s instrumental reasons for sponsoring the event too obvious. See Speed & Thompson, *supra*, at 236. The viewers’ level of interest and involvement with the sponsored activity also makes a difference, although not in straightforward ways. See Aron Levin, Chris Joiner & Gary Cameron, *The Impact of Sports Sponsorship on Consumers’ Brand Attitudes and Recall: The Case of NASCAR Fans*, J. CURR. ISSUES & RES. IN ADVERTISING, Fall 2001, at 23 (finding level of involvement affects impact of sponsorship on brand attitude but not recall); Michel Tuan Pham, *Effects of Involvement, Arousal, and Pleasure on the Recognition of Sponsorship Stimuli*, in ADVANCES IN CONSUMER RESEARCH 85 (John F. Sherry & Brian Sternthal eds. 1992) [hereinafter Pham 1992] (finding brand recall increasing with greater levels of involvement to a point and then diminishing and that greater levels of arousal diminish recall); See also *Sponsorship to Reveal Its Full Brand Potential*, MARKETING WK., Dec. 2, 2004, at 17 (reporting British ITV network’s decision to discontinue service measuring viewer recall of sponsor brands in favor of “qualitative” measurement of “the creative fit between programme and sponsor”); Rich Thomaselli, *Now, Many Words From Our Sponsor*,

look lame.⁶⁵ “Ambush marketers” can also snatch the halo from an unwary sponsor’s head with advertising messages that suggest a sponsorship relationship where none exists.⁶⁶

Marketing scholars have also long recognized another aspect of sponsorships that drew the IRS’s attention as it approached the issue in the late 1980s: halo deals usually include a significant billboard effect.⁶⁷ Popular events are natural billboards. This billboard effect of sponsorship is easy to quantify, and therefore received much attention in the 1980s, as sponsorships became increasingly commercial and professional. Evaluation consultants, eager to tout their services to sponsors, and marketers, eager to justify increasing sponsorship expenditures, liked this simple measure.⁶⁸ The IRS was heavily influenced by reports on this kind of sponsorship evaluation when it was preparing the Bowl TAMs.⁶⁹

ADVERTISING AGE, Jan. 3, 2005, at 6 (describing efforts of a Detroit Pistons’ sponsor to offset “any perception of overkill with the Rock Financial logo” by community work with Pistons players and distribution of free Pistons tickets to “charity and youth groups.”).

65. See, e.g., Kevin P. Gwinner, *A Model of Image Creation and Image Transfer in Event Sponsorship*, 14 INT’L MARKETING REV. 145, 150 (1997) (“The perceived promotional appearance of a brand’s sponsorship activities may appear anywhere along a spectrum from advertiser to benefactor. A perception towards the benefactor end of the spectrum may lead to increased feelings of goodwill towards the brand because it is perceived as donating funds to make the event possible. Conversely, there may be a negative reaction to the commercialization of events that have not been sponsored in the past. These events may be perceived as ‘selling out’ to the corporate world.”). But see Horst Stipp & Nicholas P. Schiavone, *Modeling the Impact of Olympic Sponsorship on Corporate Image*, J. ADVERTISING RES., July/August 1996, at 22, 24 (interpreting results of consumer survey of reaction to Olympic sponsorship to mean that consumers were aware of sponsors’ commercial goals, but were nonetheless favorably disposed towards them). Knauer ignores this dynamic and improbably assumes that the form of deduction a business takes for its sponsorship payments (a fact not publicly disclosed) plays a significant role in determining whether the public confers a halo. See 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, 42–43 (1994) [hereinafter Knauer, *Paradox*].

66. See, e.g., Tony Meenaghan, *Ambush Marketing—A Threat to Corporate Sponsorship*, 38 SLOAN MGMT. REV. 103, 106 (1996); Sandler & Shani, *supra* note 62, at 51; *Sponsorship Is More than Just a Logo*, BRAND STRATEGY, Sept. 15, 2004, at 46, 47–48 (reporting ambush marketing at the Euro 2004 soccer tournament and Mastercard’s efforts to counter it by leveraging its sponsorship).

67. See, e.g., Crimmins & Horn, *supra* note 62, at 12; John A. Meenaghan, *Commercial Sponsorship*, 7 EUR. J. MARKETING 5, 23–24 (1983).

68. See, e.g., Speed & Thompson, *supra* note 64, at 227 (criticizing focus of consultants with “origins . . . in publicity and public relations” on measuring exposure).

69. See Paul Streckfus, *Service’s EO Office Cracks Down on ‘Big Business’ Aspect of Nonprofits*, 5 EXEMPT ORG. TAX REV. 787, 787 (1992) [hereinafter Streckfus, *EO Office*] (quoting James McGovern, IRS Associate Chief Counsel (Employee Benefits and Exempt Organizations)); *Transcript of the Afternoon Session of the Spring EO Committee Meeting: Panel 6: Unrelated Business Income Tax Issues*, 6 EXEMPT ORG. TAX REV. 388, 391–92 (1992) (statement of Beth Purcell, Office of Chief Counsel (Employee Benefits and Exempt Organizations)) [hereinafter *Spring 1992 Meeting*]. For the reports in question, see STEPHEN A. GREYSER & JOHN L. TEOPACO, HARVARD BUS. SCH., JOHN HANCOCK FINANCIAL SERVICES: SPORTS SPONSORSHIP (1987); Michael J. McCarthy, *Keeping Careful Score on Sports Tie-Ins*, WALL ST. J., Apr. 24, 1991, at B1.

The billboard effect often provides a significant part of a sponsorship's value.⁷⁰ Marketers are generally aware, however, that they cannot draw a one-to-one correspondence between casual brand exposure in the course of an event and brand exposure through traditional advertising, in which the advertiser controls all aspects of the exposure and can convey a crafted message. There is no automatic link between brand exposure and effects on viewers. In particular, exposure seems to work differently with and without concurrent advertising.⁷¹ It is accepted wisdom among experts that a sponsor should spend several times more on advertising and other efforts to purchase exposure for (and shape the message of) a sponsorship than it spends on the actual sponsorship.⁷²

Successful sponsorships blend billboard and halo effects and leverage the resulting message with traditional advertising. For example, Capital One achieved a billboard effect merely by sponsoring (and renaming) the Capital One Bowl. To emphasize and elaborate on the association, however, Capital One also bought time from ABC to run ads for its Prime Lock cards and No Hassle Rewards program during many breaks in the broadcast.⁷³

In practice, the distinction between advertising and sponsor acknowledgement is a continuum, not a dichotomy between discrete categories. Real sponsorships fall somewhere on this continuum between a hypothetical pure advertisement and pure sponsorship. For an example of this, consider this cluster of public radio sponsorship acknowledgements:

Support for NPR comes: from Visa, offering the Visa Signature Card, featuring concierge services for travel, dining and entertainment, at visa.com/signature; from AAAS and its journal *Science*, advancing science, serving society, and promoting science literacy, on the web at aaas.org; and from Wal-Mart, providing jobs and

70. See, e.g., DAVID A. AAKER & ERICH JOACHIMSTHALER, *BRAND LEADERSHIP* 198, 201 (2000) (contrasting \$15 million cost of Mastercard's 1994 World Cup sponsorship with \$25 million value of pure brand exposure, after applying 95% discount to normal advertising rates). IEG's 2005 survey of sponsorship decision makers' goals found that about the same percentage of decision makers rated "increase brand loyalty" (68%) and "create awareness/visibility" (65%) as top goals. See IEG, Inc., *Performance Research / IEG Study Highlights What Sponsors Want*, <http://www.sponsorship.com/learn/decisionmakerstudy.asp>. "Showcas[ing] community/social responsibility" trailed at 43%. See *id.*

71. See, e.g., Levin et al., *supra* note 64 (studying differential effects of brands featured on NASCAR cars, in advertising during broadcast, and both in conjunction); Pham 2001, *supra* note 64 (finding impacts of overall brand prominence and clarity of brand-sponsor association on both sponsorship recall and brand image); Pham 1992, *supra* note 64 (finding minor brand recognition effects from billboards around a soccer field, decreasing as to intensely involved or aroused viewers).

72. See, e.g., AAKER & JOACHIMSTHALER, *supra* note 70, at 225; *Sponsorship is More than Just a Logo*, *supra* note 66, at 46. This conventional wisdom among experts is less than universal among sponsors. A 2005 survey of sponsorship decision makers found that thirty percent spent less leveraging the sponsorship than on the sponsorship itself. Roughly the same percentage spent twice as much or more on leveraging. For the remainder the ratio was 1:1. See IEG, *supra* note 70. These numbers nonetheless demonstrate that most sponsors do not expect to get all or even most of the "billboard effect" they are seeking from the sponsorship itself.

73. See *Capital One Bowl*, *supra* note 28.

opportunities for millions of Americans of all ages and all walks of life. Our people make the difference. Information at walmartstores.com.⁷⁴

The primary motive behind the Visa message seems to be advertising—the desire to publicize the high-end “Signature Card” to an affluent and educated public radio audience. Visa might also be interested in association with NPR, but the message suggests that sales promotion is the main goal. The motives of the American Association for the Advancement of Science are ambiguous. It may be sponsoring NPR in pursuit of its charitable purpose—advancing the understanding of science—and merely accepting recognition. It could also be an advertisement for the journal *Science*. Wal-Mart is trying to rent a halo. It knows many members of the NPR audience, including many community leaders who can make political trouble, view Wal-Mart as rapacious.⁷⁵ The message—which touts positive contributions to society, not everyday low prices—is designed to emphasize an association with the public radio halo. On the other hand, Wal-Mart must also be paying for the billboard effect of a nationwide radio broadcast to the target audience.

It is important to note that the 1993 Regulations and Section 513(i), like the FCC Rules they followed, use the distinction between advertising and sponsor acknowledgement. Unlike prior doctrine, they allowed exempt organizations to enter into openly commercial sponsorship deals. Rather than distinguish between commercial and gratuitous transactions, they distinguished between transactions in which the sponsor paid to be identified as such and transactions in which an advertiser sought exposure for a message promoting sales.⁷⁶ As will be discussed below, identifying this distinction allows us to see that the IRS did not simply capitulate to charities’ demands not to be taxed. Instead, it proposed a distinction between taxable and exempt revenues that fit better into the political symbolism of the exemption and the UBIT.

B. Distinction Between Advertising and Sponsor Acknowledgement Contrasted with Distinction Between Commercial and Gratuitous Transactions

With the distinction between advertising and sponsor acknowledgement clearly in mind, it is now possible to point out how it differs from the distinction that initially

74. *All Things Considered* (NPR radio broadcast Oct. 6, 2004).

75. See Constance L. Hays, *Wal-Mart Tries to Shine Its Image by Supporting Public Broadcasting*, N.Y. TIMES, Aug. 16, 2004, at C1 (quoting a spokesperson describing the goal as reaching “community leaders and [to] help them understand the value that we bring to their areas”).

76. See *supra* notes 52–55 and accompanying text. This is a simplification. The dividing line is between payments made for a “substantial return benefit” and those that are not. I.R.C. § 513(i)(2)(A); Treas. Reg. § 1.513-4(c)(1). The regulations identify certain benefits, other than advertising, that could constitute a substantial return benefit. Treas. Reg. § 1.513-4(c)(2)(iii). The thrust of Section 513(i) and the regulations, however, is not to inform us that payments to a charity in exchange for substantial goods, services, or contractual rights might result in unrelated business income. That is obvious. The innovation is that payments to a charity in exchange for valuable sponsor acknowledgements can never produce UBIT, so long as the acknowledgements do not include advertising.

drove the sponsorship controversy: the distinction between commercial and gratuitous transactions. As discussed above, payments to charities for advertising and sponsor acknowledgement, as used here, are commercial transactions. Many payments to charities, however, are gratuitous. Accordingly, we must consider a second conceptual distinction when we examine sponsorships: the distinction between gratuitous gifts to charity that the recipient charity publicly acknowledges and commercial payments made for the purpose of securing a valuable public acknowledgement.

Charities customarily acknowledge their benefactors. Usually (at least for individual donations) the parties nonetheless view the transaction as a gratuitous gift, not a purchase of acknowledgement services.⁷⁷ The psychology and economics of charitable giving by individuals is a difficult and hotly debated topic.⁷⁸ There are good reasons to believe that individuals often give, not as a calculated strategy to achieve concrete benefits, but rather because they value (as an end in itself) a self-image of generosity and responsibility, conformance with social norms, or the well-being of other people or things.⁷⁹ Such donors may expect thanks without buying them. The charity's grateful acknowledgement of the gift is the socially expected response to a display of generosity. The donor would be insulted (and society would condemn the charity) if public thanks were not forthcoming. But expectations are not the same as motivations.⁸⁰ Examples of this kind of transaction abound. Many charities, for instance, regularly distribute newsletters to their staff, donors, and volunteers listing the names of significant donors.⁸¹

By contrast, ad buys and purchases of sponsor acknowledgements are not gifts. They are payments for services. The sponsor has little or no altruistic motivation. It

77. The donor may feel subjectively that the transaction was "worth it." However, any value a genuine donor obtains (e.g., empathetic satisfaction or the satisfaction of conforming to social or ideological norms) is not a scarce good ceded by the recipient at its market value. The transfer of money is deceptive. The donor is not "buying" satisfaction. He is doing something with his money that satisfies him. As will be discussed below, this is not true of a quid pro quo sponsorship transaction in which the sponsor is deliberately purchasing a public acknowledgement.

78. See John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories For The Deduction And Tax Exemption*, 36 WAKE FOREST L. REV. 657, 667-79 (2001) (describing theories).

79. See *id.* For purposes of this discussion, there is thankfully no need to descend into fine distinctions between models of human behavior in which purely selfish individuals indulge "tastes" for the well-being of others and models in which the existence of such "tastes" is taken as evidence that people simply have unselfish motivations to begin with.

80. John Colombo labels such transactions with charities "quasi purchases" and proposes that revenue from them be taxed. His logic is that the quid pro quo form of the transaction indicates that the charity has overcome the free-rider problem in raising donations for which he believes the exemption compensates. See *id.* at 686. I agree with his characterization of the economic character of some of these transactions. In many other cases, however, I do not think a donor who is acknowledged can fairly be said to have "purchased" the acknowledgement. Social norms of gratitude may cause both the donor and donee to feel that a public acknowledgement is particularly appropriate where the donor is clearly acting altruistically.

81. See, e.g., *Thank You!*, IOWA CITY HOSPICE COMMUNICATOR (Iowa City Hospice, Iowa City, Iowa), Fall 2005, at 4-17, available at <http://www.iowacityhospice.org/documents/Fall2005Communicator.pdf> (listing donors).

values the charity's acknowledgement at or above the money paid to secure that acknowledgement. Examples of this kind of transaction also abound and have been discussed above.⁸²

This distinction between transfers made out of "disinterested generosity" and transfers made as part of a quid pro quo exchange is familiar as a legal standard. In theory, it still defines the legal divide between nontaxable gift revenues and potentially taxable income, both with respect to taxable individuals and charities.⁸³

Not surprisingly, in the initial stages of the sponsorship controversy, both the IRS and the charities viewed the issue purely in light of the distinction between commercial and gratuitous transactions. Before and in the immediate aftermath of the Bowl TAMs, both the IRS and affected charities approached the sponsorship issue as litigants. From this perspective, only existing doctrine mattered. The IRS's position was that the Bowl sponsorships were commercial arrangements, not donations. The charities' opposition mainly focused on technical UBIT issues, such as the definition of "regularly carried on" and the royalty exception.⁸⁴

The IRS's initial position is easy to understand. The structure of the UBIT suggests a dichotomy between gratuitous payments, which are exempt as gifts, and payments received in the conduct of a trade or business, which are exempt only if the trade or business is related to an exempt purpose. Congress seemed to confirm this structure in 1969 by adding Section 513(c) to tax advertisements. Likewise, the weight of doctrine in related areas leads naturally to this point of view.⁸⁵ From the IRS's perspective, the Bowl TAMs were a straightforward application of existing doctrine. A simple "thank you" was not taxable, but a deal in which a sponsor paid full value for a valuable commercial message was likely to be taxable advertising.

When the protests began, the IRS initially assumed it had been misunderstood because the egregious facts of the Bowl TAMs had been redacted to comply with taxpayer confidentiality requirements. At the height of the IRS's initial confidence, James J. McGovern, the Associate Chief Counsel (Employee Benefits and Exempt Organizations), was at pains to note that "mere acknowledgment of a donation would

82. See *supra* notes 26–28, 74–75 and accompanying text for examples.

83. See *Hernandez v. Comm'r*, 490 U.S. 680, 689–703 (1989) (charitable donations); *Comm'r v. Duberstein*, 363 U.S. 278, 285–286 (1960) (noncharitable gifts). The rules in *Hernandez* and *Duberstein* are related but not identical. *Duberstein* turns on the donor's subjective intent, whereas *Hernandez* imposes an objective test to determine whether the transfer was conditioned on receipt of a return benefit. In most cases, however, the only credible evidence of the donor's intent is receipt of a return benefit. The IRS quickly backed off of its victory against the Scientologists in *Hernandez*, apparently out of fear that the courts would force it to apply the standard to religions other than Scientology. See Allan J. Samansky, *Deductibility of Contributions to Religious Institutions*, 24 VA. TAX REV. 65, 67–68 (2004). The IRS's decision to ignore the Supreme Court's interpretation of the Code, rather than seeking new legislation in Congress, is problematic. Nonetheless, it casts serious doubts on the practical importance of *Hernandez*.

84. See *supra* notes 13–15 and accompanying text for a summary of these statutory issues. By giving scant attention to these arguments, I do not mean to imply that they were not well taken. Their merits are not relevant to the discussion here, however, because the controversy was not resolved on the basis of existing doctrine.

85. See *supra* notes 67–83 and accompanying text.

still be allowed.”⁸⁶ He then explained that “[w]hat you are seeing today is the IRS looking at (tax-exempt) universities and hospitals and seeing them for what they are—big businesses . . . a very different universe than what existed just 10 years ago.”⁸⁷ The IRS apparently thought this would quiet the protests. It assumed that the vast majority of charities were not “big business” charities participating in commercial sponsorships and those who were would recognize that they had been caught red handed.

Starting from this premise, the Audit Guidelines had two primary purposes: First they were intended to warn “big business” charities and anyone thinking about joining them that commercial arrangements would be taxable, no matter how they were dressed. Second, they were intended to allay the fears of “authentic” charities that the IRS was trying to tax customary arrangements.⁸⁸

The Audit Guidelines tried to achieve their first objective by providing auditors with a long list of facts and circumstances that might indicate a taxable arrangement.⁸⁹ Among the facts evidencing advertising were promises to feature the sponsor’s name or logo in the event name or elsewhere and payments contingent on receiving specified TV ratings or other benefits (such as VIP treatment for sponsor personnel).⁹⁰ Auditors were to watch for “promotional arrangements that do more than merely acknowledge the sponsor” such as specifications of an acknowledgement’s size, color or content, and commitments to feature the sponsor’s products or services.⁹¹

This approach left any charity negotiating a sponsorship deal in grave uncertainty, compared to the prior approach, but that did not trouble IRS officials. They felt that charities that were “negotiating deals,” rather than simply thanking their benefactors, defined the problem.⁹² Some early pronouncements about sponsorships took a very sarcastic tone.⁹³ Any charity that wanted to negotiate deals had already crossed over the line between soliciting gifts and selling advertising services. Anything it did over that line deserved no consideration.⁹⁴

86. Streckfus, *EO Office*, *supra* note 69, at 787.

87. *Id.*

88. Russlyn Guritz & Charles Barrett, *Corporate Sponsorship Income* § 4, in INTERNAL REVENUE SERVICE, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TEXT FOR FY 1993 § 5 (1992), available at <http://www.irs.gov/pub/irs-tege/eotopicf93.pdf> (discussing the Audit Guidelines as an attempt “to convey to the public the nature of the Service’s concerns, and . . . alleviate public concerns about how the ruling affected them specifically”); Streckfus, *EO Office*, *supra* note 69, at 787 (quoting James McGovern that “mere acknowledgment of a donation would still be allowed but . . . the Service would, in cases that smelled of advertising, ‘apply a facts-and-circumstances test’”).

89. See Audit Guidelines, *supra* note 43, § 178.3; Guritz & Barrett, *supra* note 88, § 6 (Audit Guidelines are designed “to publicize those factors which the Service concludes make these arrangements akin to advertising.”).

90. See Audit Guidelines, *supra* note 43, § 178.3(a).

91. See *id.* § 178.3(c).

92. See Guritz & Barrett, *supra* note 88, § 1 (quoting promotional blurb touting marketing value of Fiesta Bowl sponsorship).

93. See Streckfus, *EO Office*, *supra* note 69, at 787 (quoting James McGovern as thanking a candid John Hancock marketing consultant “for putting your John Hancock on that”).

94. See, e.g., *IRS Casts Wider Audit Net; New Guidelines Portend Broadened Taxation*, 5 EXEMPT ORG. TAX REV. 436 (1992) [hereinafter *Audit Net*] (quoting Marcus Owens, Director, IRS Exempt Organizations Technical Division) (“Our guidelines apply to organizations that

The Audit Guidelines tried to achieve their second objective—calming small and authentic charities—by reassuring them that the enforcement policy had not changed and they were not targets. The title of the press release that announced the Audit Guidelines was “EXEMPT ORGANIZATION DONOR RECOGNITION IS NOT ADVERTISING.”⁹⁵ The Audit Guidelines themselves began by stating that “mere acknowledgement” of a donor would not compromise the exempt status of a donation.⁹⁶ They also specified that certain traditional forms of donor acknowledgement were not advertising and stated that the guidelines would not apply at all “[a]s a matter of audit tolerance” to small community groups.⁹⁷

There were pragmatic reasons to ignore small groups: They were simply too small to be worth auditing. The IRS, however, also seems to have assumed that most traditional charities were not selling commercial sponsorships and would calm down if assured that they and their practices were not targets.⁹⁸ They would not mind the indeterminate facts-and-circumstances approach because they were not selling commercial sponsorships and could easily steer clear of bowl-game excesses. Their business sponsors, if any, were neighborhood merchants who gave out of public spirit and were acknowledged out of unforced gratitude.⁹⁹

As discussed further below, the IRS quickly abandoned its initial view of the problem. It soon realized that commercial sponsorships were not confined to “big business” charities. More importantly, it discovered that commercial sponsorships were not as clearly within the scope of the UBIT as preexisting doctrine suggested.

C. The Political Implications of Sponsorship and Advertising

The above subparts have introduced the conceptual distinction between advertising and sponsor acknowledgement and contrasted it with the distinction between commercial and gratuitous transactions. Before using these concepts to analyze the sponsorship controversy, I will examine one additional preliminary implication of the distinction between advertising and sponsorship: the differing meanings of advertising and sponsor acknowledgement within the symbolic politics of the UBIT and the charitable exemption.

have held themselves out as advertising vehicles. Essentially, if the sponsor’s logo is everywhere, then it’s advertising.”); *Spring 1992 Meeting*, *supra* note 69, at 392 (statement of Beth Purcell, Office of Chief Counsel (Employee Benefits and Exempt Organizations)) (“We don’t think this is even close. This is not traditional recognition of donor generosity. This is basically event sponsorship marketing, a very up to date advertising technique . . .”).

95. I.R.S. News Release IR-92-4 (Jan. 17, 1992).

96. See Audit Guidelines, *supra* note 43, at introduction.

97. See *id.* § 178.1(2) (naming university professorships, scholarships, and buildings; naming public broadcast and museum underwriters; listing contributors in event programs); *id.* § 178.2 (defining audit tolerance); *supra* notes 42–46 and accompanying text.

98. See Joanne Lipman, *Companies’ Sponsorship of Events Is Threatened by IRS’s Ruling*, WALL. ST. J., Dec. 5, 1991, at B8 (quoting IRS spokesman who stressed that “[o]nly nonprofit events that actively advertise their sponsors are at risk” from the Bowl TAMs).

99. See Streckfus & MacKinnon, *supra* note 47, at 411 (remarks of Marcus S. Owens, Director, IRS Exempt Organizations Technical Division, contrasting bowl game sponsorship contingent on television ratings with corporation whose name merely “appeared on a banner at the end of a fun run”).

Advertising and sponsorship acknowledgement are symbolically charged, in the context of the charitable exemption. As discussed above, the exemption and the UBIT are properly understood in terms of political symbolism.¹⁰⁰ The UBIT steers charities away from activities that clash with popular perceptions of charity and, thus, protects the exemption, which serves as a symbolic expression of those perceptions. Viewed in this context, the reason the UBIT applies to advertising is clear. Pure advertising is exactly the kind of unrelated business activity the UBIT is designed to deter. It is indistinguishable from normal for-profit business activities. A charity-owned billboard is exactly the same business as a billboard owned by an individual or business corporation. The billboard's value depends entirely on exposure, not on the owner's mission or activities.¹⁰¹ Accordingly, pure advertising has the same potential to undermine political support for the exemption as other unrelated business activities.

The origins of Section 513(c) of the Code illustrate the role of symbolic politics. Major exempt magazine publishers—such as *National Geographic*, *Nation's Business*, *Boy's Life*, and the *Journal of the American Medical Association*—were selling pages of advertising. The marketing materials they sent to potential advertisers made it clear that they were leasing billboards, not halos.¹⁰² Charity publishers also had tin ears for the political implications of their actions. After the IRS promulgated regulations applying the UBIT to advertising in 1967, they were so outraged by what they felt were technically unauthorized regulations and so confident in their political power¹⁰³ that they pressured Congress to hold hearings. Their technical arguments did not impress Congress. The obviously unrelated nature of their advertising businesses, however, did.

The hearings seem to have been lost as soon as the American Medical Association's (AMA) representative claimed that AMA journals' advertising was all related to the AMA's exempt purpose. He found himself lamely defending plainly unrelated ads by arguing to openly sarcastic Congressmen that soap "is an important therapeutic agent," "Coca Cola is used therapeutically," and "soup is a nutritional item which certainly is important in prescribing at times for certain types of patients."¹⁰⁴ Other exempt organizations made hapless "destination of income" arguments, apparently unaware

100. See *supra* text accompanying note 19.

101. Clear Channel and Viacom, for instance, put their trademarks on billboards they own, but advertisers do not pay for association with those brands. See, e.g., Clear Channel Comm'ns, Inc., Annual Report (Form 10-K), at 32 (Mar. 10, 2006), available at <http://www.sec.gov/Archives/edgar/data/739708/000095013406004754/d33838e10vk.htm> ("Generally, our [billboard] advertising rates are based on the 'gross rating points,' or total number of impressions delivered expressed as a percentage of a market population, of a display or group of displays. The number of 'impressions' delivered by a display is measured by the number of people passing the site during a defined period of time . . .").

102. See, e.g., National Geographic, Advertisement, *Editorial Muscle*, MADISON AVENUE, Jan. 1967 (touting circulation size and growth and high renewal rate to attract advertisers).

103. The organizations involved were not political lightweights. The National Chamber of Commerce, National Geographic, and the Boy Scouts of America were among the most prominent. Opposing them was a group of well organized, but small and dreary, trade publishers.

104. See *Hearings on the Tax Reform Act of 1969 Before the House Comm. On Ways and Means*, 91st Cong. 1331 (1969) [hereinafter *1969 Hearings*] (statement of Bernard D. Hirsh, American Medical Association).

that the UBIT had defeated that doctrine twenty years earlier.¹⁰⁵ Many organizations followed the example of their predecessors in 1950.¹⁰⁶ They could see that a general exemption for commercial advertising income was politically untenable, and argued for provisions crafted to minimize the tax on their own income.¹⁰⁷

The clear political logic of taxing advertising does not apply well, however, to sponsor acknowledgements. Initially, the argument seems clear. Assertions by Congress and the IRS that “mere” acknowledgements of a sponsor have no commercial value are fantasy. Those active in nonprofit fundraising and business sponsorship admit, in candid moments, that most businesses and many individuals who seek sponsor acknowledgements place significant value on them and pay for that value.¹⁰⁸ Nor is the value provided too intangible to value. Professional athletes and entertainers pay tax on the revenue they receive from their sponsors. The value they provide their sponsors is no more tangible than that provided by a tax-exempt organization. We simply assume that the amount a sponsor is willing to pay the athlete or entertainer, after arm’s-length negotiation, is good evidence of the value of the intangible benefit provided in exchange for that payment.

105. The charitable tax exemption applies only to organizations organized and operated “exclusively” for exempt purposes. *See* I.R.C. § 501(c)(3). Prior to passage of the UBIT in 1950, a number of courts had held that the exclusivity requirement applied in the manner in which an organization used its funds (the “destination” of its income), rather than the activities it engaged in to raise funds (the “source” of the income). *See* Stone, *supra* note 5, at 1485. The UBIT overruled this doctrine. *See id.* at 1485–87.

106. *See* Stone, *supra* note 5, at 1543–44 (discussing the failure of charities to defend the application of exemption to unrelated business income).

107. These exceptions ranged from the relatively principled attempt to exempt advertising that was screened to have some relation to the organization’s exempt purpose, to the Boy Scouts’ suggestion that only organizations chartered by Congress (i.e., the Boy Scouts) should be exempt. *See, e.g.*, 1969 Hearings, *supra* note 104, at 1071-73 (statement of John M. Lumley, National Education Association); *id.* at 1224 (statement of John C. Fontaine, Boy Scouts of America).

108. *See* Becker-Olsen & Simmons, *supra* note 64; Colombo, *supra* note 78; Crimmins & Horn, *supra* note 62, at 11; Knauer, *Paradox*, *supra* note 65, at 60–81; Mara Janis, *The Halo Effect*, *ADWEEK*, May 22, 2000, at 88; Meryl Paula Gardner & Philip Joel Shuman, *Sponsorship: An Important Component of the Promotions Mix*, *J. OF ADVERTISING*, VOL. 16, 1987, at 11; Stipp & Schiavone, *supra* note 65, at 22. In commenting on the Audit Guidelines, John Hyde, of the Dallas Methodist Hospitals Foundation, estimated with respect to eighty percent of potential sponsors that

[t]heir 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 organization 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.

John Hyde, *Comments of Dallas Methodist Hospitals Foundation*, 5 *EXEMPT ORG. TAX REV.* 935, 935 (1992).

On careful consideration, however, sponsor acknowledgements begin to look very different from advertising in two ways that impact on the political symbolism at the root of the exemption—expression of support for charitable activities.¹⁰⁹ First, many sponsor acknowledgements are not commercial in nature. Second, even commercial acknowledgements, by their very nature, are efforts to mimic genuine support for popular charitable endeavors.

The first way in which commercial sponsorships differ from pure advertisements is pragmatic: Some acknowledgements are sold in commercial sponsorship transactions, but many are simply an expected part of a gratuitous gift.¹¹⁰ Bona fide charitable donations followed by public acknowledgements could not be more different from the purchase of advertising within the context of the exemption. These acknowledgements reflect the same symbolic support for charitable activities that supports the exemption. We would therefore expect any attempt to deter them by imposing the UBIT to run into political trouble.

The above argument applies only to acknowledgements of gratuitous gifts, but the line between transfers motivated by the promise of an acknowledgement and ones made in mere expectation of an acknowledgement can easily blur. A blurry rule that turns largely on subjective goals and motives poses a serious evidentiary problem. Practical application is likely to turn on objective facts that raise presumptions about motivation. Viewed in this light, it is easier to understand the IRS's early rulings, presuming sponsor acknowledgements had no value.

109. A related but incorrect argument is that sponsorship income is “related” to an exempt purpose, within the meaning of the UBIT. The sponsor’s motive in sponsoring a charity is related to the charity’s exempt purpose. The business of selling sponsorship rights, however, is not itself an exempt-purpose activity in the way selling medical or educational services is. *See Hill, supra* note 4, at 29–31. If a nonprofit organization was formed for the exclusive purpose of marketing sponsorship rights, it would not be exempt, even if it only serviced charities. Exempt organizations also argued, prior to the passage of 513(i), that sponsorship fees were actually royalties on a trademark license, which would be exempt from UBIT. *See* I.R.C. § 512(b)(2). This is a plausible description of certain arrangements. *See Sierra Club, Inc. v. Comm’r*, 77 T.C.M. (CCH) 1569 (1999) (holding that affinity credit card income was exempt from the UBIT). It is tempting to think that the royalty exception in Section 512(b)(2) itself reflects the political preference for sponsorships discussed in this subsection. The actual history of the exception, however, indicates that Congress intended to exempt mineral rights and royalties from university patents, not trademark licensing royalties. *See Revenue Revisions, 1947–48: Hearings Before the H. Comm. on Ways & Means*, 80th Cong. 3463–65 (1948) (statement of A.W. Peterson, University of Wisconsin, discussing Wisconsin Alumni Research Fund); H. REP. No. 81-2319, at 110 (1950) (specifically mentioning “overriding royalties,” a term used principally in the financing of mineral extraction); “Recommended Changes in the Tax Treatment of Educational and Charitable Organizations” at 6 (hand-dated Apr. 25, 1949) (unsigned, but probably drafted by Laurence Woodworth of the Joint Committee on Internal Revenue Taxation staff) (on file at National Archives at College Park, Maryland (NACP), Record Group 56, Department of the Treasury, Entry 682, Office of Tax Policy, Subject Files, 1913-72, HA8 Exempt Organizations, Box 34.2, File EA-1/49.01 – Treasury-Joint Committee Staff Revenue Program for 1949-50) (assuming royalties would arise from “a patent, process or natural resource”).

110. *See supra* notes 77–81 and accompanying text.

Before sponsorship became a major form of marketing, genuine charitable intent was probably a more significant (often overwhelming) motivation for most acknowledged donations. There was also no ready market for acknowledgements that could be used to value them. Given the probability that donors were not buying acknowledgements and the difficulty of valuing them, a rule deeming them valueless made good practical sense. Some transactions might be improper, but the government could expect much trouble and little benefit from trying to find and challenge those transactions. This calculation is probably still true in the context of individual donations.

By the late 1980s, however, it became apparent to the IRS that the first, pragmatic distinction between sponsor acknowledgements and advertisements was no longer a good justification for ignoring business sponsorships of charities. Certain charities were unambiguously selling sponsor acknowledgements at high prices. The IRS's initial reaction was to abandon its earlier presumption.

The second difference between sponsor acknowledgements and pure advertisements quickly became clear to the IRS when it abandoned its initial, pragmatic, approach. The IRS found that business sponsorships implicate the exemption's symbolic politics in a different manner. To understand the connection between purely instrumental sponsorships and genuine support for an exempt purpose, it is worth recalling that the principal value of a sponsorship—the halo effect—depends on creating a strong association between the sponsor and the sponsored event or organization. Mere association is not enough, however. An association will generate a halo effect only if the target audience also perceives that the association reflects genuine support.¹¹¹ The result is that the political symbolism of successful business sponsorships of charity is very close to that of the genuine donations they simulate.

To illustrate this point, imagine a church donor who has no subjective enthusiasm for the church. She nonetheless makes a large donation to include her name on a "Defenders of the Faith" list posted in the foyer. Why? She calculates that other people are genuinely enthusiastic about the church and that she might benefit from some of that enthusiasm. Perhaps she is targeting potential customers who will be more likely to shop at her store if she appears God-fearing.¹¹² Perhaps she aims to influence potential jurors in her upcoming criminal trial.¹¹³ Perhaps she just wants to fit in socially with genuine church supporters. The point is that her calculation, albeit purely instrumental, is entirely dependent on genuine enthusiasm. She is instrumentally mimicking the uncalculated actions of a genuine enthusiast. Her actions will differ from those of a genuine church enthusiast only if she errs in her calculations. She will also be careful not to disabuse anyone of the notion that she is genuinely enthusiastic, since that would destroy the value of the transaction.

111. See *supra* notes 62–66 and accompanying text.

112. See, e.g., Pat Beall, *Investigators Probe 'Angel' Of Orchestra*, WALL ST. J., May 8, 1996, at F1 (discussing the role of a religious image in inducing trust in a fraudulent investment advisor).

113. See, e.g., Ronald L. Levy, *Sponsorship: What's in It for You?*, PUB. RELS. Q., Fall 2004, at 42, 42 (2004) (describing the "benefit of public gratitude that protects an entire company—management, employees and stockholders—when a company is eventually accused of corporate wrongdoing, falsely or perhaps not so falsely"); Russell Hubbard, *Scrushy's Charitable Donations Continue as Trial Approaches*, BIRMINGHAM NEWS, Nov. 18, 2003, at 1C.

If purely instrumental purchases of charitable acknowledgement reflect, albeit indirectly, genuine public enthusiasm for charitable purposes, we should expect politicians to view them as close equivalents to gratuitous donations. We might then expect attempts to deter them by imposing the UBIT to be problematic. In fact, purely instrumental support for charity may be preferable to genuine support in the context of the charitable exemption's symbolic politics. Whereas genuine donations may reflect highly idiosyncratic enthusiasms, instrumental support is more likely to flow to activities that fit the most popular perceptions of good works.

Understanding the political forces that disfavor advertising but favor sponsorship takes us another step towards understanding Section 513(i). It explains why both the IRS and Congress have shown such an aversion to taxing obviously commercial sponsorship transactions. Sponsor acknowledgement, like advertising, is charged with political symbolism. That symbolism, however, strongly favors sponsor acknowledgement. We now have the necessary conceptual basis to reexamine the sponsorship controversy as a clash between the nominal policies embodied in exemption doctrine and the political symbolism that actually underlies the exemption. The triumph of the latter is not a story of IRS cowardice or corruption. Rather, it is the story of an agency realizing that symbolic laws cannot be enforced according to doctrinal logic alone.

III. REEXAMINING THE SPONSORSHIP CONTROVERSY

In this Part, I will use the conceptual framework developed in Part II above to reexamine the sponsorship controversy. The IRS's reaction to charities' objections was not the unprincipled concession to political power that critics have assumed. Rather, the IRS realized that its initial attempt to deal with sponsorship revenues through the distinction between commercial and gratuitous transactions, while doctrinally correct, was practically and politically impossible. It then shifted to addressing the problem by trying to distinguish between advertising and sponsor acknowledgement. The IRS eventually realized (if only intuitively) that the real question in applying the UBIT to sponsor acknowledgements is not whether the charity is selling something, but whether its activities look like the kind of activities we like to think we are subsidizing through the charitable tax exemption.

Accordingly, the 1993 Regulations were a deliberate attempt to give teeth to the distinction between advertising and sponsor acknowledgement. They were structured to deal with the ambiguous distinction between advertising and sponsor acknowledgement by giving charities strong incentives to stay far away from ambiguous arrangements. The IRS never backed down from this position, but Congress did. While the 1993 Regulations were designed to keep charities far away from advertising, Section 513(i) is designed to allow them as close as possible. Nonetheless, Section 513(i) did not exempt advertising revenues from the UBIT. Rather, it adopted the 1993 Regulations' distinction between advertising and sponsor acknowledgement, albeit in largely symbolic form. Although this distinction had no basis in preexisting UBIT doctrine and disfavored charities, it compellingly expressed the governing symbolism.

A. Symbolic Politics and Law Enforcement

Murray Edelman has described normal administrative enforcement as a kind of game that government enforcers and citizens play within the framework of legal rules

whose symbolic validity is accepted by all players. No one expects or wants total and literal enforcement. The players develop a mutual understanding of enforcement tolerance. In the normal situation, however, those who violate the law do not question the symbolic values it expresses.¹¹⁴ Thieves generally buy into the idea that thievery should be caught and punished, even as they try to evade detection and punishment. They are gaming the property system, not rebelling against it. When enforcers proceed against them in accordance with the accepted “rules of the game” (e.g., customary detection, charging, and plea bargaining practices), they generally do not question the legitimacy of the proceedings against them, much as they might resent the result.¹¹⁵

Under Edelman’s analysis, government officials enforcing a law with symbolic importance can run into political trouble for two kinds of over-enforcement. On the simplest level, they can mistake the “rules of the game” and enforce too much. Insiders in the enforcement game would regard strict and literal enforcement of the law as inappropriate “sweating the small stuff.” Thus, a police officer who fines every traffic infraction in violation of community understandings can run into political trouble for enforcing the law.¹¹⁶ Such an officer would not be told to revise her interpretation of the law, but to “get with the program” in her enforcement habits.

A more difficult problem arises when an enforcer acts on an interpretation allowed (or even unequivocally required) by the relevant legal text that contradicts general understandings of the law’s symbolic meaning. An insider would not criticize this behavior as too picky, but rather as a fundamental perversion of the law. Those who argue that the First Amendment should not ban Ten Commandments monuments from public buildings, for instance, are generally not protesting their opponents’ picayune enforcement or linguistic mistakes. Rather, they begin their Constitutional construction with the conviction that a proper reading of the Constitution could not result in a ban on wholesome and popular religious expression.¹¹⁷

B. IRS Reaction to Criticism of the Bowl TAMs Revisited

The IRS’s position in the Bowl TAMs implicated both kinds of over-enforcement: first, the IRS appeared to have broken the rules of the “enforcement game” by suddenly reversing its previous rulings. This problem was immediately obvious and the IRS’s initial reaction was an attempt to convince charities that it was the “big business” charities, not the IRS, that had violated the rules by disguising commercial transactions

114. See MURRAY EDELMAN, *THE SYMBOLIC USES OF POLITICS* 44–72 (1964).

115. Criminals do not always accept the customary rules of the game as legitimate, but that is not the same as questioning the symbolic validity of the law being enforced. For instance, people who do not question the validity of traffic laws may nonetheless bitterly resent a disproportionate enforcement policy based on the driver’s race.

116. See EDELMAN, *supra* note 114, at 45; WAFF 48 News, *For many across the Valley, Rogersville is known as a speed trap* (Mar. 13, 2006), <http://www.waff.com/Global/story.asp?S=4527180> (reporting allegations of a Rogersville, Alabama police officer that he was instructed to ticket only out-of-town drivers).

117. See, e.g., *Silliness in Commandments Debate*, CHATTANOOGA TIMES FREE PRESS, Feb. 27, 2006, at B7 (describing the opposition to public displays of the Ten Commandments as a “ridiculous . . . effort by some malcontents to force any religious expression out of the public square”).

as gifts. Second, and more subtly, the IRS's enforcement of legal doctrine, while doctrinally consistent, was incompatible with the symbolic meaning of the exemption and the UBIT. The IRS treated sponsorship acknowledgements as advertising because it failed to understand that sponsorship arrangements reflect altruistic public support for exempt activities, despite the fact that most sponsors are commercially motivated when they pay to tap into that public support. Accordingly, neither charities nor politicians saw sponsorship support for charities as the kind of incongruous activity that the UBIT should deter. The 1993 Regulations and Section 513(i) addressed this second problem by abandoning the distinction between gratuitous and commercial sponsorships.

1. Initial Reaction: Bowl TAMs and Audit Guidelines

Going into the controversy, the IRS did think it was engaging in over-enforcement. A simple "thank you" would not transform a genuine gift into an unrelated business transaction. "Big business" charities, however, had gone well beyond simple thanks. They were engaging in quid pro quo sales of marketing services. Section 513(c) seemed to express the relevant policy as to such sales. Commercialism in the nonprofit sector seemed so obviously inappropriate that the IRS assumed that legitimate charities were not engaging in it and would join the IRS in condemning any charities that were.

Consequently, the Bowl TAMs assumed that the appropriate test was whether the transactions were commercial or gratuitous. As discussed, the IRS did not initially vary from this approach, even after the controversy began. It simply assumed it had been misunderstood.¹¹⁸ The IRS did not think it was repudiating its prior rulings. Rather, it argued that "the benefits provided in this case are significantly different from the types of donor recognition previously recognized by the Service as insignificant."¹¹⁹

Despite the rhetoric of continuity, however, the issue was deeper than novel facts. As discussed above, the IRS's earlier rulings had seemed to apply a conclusive presumption that public recognition could not transform a donation into a commercial exchange.¹²⁰ The Bowl TAMs reflected the IRS's perception that it was facing a new phenomenon. The old presumption that sponsor acknowledgements and advertisements were distinct no longer seemed safe. Business donors and charities alike were emphasizing the instrumental value of sponsor acknowledgements.

The IRS was correct in thinking that it was facing a changed landscape. What it failed to see, at the beginning, was that the change had been occurring for some time and was nearly complete. The IRS rendered its early rulings at the beginning of a general business trend toward treating sponsorship as a marketing strategy. The trend started in the 1970s but accelerated greatly in the 1980s.¹²¹ Its most important

118. See *supra* notes 43–46 and accompanying text.

119. See Cotton Bowl TAM, *supra* note 39, at *6.

120. See *supra* notes 36–37 and accompanying text.

121. See Gardner & Shuman, *supra* note 108, at 11 (comparing twenty-seven percent annual growth in sponsorship spending between 1980 and 1985 to twelve percent growth in advertising spending); Meenaghan 1991, *supra* note 62, at 5 (noting increase in worldwide sponsorship spending from \$2 billion in 1984 to \$4.1 billion in 1987); Sandler & Shani, *supra* note 62, at 9 (reporting five hundred percent increase in sports sponsorships between 1982 and 1987); William L. Shanklin & John R. Kuzma, *Buying That Sporting Image: What Senior Executives*

application was in for-profit professional sports sponsorships, but the same change in business attitudes affected nonprofit sponsorships equally. The reason for the change is unclear. Commentators who focus on charitable sponsorships have often surmised that Reagan-era budget cuts forced charities to be more entrepreneurial.¹²² Other factors are probably more important, however, since the same trend occurred simultaneously and on a much larger scale in for-profit sports. Marketing scholars have generally cited the increased cost of broadcast media, marketers' growing acceptance of sponsorships as a marketing tool as they became more familiar with it, and the effects of increased "clutter" and "ad zapping" on the effectiveness of advertising.¹²³

Whatever the cause, the change was dramatic. Businesses and sponsored organizations had long viewed sponsorships as donations. They justified their sponsorships vaguely as attempts to improve their public image. In practice, however, business sponsorships often reflected the genuine (but not business-related) interests and sympathies of high executives. It is easy to see why the IRS was not interested in trying to distinguish between pure philanthropic motives and the largely pretextual commercialism of these early sponsorships.

By the 1980s, companies were removing their sponsorship programs from their charity and public relations budgets and placing them into their marketing budgets, where expenditures were evaluated more coldly for commercial value.¹²⁴ The result was sponsorship agreements that were more specific about their marketing objectives and marketers boasting about their achievements.¹²⁵ Both caught the IRS's attention in the late 1980s, highlighting the differences between the vague self-interest of traditional sponsorship and the specific return-on-investment claims in the new market for sponsorships. In a February 1992 meeting of the D.C. Bar, one IRS official "analogized charities' efforts at attracting corporate sponsors to a billboard that read,

Need to Know About Corporate Sports Sponsorship, MARKETING MGMT., Spring 1992, at 59, 59 (comparing \$3 billion in estimated 1992 U.S. sponsorship spending to \$500 million in estimated 1982 spending).

122. See, e.g., 1993 *Hearing Transcript*, *supra* note 56, at 5–7 (statement of Mike Berry, International Festivals Association); Farbman, *supra* note 6, at 64–65; Streckfus, *EO Office*, *supra* note 69, at 787 (quoting James J. McGovern, the IRS Associate Chief Counsel (Employee Benefits and Exempt Organizations)).

123. See Gardner & Shuman, *supra* note 108, at 12; Meenaghan 1991, *supra* note 62, at 5; Shanklin & Kuzma, *supra* note 121, at 59.

124. See, e.g., Meenaghan 1991, *supra* note 62, at 6; Shanklin & Kuzma, *supra* note 121, at 60, 64. The transformation has not been complete. A recent survey, for instance, found that forty-two percent of responding sponsors made no efforts to evaluate the effectiveness of their sponsorships. See *Marketers Weigh in on Sponsorship ROI*, INCENTIVE, Aug. 2006, at 12 (reporting IEG survey).

125. See, e.g., McCarthy, *supra* note 69 ("Philanthropy and patron-of-the-sport days are gone," says Jack Mahoney, [John Hancock's] sports marketing consultant. "We wanted the recognition."). The measurement of sponsorship value by exposure time is still popular. See, e.g., Barrand, *supra* note 62, at 17 (quoting an advertising agency executive, noting that "[t]here will always be people who equate sponsorship to a media buy because it makes it easier to understand"); Joyce Julius & Associates, *Team Sponsorships & Partnerships*, A SECOND LOOK, June 2006, http://www.joycejulius.com/Newsletters/a_second_look__june_2006.htm.

‘This space for rent.’¹²⁶ Other IRS officials emphasized the importance to their internal deliberations of a Harvard Business School case study¹²⁷ and *Wall Street Journal* article,¹²⁸ each of which praised John Hancock’s decision to sponsor a bowl game as a very efficient ad buy.¹²⁹

By the time the IRS focused on “big business” charity sponsorships, the shift was well advanced. A wide gap had opened between the IRS’s and the charities’ perceptions of the rules of the enforcement game. The stage was set for a crisis. Each side was primed to become outraged at the other’s treatment of the same conduct. This explains why the Audit Guidelines fell far short of their aims of warning charities away from commercial sponsorships and reassuring them that the rules had not changed for their usual activities.¹³⁰ A broad cross-section of charities already considered commercial sponsorships to be a normal and unproblematic activity.

2. Reconsideration: 1993 Regulations

As negative comments poured in from a wide variety of charities,¹³¹ the IRS began to understand two elements of the new landscape. First, corporate sponsorships were already pervasive and pervasively important in the nonprofit sector.¹³² Second, business sponsors were largely, if not exclusively, motivated by sponsorships’ commercial value.¹³³ Because exempt organizations knew that corporate sponsors paid them largely for valuable services, they correctly perceived that most sponsorship arrangements involved the commercialism the IRS was targeting. The IRS thought it was sending its auditors to pick a few bad apples out of the barrel. It quickly

126. Paul Streckfus, *Three Recent Gatherings Discuss Corporate Sponsorship Guidelines*, 5 EXEMPT ORG. TAX REV. 196, 197 (1992) (quoting Marcus Owens, Director, IRS Exempt Organizations Technical Division).

127. See GREYSER & TEOPACO, *supra* note 69.

128. See McCarthy, *supra* note 69.

129. See *Spring 1992 Meeting*, *supra* note 69, at 391–92 (remarks of Beth Purcell, Office of Chief Counsel (Employee Benefits and Exempt Organizations)); Streckfus, *EO Office*, *supra* note 69, at 787 (quoting James McGovern, IRS Associate Chief Counsel (Employee Benefits and Exempt Organizations)).

130. For a discussion of these aims, see *supra* notes 88–99 and accompanying text.

131. Streckfus, *Gift*, *supra* note 48, at 179.

132. See *Audit Net*, *supra* note 94 (reporting widespread concern); Marlis L. Carson, *Report on the Tenth Annual Nonprofit Organizations Institute, Sponsored by the University of Texas School of Law, Held on January 28 & 29, 1993, Reports Compiled by Marlis L. Carson: Service’s Beth Purcell Discusses Evolution of Corporate Sponsorship Regulations*, 7 EXEMPT ORG. TAX REV. 363, 363 (1993) [hereinafter Carson 1993] (“The Service soon discovered a problem with this reasoning because the practice of using corporate logos is widespread and not just restricted to bowl games, Purcell explained.”); Bertrand M. Harding, Jr., *Owens Gives Some Comfort to Public Broadcasters on Corporate Sponsorship Income*, 6 EXEMPT ORG. TAX REV. 400, 400 (1992) (reporting statement by Marcus Owens, Director, IRS Exempt Organizations Technical Division, that the IRS “does not have a good understanding of how the corporate underwriting system [for public broadcasters] operates”); Lipman, *supra* note 98, at B8 (quoting Lesa Ukman, editor of Special Events Report, who stated, “I don’t think the IRS has a clue of the ramifications of all of this.”).

133. See, e.g., Hyde, *supra* note 108.

discovered that it was sending them out with shotguns and instructions to shoot the biggest fish in a crowded barrel. Little fish were understandably nervous.

The pervasiveness of nongratuitous sponsorships, in and of itself, posed a serious problem for the IRS. It is important to note, however, that this problem was not necessarily politically insurmountable. Where there is little disagreement about the symbolic meaning of a law, it can be sporadically enforced (subject to conventions of enforcement tolerance) with little or no political trouble. Income tax enforcement is a good example. Tax evasion and avoidance is fairly pervasive, but few insiders in the enforcement game would argue that this invalidates the income tax. Most accept that selective enforcement, even random enforcement, is valid. If the problem had been of this sort, an effort to convince charities that the IRS was not exceeding normal enforcement tolerances would probably have worked politically, even if violations were rampant. Politicians would have been suitably scandalized by the charities' commercialism, and the offending charities would have sheepishly promised full cooperation with the new "regulatory environment."¹³⁴

By late summer 1992, however, the IRS was realizing that it had a deeper problem. The Audit Guidelines had increased, rather than quieted, protests by charities. In Congress, the IRS's attempt to isolate obvious abusers from the majority of legitimate charities actually seemed to strengthen the targets' case for persecution. In the fall of 1992, the IRS's enforcement initiative seemed to be backfiring. It appeared that the IRS's initiative would miss its original targets completely and hit *only* charities it meant to leave alone.¹³⁵ The IRS had started with the idea of targeting the advertising income of a few commercialized pseudo-charities, but the Audit Guidelines comments and hearings had clarified that its efforts would impact "authentic" charities, not just "big business" charities. Meanwhile, Congress was passing legislation that was so tailored to the interests of college bowl games, the NCAA, and the Olympics that it excluded many other charities. Internally, the staff apparently began to question its initial assumption that cracking down on commercially motivated sponsorship arrangements was either practical or normatively desirable.

At the same time that the IRS began to realize how difficult a situation it was in, it began to see a way out. In commenting on the Audit Guidelines, public broadcasters pointed out that the FCC had been dealing with commercialism in sponsorship acknowledgements for fifteen years in its licensing rules for public television and radio stations.¹³⁶ The FCC had confronted the issue early, since its rules required

134. See, e.g., *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Hearings Before the Subcomm. on Investigations of the S. Comm. on Gov't Affairs*, 108th Cong. 325 (2003) (submission by Deutsche Bank AG) ("Deutsche Bank continuously monitors changes in the law and the regulatory environment and adapts its business practices, policies and procedures to comply with the ever-changing legal and regulatory environment. Deutsche Bank is cognizant of the Internal Revenue Service's highly publicized tax shelter initiatives and is committed to complying with all applicable rules related to tax shelter registration and disclosure.").

135. See James J. McGovern, *Service's McGovern Explains Proposed Corporate Sponsorship Regulations*, 7 EXEMPT ORG. TAX REV. 381, 381-82 (1993).

136. See FCC Rules, *supra* note 33; Juliann Avakian-Martin, *IRS Faces Tough Crowd at Hearing on Corporate Sponsorship Guidelines*, 6 EXEMPT ORG. TAX REV. 370, 370-71 (1992) (reporting questioning by Marcus Owens, Director, IRS Exempt Organizations Technical

broadcasters to identify their sponsors in the name of openness. The FCC's rules for nonprofit broadcasters ("FCC Rules") therefore allowed sponsor identification but prohibited promotion of a sponsor's products and services. The FCC's approach, though itself not without controversy, had several practical advantages. It was established and had been endorsed by Congress.¹³⁷ It had proven workable for public broadcasters. Finally, public broadcasters would support it, since they were already living with it and did not want two inconsistent regulatory regimes.

The public broadcasters brought up the FCC Rules as a special pleading, not a general solution. They argued that any acknowledgement that comported with the FCC Rules should suffice for UBIT purposes, because the FCC forced them to acknowledge sponsors and Congress had expressly blessed "enhanced underwriting" sponsor acknowledgements.¹³⁸ At the Audit Guidelines hearings, however, the IRS and representatives of other charities were already considering a broader use of the FCC approach.¹³⁹ A few months later, the IRS issued the 1993 Regulations, adopting the FCC's distinction between acknowledgement and promotion. Carefully chosen examples reassured college sports, street festivals, performing arts organizations, and other key critics of the IRS's original approach that they had little to fear.¹⁴⁰ The shooting war was over.

Critics quickly labeled the 1993 Regulations an unprincipled capitulation to political pressure.¹⁴¹ The charge was unfair, but understandable. The critics noticed that the IRS had abandoned the distinction between commercial and gratuitous transactions. Existing doctrine seemed to require this distinction. A rule that would exempt the most egregious violators seemed, therefore, to be a craven retreat from enforcing the law.

Division, regarding appropriateness and provisions of FCC rules); Carson 1993, *supra* note 132, at 363 (explaining IRS decision to substitute FCC approach for earlier approach after comments and public hearings); Harding, *supra* note 132, at 400 (reporting July 1992 comments of Marcus Owens to public broadcasters, stating that IRS exempt organizations' officials were not familiar with the FCC rules and planned to meet with FCC officials to familiarize themselves).

137. See 47 U.S.C. §§ 399A–399B (2006).

138. For example, National Public Radio's comments on the Audit Guidelines stated that: [p]ublic broadcasting is expressly authorized by federal statute to raise revenue through 'enhanced underwriting' and the regulatory structure of the Federal Communications Commission (FCC) assures that such enhanced underwriting credits are not promotional announcements. Thus, public broadcasting underwriting acknowledgments falling within the accepted limits of the FCC's rules are activities fully related to the exempt purposes of the public broadcaster and do not constitute advertising.

Comments of National Public Radio, 6 EXEMPT ORG. TAX REV. 558, 559 (1992).

139. The Exempt Organization Tax Review led its account of the hearings with a statement by Marcus Owens, Director, IRS Exempt Organizations Technical Division, that the IRS would give "special consideration" to applying the FCC approach to all charities. See Avakian-Martin, *supra* note 136, at 370.

140. See 1993 Regulations, *supra* note 52, at 5,690, § 1.513-4(g), Examples 1 (charity marathon), 2 (art museum exhibit), 3 (charity sports tournaments), 4 (bowl game), 5 (little league team), 6 (art festival), 7 (public radio), 8 (symphony orchestra).

141. See Knauer, *Influence*, *supra* note 4, at 1031; Sheppard, *supra* note 4; Streckfus, *Gift*, *supra* note 48.

The IRS understood (if only intuitively) what its critics missed: Enforcement agencies are granted enforcement discretion not only to prioritize limited public resources, but also to assure that literal enforcement does not go beyond the symbolic legitimacy of the rules they are enforcing. The IRS did not abandon enforcing the UBIT's limits on the charitable exemption; it abandoned a doctrine that, taken literally, led beyond the UBIT's symbolic reach. It called off literal enforcement of existing doctrine, but only in favor of a new rule designed to place real limits on charities' activities. The tainting rule denied automatic tax-exempt treatment to any arrangement that combined elements of both advertising and sponsorship.¹⁴²

When the IRS proposed the 1993 Regulations, it explained that it was attempting to fix a "clear line" that both the IRS and charities would find easier than the muddy distinction between gratuitous and commercial transactions.¹⁴³ Charities praised the proposal on the same basis.¹⁴⁴ It is hard to take these claims seriously. As discussed above, the distinction between advertising and sponsor acknowledgement is at least as ambiguous as the rule it displaced.¹⁴⁵ The IRS implicitly recognized the ambiguity by including the tainting rule, as did the charities by opposing it.

Under the tainting rule, the charities were hoist on their own petard. The IRS had adopted the ambiguous distinction they favored, but had burdened them with most of the risk of the ambiguity. A charity that sold advertising and acknowledged a sponsorship could still try to bifurcate its services, but it had no assurance any of them would be exempt. The rule gave charities a strong incentive to keep their sponsor acknowledgements as pure as possible.

Accordingly, the charities argued against the tainting rule.¹⁴⁶ Although they often said they were looking for clarity, they were really seeking ambiguity. They were content with the IRS's admission that selling sponsor acknowledgement on an openly quid pro quo basis was not an unrelated business per se. After that, all they needed was the right to minimize and cabin any taxable revenue from services that crossed the fuzzy line.¹⁴⁷ The right to bifurcate revenue would put the IRS in such an unfavorable position that a well-planned deal could be effectively bulletproof.

142. See *supra* note 55 and accompanying text.

143. See Marlis L. Carson, *Corporate Sponsorship Regs Provide 'Clear Line' for IRS, Charities, Says Owens*, 7 EXEMPT ORG. TAX REV. 917 (1993) (acknowledging that the 1993 Regulations "permit exposure that would ordinarily be considered advertising" in favor of a "clear line").

144. At the hearings on the regulations, for instance, Marilyn Mohrman-Gillis, representing America's Public Television Stations, praised them as "based on, and intended to . . . establish clear bright light standards." *1993 Hearing Transcript, supra* note 56, at 11. John Samuelson, representing the United States Olympic Committee, applauded them as an effort "to provide clear and unambiguous guidance." *Id.* at 24. Julie Noel Gilbert, representing the Exempt Organization Committee of the ABA's Section on Taxation, described them as a "new bright-line standard." *Id.* at 26.

145. See *supra* notes 74–76 and accompanying text.

146. For example, Henry Morris, Jr., of the American Heart Association, commented, "Because the final regulations implemented by the IRS will explicitly define what constitutes advertising and what constitutes acceptable tax-free acknowledgement, nonprofit organizations and corporate sponsors can realistically differentiate between advertising and acknowledgements in our written contract." *1993 Hearing Transcript, supra* note 56, at 4.

147. See, e.g., *id.* at 17–20 (statement of Pete Scott, Coopers & Lybrand).

3. Resolution: Section 513(i)

As discussed above, however, the IRS refused to abandon its position. The charities had to return to Congress for legislation that resolved the controversy in their favor.¹⁴⁸ Although Section 513(i) appeared to follow the 1993 Regulations, it was actually an end-run around them.¹⁴⁹ It gave the charities the ambiguity they wanted: It eliminated the tainting rule. It also replaced the 1993 Regulations' functional test for advertising with a short list of examples, leaving the treatment of any message outside those examples highly ambiguous.

Does Section 513(i) then represent the capitulation the standard story describes? Again, the standard story falls short and for the same reason. If Congress was simply giving "big business" charity's lobbyists what they were seeking, why not return to the express exemption of advertising revenue it had passed in 1992?¹⁵⁰ That language was reintroduced in a 1995 bill that died in committee.¹⁵¹ That same year, Congress passed language that eventually became Section 513(i).¹⁵² It adopted the 1993 Regulations' distinction between advertising and sponsorship and insisted on excepting periodical advertisements, thus preserving the original purpose and function of Section 513(c).

A cynic would say that canny lobbyists and members of Congress left a hollow tax on advertising to provide political cover for a sellout. I assume this is true, but it begs the question. Why was political cover necessary, and how did a nominal tax on advertising provide it? In thinking about this question, it is important to remember that maintaining the appearance of taxing advertising is not costless to charities. Section 513(i)'s distinction between advertising and sponsorship imposes expensive compliance costs on charities, even though it no longer promises the government any

148. See *supra* notes 56–60 and accompanying text.

149. See *supra* notes 26–30 and accompanying text.

150. It is worth noting that I do not assume charities normally influence Congress or the IRS in any improper way. IRS officials were rightly indignant at contemporary suggestions to the contrary. See McGovern, *supra* note 135. James Q. Wilson has described the process by which agencies charged with administering a statute in which a single, organized group has a vested interest tend to be influenced by that group. The agency finds it hard to avoid that group's point of view because that group is likely to be the most significant (often the only) source of information. See JAMES Q. WILSON, *BUREAUCRACY* 79 (1989). The same observation is only slightly less applicable to Congress itself. As one contemporary observer put it, "You get episodic or anecdotal information in front of the Congress, and standing alone, without looking at the big picture, you're left with this notion of the big, bad IRS beating up on this little, teeny, sweet organization . . ." Fred Stokeld, *EO Repeals Like Corporate Sponsorship Provision—For the Most Part*, 17 EXEMPT ORG. TAX REV. 382, 383 (1997). As Edelman noted, an agency whose mission is to serve the public generally, but whose actions practically impact on an organized interest group, is likely to end up serving the interests of that interest group, but only in ways that maintain a symbolic dedication to the broader mission. See EDELMAN, *supra* note 114, at 44–72. Again, the same is largely true of Congress and perfectly predicts Section 513(i).

151. See H.R. 1161, 104th Cong. (1995).

152. That bill was vetoed for reasons unrelated to sponsorships. See Devroy & Pianin, *supra* note 58.

significant revenue or restraint on commercialism.¹⁵³ In 2004, for instance, the Nokia Sugar Bowl reported \$21,500 out of approximately \$800,000 in sponsorship revenue as unrelated business income.¹⁵⁴ The Capital One Bowl reported no unrelated business income, but reported spending \$124,693 in professional fees, at least some of which presumably went to assuring that its sponsorship arrangements were not taxable.¹⁵⁵ Both organizations probably would prefer the vetoed 1992 law under which all their sponsorship revenue was simply exempt. This point was not lost on the charities' representatives.¹⁵⁶

C. Reinterpreting the Shift from Taxing Commercialism to Taxing Advertising

If the shift to distinguishing between advertising and sponsor acknowledgement was not a capitulation, what was it? I propose that the actions of the IRS and Congress are much easier to understand if we view the problem in terms of political symbolism. The IRS, the charities, and Congress liked the distinction between advertising and sponsor acknowledgement because it fit the symbolic role of the UBIT in deterring activities that undermine the exemption.¹⁵⁷ It shifted the question to what it should be within the political symbolism of the UBIT: not whether the charity is selling something, but whether its activities look like the kind of activities we like to think we are subsidizing through the charitable tax exemption. As discussed above, commercial sponsor acknowledgements are nothing like advertising from this perspective.¹⁵⁸ Advertising is exactly the kind of activity the UBIT is designed to deter. A commercially successful charity sponsorship, by contrast, is one that makes us feel the sponsor genuinely supports the charity's exempt activities. It is favored by the politics of the exemption.

The IRS had misperceived both the pervasiveness and the political meaning of commercial sponsorships when it began the controversy. Once it caught on, however, the IRS's reaction was so politically astute that it completely supplanted earlier and cruder legislative attempts to serve the narrow interests of the IRS's targets. Section 513(i) is a gutted version of the 1993 Regulations. It is almost purely symbolic legislation. The charities, however, applauded the symbolism and Congress kept it, despite its obvious costs. The important lesson is that the symbolic function of the UBIT is still politically potent. This lesson has been lost not only on critics of the 1993

153. It also places outer limits on the services a charity can offer tax-free. I assume compliance looms larger than any actual economic effect, since Section 513(i) allows charities to allocate payments, and sponsors do not mainly want pure advertising services from charities. In fact, I assume that charities had some such calculation in mind when they supported the 1993 Regulations (but opposed the tainting rule) and later welcomed Section 513(i).

154. See Sugar Bowl, Return of Organization Exempt from Income Tax, Form 990, Part VII Line 93 & Stmt. 13 (2004), available at <http://www.guidestar.org/FinDocuments/2005/720/272/2005-720272830-021e789d-9.pdf>. It presumably had sufficient expenses to offset this income and owed no tax.

155. See Capital One Bowl Form 990, *supra* note 27, at Stmt. 2.

156. See *Edited Transcript of the July 31, 1998 ABA Exempt Organizations Committee Meeting*, 22 EXEMPT ORG. TAX REV. 75, 97-99 (1998) (comments of Celia Roady).

157. For a discussion of the function of the UBIT, see *supra* note 19 and accompanying text.

158. See *supra* notes 109-113 and accompanying text.

Regulations and Section 513(i). As will be discussed below, the charities also missed it and may have obtained an unstable victory as a result.

IV. CONSTRUCTING THE LEGAL RULE TO DISTINGUISH ADVERTISING FROM SPONSORSHIP

As discussed above, the functional continuum between advertising and sponsorship generates a corresponding political continuum in the context of the exemption and the UBIT. Part IV considers the implications of this continuum for designing a legal rule to distinguish advertising from sponsorship and uses it to understand Section 513(i). In Subpart A, I set out the conceptual test suggested by the continuum for distinguishing taxable advertising revenue from exempt sponsorship revenue: predominance of effect. I then discuss practical considerations that militate against this conceptual test as an operative legal rule. In Subpart B, I reconsider Section 513(i) in this light and demonstrate that it is inherently unstable because it continuously tempts charities into politically dangerous activities. In Subpart C, I consider the possibility of a workable safe-harbor rule.

A. A Conceptual Rule and Practical Complications

At the extremes on the continuum between advertising and sponsorship, it is easy to apply the charitable exemption and the UBIT. Selling advertising pages in *National Geographic*, although theoretically within the exemption's policy of subsidizing charity, is taxed under the UBIT because of its undesirable symbolism. Conversely, selling a pure sponsor acknowledgement, although theoretically within the UBIT's rule of deterring unrelated business activities, is not taxed under the UBIT because it poses no symbolic problems. A pure sponsor acknowledgement reflects strong and genuine, if indirect, support for the sponsored organization's exempt activities. Real business sponsorships are rarely so easy. They fall in a blurred zone between advertising and sponsor acknowledgements where conflicting political inclinations meet.¹⁵⁹

A legal rule to deal with the mixed cases presented by the real world could use one of four approaches. The first approach is a piecemeal test: if elements of advertising and sponsor acknowledgement mix, allocate the payment between them and apply the UBIT to the advertising portion. This is the approach adopted in Section 513(i). Ironically, it was also the approach initially adopted by the IRS (before it realized that it was dealing with a highly ambiguous conceptual distinction). The second approach is an in terrorem rule: If any advertising is present, apply the UBIT to the entire

159. For instance, when Maryland Public Television fired Louis Rukeyser from his longstanding position as host of *Wall Street Week*, Rukeyser quickly arranged to air an identical program on CNBC, which would then make the program available for rebroadcast on public television stations at nominal cost. Rukeyser brought most of the sponsors of the PBS program with him to CNBC, and CNBC was willing to air the sponsor acknowledgements in a format that would meet the FCC and IRS rules for public television. See Philip Kennicott, *Wall Street's' Shortcut Back Home*, WASH. POST, July 12, 2002, at C7. Apparently, a purely commercial broadcaster was satisfied with the prices sponsors were willing to pay for "acknowledgements."

arrangement.¹⁶⁰ This is the approach adopted in the 1993 Regulations. The third approach is a predominance test: If elements of advertising and sponsor acknowledgement mix, allocate the payment between them and apply the UBIT to the advertising portion. It should be noted that the threshold for “predominance” in such a rule could mean anything from slightly more important to overwhelmingly predominant. The fourth approach is a safe harbor: If elements of advertising and sponsor acknowledgement mix, exempt the entire arrangement from the UBIT, if it meets certain clear but arbitrary tests that tend to indicate the predominance of sponsorship over advertising.

It should be noted that each of these approaches deals in different ways with the ambiguity of distinguishing between advertising and sponsor acknowledgement. The first and third ignore the ambiguity. The legal treatment of a given arrangement depends on a precise application of an inherently imprecise test. The resulting rule is difficult to apply, requiring the careful consideration of as many facts as are available. It is also largely unpredictable in many cases. As noted above, this explains why charities lobbied for Section 513(i), but not a predominance test.¹⁶¹ By placing the burden of an ambiguous and fact-intensive case on the IRS, while cabining the cost of any taxpayer loss, Section 513(i) puts nearly all the risks of ambiguity on the IRS. This deters enforcement in all but the most egregious cases.

The second and fourth approaches both try to avoid the ambiguity of the underlying distinction. The *in terrorem* rule does this by making the consequences of ambiguous facts so drastic that planners will shy away from ambiguous arrangements. This strategy helps the government by shooing taxpayers away from creating ambiguous facts. It does not, however, benefit the taxpayer. Not surprisingly, the IRS was comfortable with the 1993 Regulations and the charities were staunchly opposed. The charities did not want to confine themselves to unambiguous sponsor acknowledgements and saw no reason they should have to do so. In the end, Congress was sympathetic for the same reason the charities were unabashed: One pole of the advertising-sponsorship continuum pulls harder. Politicians are eager to support popular charities.¹⁶² Politicians are also eager to pummel charities that embarrass them by engaging in uncharitylike business.¹⁶³ When forced to choose, however, they like supporting popular organizations more than they like pummeling commercial nonprofits.¹⁶⁴

When sponsorship and advertising mix, the advertising involved will rarely be easily separable from the sponsorship. Rather, the advertising is often designed to emphasize or otherwise exploit the sponsor’s association with the sponsored organization or event. Both the sponsor and the charity have a strong incentive to assure that sponsorships, including any associated advertising, convey a strong impression of genuine support. Sponsors’ efforts to convince their target audiences to

160. I am not assuming that all sponsor acknowledgements would be taxable under the UBIT, but that some would be arguably taxable in the absence of special treatment.

161. *See supra* notes 146–147 and accompanying text.

162. *See supra* notes 108–113 and accompanying text.

163. *See supra* notes 19, 100–107 and accompanying text.

164. As noted *supra* note 6, this was essentially the NCAA’s response to recent Congressional inquiries into the basis for granting a tax exemption to popular college sports: We are exempt because we are popular with members of Congress and their constituents.

confer the halo of charity can also convince the charities' target audiences (e.g., Congress). The success of sponsorships in conveying the desired impression tends to tip the political balance toward sponsorship in mixed cases until the elements of sponsorship are negligible and the arrangement approaches pure advertising.

The fourth approach—a safe-harbor rule—was never suggested during the debate. A well-designed safe harbor grants taxpayers certainty as to a range of transactions that are, in any case, likely to receive favorable treatment under a facts-and-circumstances analysis. Safe harbors are common in tax legislation and regulation.¹⁶⁵ They benefit both taxpayers and the government. Taxpayers gain because they can plan with certainty. The government gains because it has lower enforcement costs: The cases it gives up (questionable transactions within the safe harbor) are best abandoned, since they would be marginal and expensive to pursue. Meanwhile, overall enforcement becomes easier as most taxpayers cluster within the safe harbor, allowing the IRS to concentrate on a smaller number of more egregious violators.¹⁶⁶

It is not clear how the charities would have responded if the IRS had proposed a true safe harbor, rather than an *in terrorem* rule, in the 1993 Regulations. It is possible that such a rule would have offered enough benefits to charities that they would have accepted significant restraints. I will discuss the possible practicality of such a rule below. For now, however, it is enough to observe that the charities' response was entirely understandable, given the rule the IRS proposed. In essence, the IRS proposed to take away all ambiguous cases (and many unambiguous ones) with no corresponding benefit of certainty. The charities responded by reclaiming all ambiguous cases with almost no corresponding danger of uncertainty.

This analysis leads to one other observation about Section 513(i): It is not a pure piecemeal approach. While it leaves the distinction between advertising and sponsor acknowledgement largely to the imagination, it also contains a list of examples that are deemed unambiguous advertising.¹⁶⁷ This adds what I will call a “dangerous-harbor” rule.¹⁶⁸ As the name suggests, a dangerous-harbor rule is the opposite of a safe harbor. It establishes certainty of violation as to a range of transactions that are, in any case, likely violations under a facts-and-circumstances analysis. In the case of Section 513(i), the kinds of blatant sales promotion messages described in the examples would likely fail a facts-and-circumstances test for “mere acknowledgement.” Where the sponsored organization delivers the sponsor's overt sales message, the halo effect of

165. To give an example, shareholders may treat distributions in partial liquidation of the incorporated business as capital gains, not dividends. *See* I.R.C. § 302(b)(4). A distribution qualifies as a partial liquidation, however, only if it is “not essentially equivalent to a dividend.” *See id.* § 302(e)(1). The Code then adds a safe harbor to this indeterminate standard. Section 302(e)(2) provides that a distribution is included in (e)(1) if it “is attributable to the distributing corporation's ceasing to conduct, or consists of the assets of, a qualified trade or business” and the distributing corporation continues a “qualified trade or business” after the distribution. For another example, *see* Rev. Proc. 77-37 § 3.01, 1977-2 C.B. 568 (listing minimum numerical requirements for advance rulings under I.R.C. § 368).

166. Returning to the example of I.R.C. § 302(e)(2), the safe harbor cedes little revenue. The vast majority of cases covered by it would satisfy the facts and circumstances test. It is valuable to taxpayers, however, to know that a common set of facts will be safely within the rule.

167. *See supra* note 29 and accompanying text.

168. My thanks to Dan Klerman for coining this phrase.

association is likely to be purely secondary to the billboard effect of conveying an overt sales message.

For all that Section 513(i) is a dangerous harbor in form, however, its harbor is not very dangerous. Without the tainting rule, if a charity puts a toe over the line, only the toe is at risk (and, practically speaking, only if it is a big enough toe to justify significant enforcement costs). Still, like the retained tax on advertising, the dangerous harbor list of messages deemed to constitute advertising is not costless to charities. Its presence in Section 513(i) is therefore further evidence that the symbolic politics of the UBIT were still alive in 1997.

B. Dangerous Safety: The Inherent Political Instability of Section 513(i)

As discussed above, Section 513(i)'s dangerous-harbor tax on advertising provides evidence that the political forces underlying the UBIT are not dead. For the moment, however, those forces are quiescent. Section 513(i) makes only the barest of symbolic nods in their direction. Its apparent safety for charities is deceptive, however. By reducing the taxation of advertising revenue to a symbolic veneer, Section 513(i) may face future political instability.

It stands to reason that sponsors will pay more for commercial messages if there are fewer restrictions on their nature and format.¹⁶⁹ Sponsors want to rent halos, but they are willing to pay extra for the use of any available billboards for their promotional messages. The practices (and occasional statements) of exempt organizations bear this out.¹⁷⁰ The result is pressure on exempt organizations to crowd the line demarcating the dangerous harbor. Adding to the temptation, Section 513(i) is designed to limit the financial consequences of straying across the line.¹⁷¹ While Section 513(i) limits the financial risk of this tendency, it does not limit the political risk.

If the principal political purpose of the UBIT is to direct exempt organizations away from defined politically problematic activities, a rule that invites organizations to crowd the dangerous harbor line is politically perilous. Because Section 513(i)'s dangerous harbor rule tempts exempt organizations to push the outer limits of the public's perception of charity, it invites a political reaction. A traditional safe-harbor rule would produce the same tendency to crowd the line, but the line would not be politically dangerous. The taxpayer who strays out of a safe harbor is usually still safe (and politically acceptable). The taxpayer who strays into a dangerous harbor is in automatic trouble. Since Section 513(i) constantly tempts charities to sell sponsorships as close as possible to the dangerous-harbor line, it presents the constant risk that a large number of charities (or a few high-profile ones) will concurrently cross the line.

169. It does not necessarily follow, however, that they will not pay enough for a restricted format to satisfy even a commercial broadcaster. *See supra* note 159.

170. For example, PBS used focus groups to determine if viewers would tolerate the addition of corporate mascots to sponsor acknowledgement spots in children's shows, presumably because sponsors were willing to pay more if they could get their mascots on television. It turned out that viewers were willing to accept stationary mascots but felt that animated ones were incompatible with the noncommercial brand image of public television. *See* Karen Everhart, *Corporate Mascots (Still as Rocks) and Celebs to Appear in Sponsor Credits*, CURRENT, July 8, 2002, available at <http://www.current.org/cm/cm0212pbs.html>.

171. *See supra* note 30 and accompanying text.

Such a noticeable foray into the nearly pure advertising might spark the kind of political reaction that created the UBIT in 1950 and expanded its scope in 1969.

It is sometimes observed that Congress has amended the UBIT a number of times since 1950 to protect one or another unrelated business in which charities wanted to engage.¹⁷² The intended conclusion is that the UBIT is a political dead letter; charities have the political power to counter any real attempt to enforce it. The conclusion is tempting, but shortsighted. It is something like observing that a volcanic island erodes steadily into the sea and concluding that it can only get smaller. Erosion is an easily observed, daily occurrence. The last volcanic eruption may have happened before living memory. Ignoring the eruptions, however, leads to a flawed understanding of the island and its probable future. It is important to understand the intermittent but powerful force that raised it above sea level in the first place. If that force is still active, a single eruption tomorrow could replace thousands of years of erosion. As discussed above, Section 513(i) seems to demonstrate that the symbolic political force that produced the UBIT in 1950 and expanded it in 1969 may be dormant, but is not extinct.¹⁷³ It is therefore dangerous to assume that it will never again become significant.¹⁷⁴

The timing and nature of the political reaction (if it ever comes) are difficult to predict. Section 513(i) tempts charities into practices that raise persistent, low-level dissent, but there is no current sign of serious political trouble.¹⁷⁵ The forces of

172. See, e.g., McGovern, *supra* note 135, at 382 (“We could have sat back and let corporate sponsorship become the latest addition to the piecemeal repeal of UBIT.”); Stokeld, *supra* note 150, at 383. Arthur Andersen seemed to be making a similar point in a 1992 lobbying memorandum to the IRS staff. The memorandum dwells on previous IRS attempts to apply the UBIT to bingo games and booth rentals at trade shows, both of which ended when Congress passed amendments to the UBIT to exempt the specific revenues in question. See Memorandum from Rachelle Bernstein, Arthur Andersen & Co., to Terrill A. Hyde, Tax Legislation Counsel, Dep’t of the Treasury (Feb. 6, 1992), available at *Arthur Andersen Advocates Clarification of College Bowl Income Rules*, 5 EXEMPT ORG. TAX REV. 445 (1992). The memorandum characterizes these amendments as evidence that the UBIT does not apply to any activity the IRS cannot show to be in actual competition with a taxable business. Given that neither of the cited amendments added such a requirement, the real message was presumably that the IRS’s efforts were futile, because the charities had enough clout in Congress to get a special UBIT exception for their sponsorship revenues.

173. The Tax Reform Act of 1969 did not merely add Section 513(c) to the Code. It also expanded the tax on debt-financed income and extended the UBIT to cover churches and other tax-exempt organizations. See Tax Reform Act of 1969, Pub. L. No. 91-172 §§ 121(a)(1)–(3), (d)(1), (3)(A)–(B), 83 Stat. 487, 543–548.

174. The recent criticism of commercialism in college sports, discussed *supra* note 6, is good evidence that the forces that created the UBIT are still with us. The mere fact that pundits and politicians alike find the rhetoric attractive is significant, whatever one thinks about the chance it will result in real change.

175. See, e.g., Sarah McBride, *Mixed Messages: As Sponsorship Sales Blossom, Public Radio Walks a Fine Line*, WALL ST. J., Mar. 17, 2006, at A1 (citing listener complaints that public radio has been commercialized and commercial radio operator complaints of unfair competition for advertising revenues). See also the discussion *supra* note 6 of recent ferment in the media and Congress over college sports. For the moment, it does not appear that this criticism represents the kind of political momentum necessary to overcome the popularity of college sports (much less charities in general), but it is hard to predict the outcome.

political inertia and entrenched interest politics are strong. An event of sufficient force to jar loose their grip on exemption policy may never come. Presumably it would take a scandal or some other precipitating event to convert scattered discomfort into legislative action. Section 513(i) seems safe for the foreseeable future, but the future is notoriously unforeseeable.¹⁷⁶

The event that precipitated Section 513(c) in 1969 was, ironically, the charities' insistence that Congress hold hearings. Ignoring the politics of the UBIT, they were confident that they could best the taxmen and the trade journal publishers with a combination of technicality and political clout. They miscalculated the politics, technicalities fell away, and the hearings became a rout. That particular scenario will probably never repeat itself (in the 1990s, charities sought legislative relief without hearings), but lawmakers call their own hearings when events make them sufficiently uneasy.¹⁷⁷ The political potential for such a turning point is ever-present and Section 513(i) tempts charities into the behavior that might precipitate it.

C. The Possibility of a Safe Harbor

If the status quo is shaken, the event that shakes it will determine the most likely response. If history is any guide, if charities act in ways that do not meet politicians' views of charity, politicians will react by banning the specific actions that bother them.¹⁷⁸ To give a simple hypothetical, imagine a network of public radio stations that succeeded in growing to the point that it was noticeably competing with struggling for-profit networks.¹⁷⁹ Its competitors and potential competitors might react by trying to rile up public anger at the so-called nonprofit, living off of both rich ad revenues and hard-earned tax dollars. A head of political steam could easily build if enough politicians were either pressured by public opinion, persuaded with campaign contributions, or simply attracted to the theme (out of personal ideology or a calculation of constituent ideology). Since those stoking the controversy would have a narrow goal (shutting down a competitor), the resulting legislation would probably be restricted to radio stations (or even particular radio stations).

In the absence of a clear understanding of the problem's source, such a fly-swatting response is almost inevitable. It is not, however, the only possible or best response. A more stable solution would be to substitute a true safe-harbor rule that would allow

176. "It's tough to make predictions, especially about the future." Yogi Berra. It is possible that the anger over the extraordinary pay packages recently granted to a few high-profile college sports coaches could provide the impetus for Congress to act. *See, e.g.*, Richard Wolf, *Athletic Spending Under Fire in Senate*, USA TODAY, Jan. 5, 2007, at 9C.

177. *See, e.g.*, *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities: Hearings Before the S. Comm. on Finance*, 108th Cong. (2004); Thomas W. Joo, *Legislation and Legitimation: Congress and Insider Trading in the 1980s*, 82 IND. L.J. (forthcoming 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=885203&high=%20thomas%20joo (abstract) (describing symbolic role of Congressional hearings on insider trading). As noted, *supra* note 6, Senator Grassley has been calling for hearings on the tax exemption of college sports.

178. *See* Stone, *supra* note 5 (describing the 1950 UBIT and 1969 amendments as such responses).

179. *See, e.g.*, McBride, *supra* note 175.

politically popular sponsorships to proceed on commercial terms while staying well clear of pure advertising. The purpose of this Subpart is to lay down the design principles and sketch out a few possible contours of such a safe harbor.

In addressing this question, it is important to reemphasize that Section 513(i) in its current form is consistent with the basic politics of the exemption and the UBIT. The problem with exempting revenues from commercial sponsorships is not, as some have indicated, that it is indefensible as a matter of basic UBIT policy or even that it may leave questionable revenues exempt.¹⁸⁰ As discussed above, Section 513(i) represents a political decision to give the benefit of the doubt to certain sponsorships because political preferences for protecting sponsorship outweigh political distaste for charities engaging in unrelated business activities.¹⁸¹ The problem is that Section 513(i) is unstable and might thus eventually need amendment or substitution. It seems unlikely, however, that any substitute would or should abandon the major hallmark of Section 513(i)—the recognition that pure sponsorship acknowledgement can be exempt from the UBIT even if it is part of an overtly commercial transaction. Rather, a realistic substitute should aim at constraining the natural drift into advertising more effectively.

Is a more stable safe-harbor rule possible within the above parameters? We should first consider the rule proposed by the IRS in the 1993 Regulations, based on the FCC's rules. The problem with this attempt was the very aspect that made it acceptable to sophisticated charities. The distinction between "merely" acknowledging the sponsor and its products and services, on the one hand, and promoting them, on the other hand, is no less ambiguous than the distinction between advertising and sponsorship. The IRS sought to protect itself from fighting over difficult cases by scaring charities away from them with the tainting rule. This in terrorem strategy is justifiably less attractive to taxpayers and therefore more politically risky than a safe-harbor strategy. A true safe harbor keeps planners within acceptable bounds by promising safety, not by threatening danger.

Accordingly, the key to designing a more realistic safe-harbor rule is to accept that, in granting taxpayers a realm of clear safety, it will necessarily and somewhat arbitrarily abandon some meritorious claims. The need to benefit both the government and the taxpayer leads to two opposing requirements for an effective safe-harbor rule. First, most conduct within the bright line should be clearly "safe" even under a facts-and-circumstances analysis. This requirement assures that the government does not give up too much to secure certainty and convenience of application. In a sponsorship rule, sponsorship should clearly predominate over advertising in most arrangements within the bright line. Second, the bright line should include most of the conduct that good faith taxpayers think is (or should be) "safe" under the facts-and-circumstances test. This requirement assures that planners will find enough opportunities within the rule to make the certainty it offers tempting. In a sponsorship rule, a good portion of mainstream sponsorship practice must be included.

The first requirement involves devising rules that exempt little conduct that would otherwise be taxable. The conceptual distinction between advertising and acknowledgement suggests some useful rules that would not trouble a business chiefly interested in a charitable halo, but would be unacceptable to a business mainly

180. For commentators taking this position, see *supra* note 4.

181. See *supra* notes 162–163 and accompanying text.

interested in renting a billboard. A combination of such rules could produce a fairly good proxy for arrangements in which sponsorship clearly predominates. Some examples follow.

None of these examples should be taken as a necessary element of an effective safe harbor. Nor am I suggesting that a good rule would include all of them. To the contrary, combining all of these restrictions would create a rule that was far too restrictive, sacrificing too much of the certainty and convenience of application needed to attract taxpayers into the harbor, in exchange for too little added political safety. My examples are only intended to show that fairly clear lines could be drawn to discourage advertisers without imposing impractical constraints on bona fide sponsors.¹⁸² Each example is arbitrary and can only be justified based on the probability that it will exclude mostly advertising and include mostly sponsorship. The examples are as follows:

- *Exclude any transactions in which payment was contingent on the number of people exposed to the message.* For instance, a sponsorship payment that ratcheted up by \$10,000 for each additional hundred thousand television viewers would not be safe.¹⁸³ This targets the purest advertising deals by making it hard to link payment to exposure.
- *Require that the sponsored organization's name and logo be at least as prominent as the sponsor's name and logo in any message.* For instance, the Capital One Bowl would not be safe unless it was renamed the "Capital One Citrus Bowl."¹⁸⁴ This precludes pure advertising. It also tends to identify messages in which sponsor acknowledgement is important.
- *Exclude arrangements that involve displays of the sponsor's products.* For instance, a bowl game would not be safe in accepting a car company sponsorship conditioned on the right to place its cars at the stadium entrance. Admittedly, such a rule might inconvenience bona fide sponsors who want to attach a halo to a particular product. It would arguably inconvenience many more advertisers.

182. A number of these rules correspond to facts and circumstances highlighted in the Audit Guidelines. The difference between this suggestion and the Audit Guidelines is that the Audit Guidelines list was intended to highlight potentially significant facts for a facts-and-circumstances determination. This had the intentional effect of increasing uncertainty for any transaction with a whiff of advertising about it, leaving charities guessing as to which facts or groups of facts might be determinative. *See supra* notes 89–94 and accompanying text. My proposal is for a safe-harbor rule, which aims to increase certainty (without giving up too many good cases) by making a certain set of strategically chosen facts arbitrarily determinative.

183. Section 513(i) already imposes this rule. *See* I.R.C. § 513(i)(2)(B)(i).

184. Some prominent bowl games already do this. The game presented by The Orange Bowl Committee, Inc., for instance, is currently named the FedEx Orange Bowl. *See* The Orange Bowl Committee, Inc., Home Page, <http://www.orangebowl.org> (last visited Aug. 22, 2006). The Rose Bowl does not sell naming rights, merely indicating its primary sponsors prominently. *See, e.g.*, PASADENA TOURNAMENT OF ROSES ASS'N, ROSE BOWL GAME: GAME DAY GUIDE (2006), available at http://www.tournamentofroses.com/rosebowlgame/2006_GameDayGuide.pdf.

- *Exclude messages describing the sponsor's products or services except as necessary to identify the sponsor's main class of products or services.*¹⁸⁵ For instance, describing Capital One as "a leading credit card issuer" would be acceptable, but describing it as "issuer of the new Prime Lock card, guaranteeing you prime rate on all your balances" would not. This would not prevent a sponsor from associating its brand and products with the sponsored organization or event, but would preclude many sales promotion messages.
- *Exclude messages that include "production elements," such as music and pictures (other than a depiction of the sponsor's and the exempt organization's respective names and logos).* For instance, showing the Ford logo at the beginning of an hour of public television would be safe, but thirty seconds of footage showing a Ford Taurus cruising across beautiful landscapes would not. This rule, again, might cramp some bona fide sponsor's options, but would not preclude association with the sponsored event or organization (especially if "leveraged" with separate advertising).¹⁸⁶ It would pose a serious challenge, however, to advertisers who generally want to convey more elaborate messages. Pure advertisers do not want to "leverage" an ineffective ad buy with another ad buy.
- *Exclude sponsorship by particular products or services, as opposed to a business organization's name.* This rule would, again, inconvenience some legitimate sponsorships (and discriminate arbitrarily between sponsors whose name is also their brand and those who have separate brands), but it would restrain a large class of thinly-disguised sales promotion messages (e.g., "brought to you by [MOVIE TITLE], the new hit romantic comedy starring [STARS' NAMES], now playing at a theater near you").

Could such rules meet the second requirement of clearly safeguarding a significant amount of current sponsorship practices? As discussed above, from the charities' perspective, no safe harbor could be preferable to current law. The premise of this discussion, however, is that Section 513(i) is vulnerable to upset by an event that changes the political balance. The crucial question, then, is not whether Congress is likely to replace Section 513(i) with a safe harbor under current political conditions, but rather whether a safe harbor could be attractive if Section 513(i) became untenable. Put differently, would any safe-harbor rule exclude so much current nonabusive conduct that it would fail its basic purpose of adding a meaningful amount of certainty?

The cynical reader may feel that the answer to this question is obvious. One look at the commercialism in recent bowl game sponsorships may seem proof enough that any safe harbor that confined itself to messages in which the acknowledgement element predominated would exclude so much politically and economically significant conduct to doom itself politically. This reaction bears further consideration.

185. An example of this kind of restriction is the so-called identifying statement by which issuers of securities can announce a pending issuance without being deemed to be "conditioning the market" for the issuance. Among other things, such a statement can include "[a] brief indication of the general type of business of the issuer." 17 C.F.R. § 230.134(a)(3).

186. As discussed *supra* note 72 and accompanying text, such leveraging is common among sponsors.

The safe harbor elements proposed above would probably have little effect on most bowl game sponsorships.¹⁸⁷ Some readers may feel that, if true, this is a flaw in the proposal. This feeling probably stems from some combination of discomfort with exempting quid pro quo payments as “donations” and discomfort with describing certain exempt activities (such as college football) as “charity.” As discussed above, discomfort with favoring commercial sponsor acknowledgements has much less political validity than the doctrine on which it is based might suggest.¹⁸⁸ Discomfort with the scope of the exemption, by contrast, is a matter of taste.¹⁸⁹ Those who feel it, however, should understand that the UBIT’s principal political function is to foreclose such fundamental thinking about who gets the charitable exemption subsidy and why. It seems unlikely that Congress or many charities would want to open such a discussion. Accordingly, a rule that allows sponsors to share in the popular glow of college sports cannot be dismissed as an inappropriate result under existing law.

The main group of exempt organizations toeing the line of the current dangerous harbor seems to be those whose exempt activities involve the production of traditional advertising media, principally public broadcasters and operators of popular nonprofit websites.¹⁹⁰ Clearly these organizations could live within a more restrictive safe-harbor rule (or take risks in leaving the safe harbor), but might receive considerably less revenue. The political question, if it arises, will be how important advertising revenue is to these organizations and how important these organizations are to Congress, given whatever circumstances precipitate change. This balance cannot be predicted; the position of exempt organizations will change over time, and the political context of any reform proposal cannot itself be predicted.

For the reasons discussed above, I cannot give a complete blueprint for the future reform of Section 513(i). Nor do I advocate such reform as a matter of substantive policy.¹⁹¹ My purpose is merely to point the way toward a more stable version of the current solution. If, as seems possible, Section 513(i) becomes unstable in the future, it might help guide policymakers away from the reactive legislation that has characterized the UBIT since 1950.

187. See *supra* notes 27–28 and accompanying text (describing acknowledgement of Capital One at Capital One Bowl). The one significant exception to this is the “equal billing” constraint which would preclude exclusive naming rights.

188. See *supra* notes 111–112 and accompanying text.

189. See *supra* note 6.

190. Periodical publishers are in a similar substantive position, but are treated specially under the UBIT. As discussed *supra* notes 102–107 and accompanying text, Congress added Section 513(c) to the Code in 1969 specifically to tax advertising in exempt periodicals. Congress and the IRS recognized this special history by excluding print periodicals from Section 513(i) and, earlier, the 1993 Regulations. See I.R.C. § 513(i)(2)(B)(ii); 1993 Regulations, *supra* note 52, at 5,690, §1.513-4(a).

191. In other words, I do not think advertising income raises any social issues that other types of exempt income do not. Nor do I think the revenue at stake is so significant as to compel action. I do think a true safe harbor would be superior to Section 513(i), but only because it would be more stable politically.

CONCLUSION

The treatment of charitable sponsorships under the UBIT has often been held up as a glaring example of a shameful retreat by the IRS from the disinterested and principled application of the tax law and a prime example of interest-group tax legislation by Congress. There is no denying that Section 513(i) bears the marks of lobbyists. Focusing on that fact, however, obscures the complexity of the issue and of the political response to it. It assumes that the IRS's initial position on the issue was the right one, simply because charities opposed it out of self-interest. It also assumes that commercial sponsorship arrangements and advertising are equivalent under the UBIT and that the self-interest of charities is consequently the only interest at stake.

In this article, I have challenged those assumptions and tried to show why the distinction between advertising and sponsorship is important to understanding the problem, the solution we have reached, and the potential instability of that solution. Unlike participants in the controversy and past commentators, my analysis does not end with parsing technical elements of the UBIT. Rather, it examines the economic realities and political intuitions that eventually lead to Section 513(i).

At the core of the problem is the distinction between advertising and sponsor acknowledgement. Since the early 1980s, marketers have understood that buying a "halo effect"—the right to associate one's brand with the goodwill of a popular organization or event (sponsorship) is both commercially valuable and fundamentally different from buying the "billboard effect" of simple visibility (advertising). They have also understood the natural tendency of these two different services to mix into an interrelated whole.

In the context of the exemption and the UBIT, this distinction is politically crucial. Charitable sponsorship is a close analogue to genuine charitable donation and is therefore closely aligned with the political impulse behind the charitable exemption's blanket subsidy of exempt activities. Advertising, like other unrelated business activities, does not match the perception of the kind of activities subsidized and is therefore well within the political impulse that discourages such activities by taxation under the UBIT.

Tax policymakers and commentators have long felt but not understood this distinction. Traditionally, they have tended to focus on the distinction between commercial and noncommercial transactions to distinguish between arrangements that looked like donations and arrangements that looked like an unrelated business. As marketers began to view sponsorships in commercial terms during the 1980s, however, the unreality of this distinction, as applied to business sponsorships, became apparent.

This flawed understanding of the problem presented by sponsorships drove the fluctuating actions of the IRS and Congress from 1991 to 1997. The IRS's initial instinct that it should tax all commercial sponsorships immediately brought out a reality the IRS had missed—that most business sponsorships were commercially driven, but that the symbolic politics of the exemption favored them, even as disfavored advertising sales by charities. Accordingly, the IRS quickly shifted to proposing regulations based on the distinction between advertising and sponsorship.

At the same time, Congress underwent the opposite transformation. It started from a simple desire to appease college football and the Olympics and passed a narrow exemption for their advertising revenues. After that bill was vetoed, however, later bills, including eventually the 1997 law that enacted Section 513(i), followed the IRS's lead in maintaining the appearance of taxing advertising. Section 513(i) retains the

symbolism of a tax on advertising, but not the reality. Charities eagerly pushing toward the lucrative advertising end of the continuum between sponsorship and advertising did not want a safe harbor that would allow them to conduct commercial sponsorships in peace. They wanted an exemption for most advertising and they got it. The symbolism of a tax on advertising income, however, was still important enough that Congress retained it and the charities concurred, despite the cost and inconvenience to them.

The question raised by Section 513(i) is not whether it is technically in keeping with the UBIT. That is the wrong question because the UBIT, at its core, is not about technical revenue issues, but rather the political perceptions that support the charitable exemption. Rather, the question is whether Section 513(i) will be politically stable in the long term if it encourages charities to engage in business activities that do not match those political perceptions. It was that disconnect between the perception and reality of charities' activities that brought about the UBIT in the first place, as well as its expansion to tax advertising in 1969. Section 513(i) encourages charities into activities that could trigger similar political forces. The exact political event that could disturb the status quo is hard to anticipate, just as the rainstorm that dislodges a boulder at the top of the hill cannot be predicted with certainty. The direction of the roll, however, is predetermined.