

# IEG Sponsorship Report

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## Signs Point To Higher Scrutiny of Nonprofit Sponsorships By IRS

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*Nonprofits should pay attention to IRS developments and continue best practices related to managing and reporting sponsorship income.*

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**6/7/10:** The Internal Revenue Service may be preparing to revisit whether certain types of nonprofit sponsorship revenue should be considered taxable unrelated business income.

While the IRS has taken no definitive steps in that direction, experts say nonprofit organizations and their corporate partners should be alert to the possibility of a review of the safe harbor for some sponsorship benefits and, more immediately, be aware of the government's recent heightened scrutiny of sponsorship activity.

Marcus Owens, an attorney with law firm Caplin & Drysdale, and the previous director of the IRS's Exempt Organizations Division, points to two developments that signal the service's rekindled interest in sponsorship payments to nonprofits.

The first is the IRS's increased use over the past several years of questionnaires as a tool to examine nonprofits' sources of income.

"The IRS has greatly expanded its use of questionnaires, which allow it to collect information in greater detail than the Form 990 tax return would generate," Owens said. "The IRS is becoming more sophisticated about data collection, and nonprofits need to be prepared for the distinct possibility that an IRS questionnaire will probe sponsorship arrangements in greater detail.

"It is far easier for the IRS to send a questionnaire than conduct an audit."

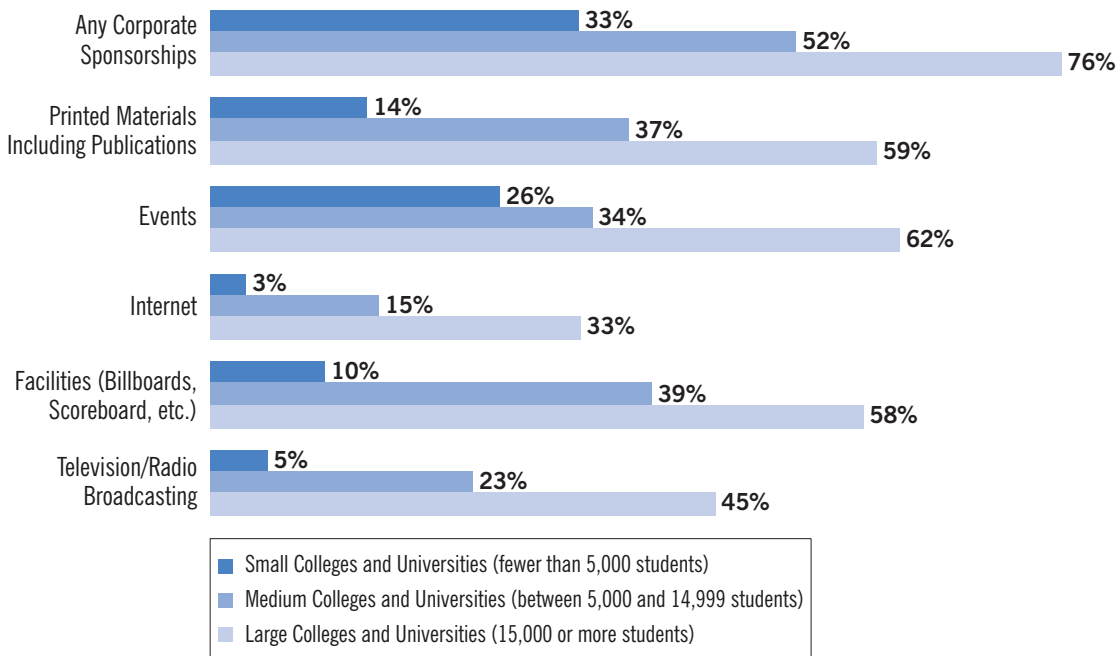
The second indicator that the IRS is interested in delving deeper into sponsor/nonprofit relationships is the examination of sponsorship activity as part of the service's current Colleges and Universities Compliance Project.

The investigation by the IRS into conduct, practices and reporting by one of the largest segments of the nonprofit sector (in terms of revenue and asset size) got underway in October '08 with questionnaires sent to 400 public and private institutions of higher education.

According to the IRS, the project is focused on: “(1) the conduct and reporting of exempt or other activities that may generate unrelated business taxable income; (2) investment, management and use of endowment funds; and (3) executive compensation practices.”

One of the questions asked by the project is whether the institution engaged in corporate sponsorship activities. The IRS reported the results of that question and the others in its interim report ([www.irs.gov/pub/irs-tege/cucp\\_interimrpt\\_052010.pdf](http://www.irs.gov/pub/irs-tege/cucp_interimrpt_052010.pdf)) on the project issued last month.

### Percentage of Organizations that Reported Engaging in Corporate Sponsorship Activities



Although the interim report does not otherwise address sponsorship, it is noteworthy that as a result of the responses to its questions, the IRS already has opened examinations of more than 30 colleges and universities. The examinations “focus principally on unrelated business taxable income and executive compensation issues,” according to the report.

The document goes on to state that further work related to the project is expected to include “additional analysis in a number of areas, including...the reported differences in treatment by organizations of various activities as exempt or unrelated.”

“This compliance project, like our previous one on nonprofit hospitals, gives us a lot of valuable information on activities conducted by those organizations that will help us in our enforcement and services efforts,” said Lois Lerner, IRS director of exempt organizations, in a statement.

While nonprofits wait to see what steps the IRS will take next, Owens advises them to continue best practices related to the managing and reporting of sponsorship revenue (“Revisiting The IRS Regulations: What Nonprofits And Their Sponsors Need To Know,” 9/11/06).

He also reminds tax-exempt organizations that deciding to offer substantial benefits to sponsors and potentially being subject to UBIT on a portion of the income is a viable option.

“Nonprofits need to recognize the tradeoff between sponsorship income that is passive in nature and not taxed and the greater fees that would be earned if they took a more active role in marketing their sponsors’ products.

“It’s a business decision. They need to crunch the numbers.”

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*Sources*

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