O. CORPORATE SPONSORSHIP INCOME

by
Gioia Ligos and Russlyn Guritz

1. Introduction

A. History of UBIT and Corporate Sponsorship

Corporate sponsorship represents a significant funding source for nonprofit organizations and an important strategy for corporations. Sponsorship creates corporation identification with charitable activity. This type of identification has become very valuable to corporations seeking new ways to boost publicity, to enhance and expand markets and even to entertain clients. Between 1986 and 1991, total corporate sponsorship of sports, arts, music, community, and cause-related events has nearly tripled to $2.9 billion and the number of companies sponsoring events has doubled to 4,200, according to the Special Events Report newsletter.

The fundamental problem presented by the issue of corporate sponsorships is distinguishing normal fundraising and the associated acknowledgment of donors from the sale of advertising.

Support from business is crucial for some tax-exempt organizations to obtain the resources needed to carry out their respective missions. The Internal Revenue Code (IRC) supports charitable organizations through exemption from federal income tax and through charitable deductions to their itemizing donors. However, this may give exempt organizations an undue competitive advantage if used to compete in traditionally taxable activities. As exempt organizations develop more innovative fundraising techniques and marketing strategies, the scope of activities reached by the unrelated business income tax (UBIT) has increased.

This article explores the issues involved in determining under what circumstances the sponsorship income received by an exempt organization conducting public events may constitute unrelated trade or business income under IRC 512(a)(2), subject to tax under IRC 511.

2. Statutory Framework of the Unrelated Business Income Regulations

An organization described in IRC 501(a) generally must pay tax on its unrelated business taxable income as defined in IRC 512. Three elements must be established before income received by an exempt organization will be subject to the unrelated business income tax. First, the income must be derived from a trade or business. Section 513(c), which is captioned "Advertising, Etc., Activities," provides that the term "trade or business," in this context, has the same meaning it has in IRC 162, and generally includes any activity carried on for the production of income from the sale of goods or performance of services. Second, the trade or business must be "regularly carried on" by the organization. Treas. Reg. 1.513-1(c). The regulations provide that business activities of an exempt organization will generally be considered regularly carried on if they are frequent and continuous, and the manner in which they are pursued is generally similar to comparable commercial activities of nonexempt organizations. Reg. 1.513-1(c)(1). The proposed regulations, discussed later in this article, do not amend the rules in Reg. 1.513-1(c) as to whether trade or business from which a particular amount of gross income derives is regularly carried on within the meaning of IRC 512.

The final determination to be made in the unrelated business income analysis is whether the business in question is substantially related to the organization's performance of its exempt function. A business activity will be considered substantially related if it contributes importantly to an organization's exempt function. The relation of the business activity to the organization's exempt purpose must be more than financial. *See* Reg. 1.513-1(d)(1).

Even if the three tests have been met in determining that there is unrelated trade or business income, income otherwise unrelated will be excluded from the UBIT if it falls within the specific exceptions and exclusions set forth in the IRC. Thus, for example, income from a trade or business, substantially all the work of which is carried on by volunteers, is not taxable (IRC 513(a)(1)), nor is income received from royalties (IRC 512(b)(2)).

3. Brief History of Events Leading up to the Proposed Regulations

A. Technical Advice Memorandums (TAMs)

Intercollegiate athletic organizations are considered to be educational in nature and, therefore, receive beneficial tax treatment under IRC 501(c)(3). In August 1991, the IRS demonstrated the boundaries of this beneficial treatment and ruled in TAM 91-47-007 that an athletic association must pay UBIT on the approximately $1.5 million in sponsorship fees that it receives annually. A second

ruling, TAM 92-31-001, was released in October 1991 and reached the same conclusion in a similar fact pattern. The IRS held that the exempt organizations were selling advertising and that this sale of advertising constituted the conduct of a business that was not substantially related to their educational purpose. However, the TAM's did not challenge the underlying exemption of athletic associations.

Together these TAM's disclosed key facts about the sponsorship arrangements between the exempt organizations and their corporate sponsors. The arrangements showed that in return for payment, the exempt organizations provided a substantial quid pro quo. What the exempt organizations provided amounted to much more than mere recognition of generosity. The services provided by the organizations were commensurate with the value of the payments received. These services included changing the game logo to a new logo that included the name/logo of the corporate sponsor and the name of the football game. Furthermore, the organizations agreed to arrange for television broadcast, to display the logo at different times and places, to provide signage space, to make public address/scoreboard announcements and to provide numerous other services for the corporate sponsors. In addition to these provisions, the organizations provided automobiles, thousands of tickets, hospitality sites, VIP hotel suites, receptions, and invitations and tickets to various events in conjunction with the games.

The Service concluded that the services provided by the organizations were commensurate with the value of the payments received, and constituted a regularly carried on trade or business, unrelated to the exempt purpose of the organization.

In support of their position the Service cited United States v. American Bar Endowment, 477 U.S. 105 (1986), in which the Supreme Court stated that the standard test for the existence of a "trade or business" is whether the provision of goods or services is entered into with the dominant hope and intent of realizing a profit. The Service concluded that by providing valuable services, including advertising services, in return for large payments, the organizations were engaged in an activity for the production of income from the provision of services. Hence, the organizations were engaged in a trade or business activity.

The Service then adopted a facts and circumstances approach to determine if the payments made by the corporate sponsors were made with an expectation of receiving from the organization a substantial return benefit. Citing (Hernandez v. Commissioner, 490 U.S. 680 (1989)), the Service stated that a payment to a

charity is a contribution or gift for IRC 170 purposes if it is made without an expectation of a return benefit commensurate with the amount of the payment. In this instance, however, the Service determined that the package of benefits the organizations provided went far beyond what previously had been established as recognition of a benefactor that results in merely an incidental benefit. Normally, limited recognition of a donor's generosity is considered merely an incidental benefit. This long-standing position of the Service has been enunciated in Rev. Ruls. 67-342, 1967-2 C.B. 187, and 77-367, 1977-2 C.B. 193. The TAMs also stated that the activities did not contribute importantly to the organization's exempt function (United States v. American College of Physicians, 475 U.S. 834 (1986)).

Furthermore, the advertising and promotional activities were determined to be "regularly carried on," rather than intermittent, thus satisfying the final requirement that must be met in order for there to be unrelated trade or business income. With regard to the "regularly carried on" test, the Service stated that the determination should not be based merely on the duration of the game. Rather, it is necessary to consider the normal time span for the trade or business, together with whether the activity is carried on in a manner comparable to that of a non-exempt organization.

However, whether an activity constitutes advertising or acknowledgments does not determine whether a sponsor may deduct its payment under IRC 162 or IRC 170.

B. IR 92-4

In response to the confusion and concern of the exempt organization community over the recently released and heavily redacted TAM 91-47-007, the IRS issued News Release IR 92-4 on January 17, 1992, to reassure these organizations and reiterate the Service's policy regarding donor recognition. The news release stated that tax-exempt organizations can publicly acknowledge donors for their contributions, but if the organizations conduct advertising for donors the payments unrelated business are taxable income, not tax exempt contributions. The release further stated that donations received by a charitable organization are nontaxable contributions if the organization does not, in return, provide a valuable benefit or service to the donor. Mere recognition of a contributor as a benefactor will not give rise to unrelated trade or business income.

However, an exempt organization that goes beyond mere recognition and

extensively performs valuable advertising, marketing, and similar services, on a quid pro quo basis is engaging in activities which are unrelated to the mission of tax exempt organizations. In these cases, exempt organizations must pay UBIT on the payments received in exchange for advertising services provided.

C. Announcement 92-15

The Service developed proposed examination guidelines to provide IRS agents, and the exempt community with a framework for determining under what circumstances payments received by exempt organizations from sponsorship arrangements might result in income from unrelated trade or business. The proposed guidelines were published as Announcement 92-15, 1992-5 I.R.B. 51 (Feb. 3, 1992), and interested parties were invited to comment on the guidelines.

The proposed examination guidelines contained a framework for an analysis of the payments received by exempt organizations from corporate sponsorship arrangements and set forth specific indicators to be considered in making a determination as to whether an organization is engaged in an unrelated trade or business activity.

Announcement 92-15 dealt with the distinction between advertising and an acknowledgment of a contribution by providing that payments to exempt organizations from businesses would be nontaxable contributions if there were no expectation that the businesses would receive a substantial return benefit. Mere acknowledgment or recognition of a sponsor as a benefactor normally is incidental to the receipt of a contribution and is not in itself of sufficient benefit to the sponsor to give rise to unrelated trade or business income. However, Announcement 92-15 stated that if an exempt organization performs valuable advertising, marketing and similar services on a quid pro quo basis for the sponsor, the payments are not contributions and questions of unrelated trade or business arise.

The Announcement further stated that the Service would not apply the guidelines to organizations that are of a purely local nature and that receive relatively insignificant gross revenue from corporate sponsors and that generally operate with significant amounts of volunteer labor.

D. Hearings

In response to the numerous written comments received on the proposed

audit guidelines, the Service held three days of hearings in July of 1992. Twenty-nine speakers appeared during these public hearings. The speakers represented such organizations as Independent Sector, U.S. Olympic Committee, The Football Bowl Association, the LPGA, American Arts Alliance, American Association of Museums, America's Public Television Stations, Little League Baseball, American Heart Association, International Association of Fairs and Expositions, the U.S. Volleyball Association, the American Institute of Certified Public Accountants, and the Section of Taxation of the American Bar Association.

Many public comments suggested that the guidelines should be issued in the form of proposed regulations which would provide clear precedential value for the exempt organization community. Some comments took issue with providing seating, transportation, and hospitality as an advertising factor. The commentators felt that these "perks" to the sponsor should be an offset against the corporate contribution and not a determinant of advertising.

Most of the commentators argued that the proposed guidelines were too overreaching and vague, and would have a harmful effect on traditional, and essential, fundraising activities. Specifically, it was suggested that the substantial return benefit test was too vague or subjective and would not provide exempt organizations with the certainty they sought in this area. Some commentators requested that the guidelines clarify whether the allocation rule governing the exploitation of exempt activities applied to sponsorship income or raised other questions regarding allocation of expenses and deductions.

Other commentators requested that the audit guidelines expressly recognize that the use of written agreements or the participation of outside legal or other professionals would not necessarily indicate that payments received constituted advertising income. Numerous other comments related to the specific concerns of individual organizations. Many of the comments expressed alarm that the guidelines could adversely affect local organizations. One lone commentator expressed the view that the proposed guidelines did not go far enough but rather condoned the use of the nonprofit sector for private, commercial purposes.

There were numerous suggestions that the Service needed to substantively define advertising. Further suggestions were made by America's Public Television Stations that the Service should study the Federal Communications Commission's (FCC) rules governing underwriting credits for public broadcast stations because the FCC's rules define "advertising" and "acknowledgement" and many organizations already comply with these rules.

At the conclusion of the hearings, Marc Owens, Director, Exempt Organizations Technical Division, singled out three specific areas as meriting the Service's careful consideration: the advisability of adopting the FCC standards for public broadcast stations, and other exempt organizations as well; clarification of what constitutes regularly carried on; and the applicability of the proposed guidelines to trade show and state fair activities under IRC 513(d).

E. Congressional Action and the Presidential Veto

During the summer of '92, concerned with the ramifications of the IRS rulings and proposed guidelines, Congress passed legislation directed at resolving the concerns of major bowl games and other organizations regarding classification of corporate sponsorship payments. H.R. 11 (the "Revenue Act of 1992") was favorably reported, as amended, by the House Ways and Means Committee on June 25, 1992, and passed the House of Representatives on July 2, 1992. H.R. 11 would have applied to fundraising events that do not exceed 30 consecutive days and are the only event of that type conducted by the organizations during that year. While this would have taken care of the annual bowl game, it would have left a number of unresolved issues for local exempt organizations.

Section 2201 of the House bill directed the Treasury Department to conduct a study of the tax treatment of sponsorship payments received by charitable and other tax-exempt organizations from corporations and other sponsors in connection with athletic and cultural events. In addition, the Treasury Department was directed to conduct a study of the ramifications of the proposed examination guidelines on these organizations. Within one year after date of enactment, the Secretary was to report the results of the study to the tax-writing committees of the Congress.

H.R. 5645, "The Jenkins bill," was introduced in the House on July 22, 1992, in order to exclude certain sponsorship payments from the unrelated business income of tax-exempt organizations. The bill provided that the term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments with respect to any qualified public event if the event is substantially related to the organization's exempt purpose. "Qualified sponsorship payments" that are excluded from UBIT are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than:

a. the use of the name or logo of the person's trade or business in connection with a qualified event under arrangements (including advertising) in connection with such event which acknowledge such person's sponsorship or promote such person's products or services, or

b. the furnishing of facilities, services, or other privileges in connection with such event to individuals designated by such person.

The Jenkins bill passed the House of Representatives on July 28, 1992.

On August 3, 1992, the Senate Finance Committee favorably reported H.R. 11, with amendment. Section 8005 of this bill, as amended, stated that the term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments with respect to any qualified public event. "Qualified sponsorship payments" are defined as any payment by a person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use of the name or logo of such person's trade or business in connection with a qualified public event. The use of the name or the logo of such person's trade or business does not include advertising or promotion of such person's products or services.

The type of advertising or promotional activities by an exempt organization of a sponsor's products or services that would not be within the safe harbor provided for by the bill included a call to action to purchase the sponsor's products, superlative descriptions or qualitative claims about the company (or its products or services), and direct comparisons with other companies, price or value information, inducements to buy or endorsements. The Committee cited the Public Broadcasting System (PBS) National Program Funding Standards and Practices as generally specifying permissible identification of sponsors as opposed to advertisements or promotions which would give rise to UBIT.

A "qualified public event" was defined as any public event conducted by an organization described in paragraph (3), (4), or (5) of IRC 501(c), if substantially all the activities of the organization in conducting the event are not subject to UBIT; and the net proceeds from the event are used for a purpose described in IRC 170(c)(2)(B).

The Senate and the House bills also contained reassurances regarding royalty income for the U.S. Olympic Committee and the Atlanta Committee for the Olympic Games.

H.R. 11 was favorably reported, as amended, by the Senate Committee on Finance on July 29, 1992, and passed the Senate on September 29, 1992. On October 5, 1992, the conference agreement on H.R. 11 contained the Jenkins bill language. The conference report on H.R. 11 passed both Houses of Congress on October 20, 1992 and October 22, 1992, respectively. For reasons having nothing to do with corporate sponsorship, the bill was pocket vetoed by President Bush in November of 1992.

4. The Proposed Regulations

In response to the oral and written comments on the proposed guidelines, and the input from the public hearings, the IRS issued Prop. Treas. Reg. 1.513-4, 58 Fed. Reg. 5687 (Jan. 22, 1993), IRB 1993-7, 71 (Feb. 16, 1993), which would provide precedential guidance for exempt organizations that receive corporate sponsorship payments. The proposed regulations take into account both an exempt organization's need to attract private sector support and the statutory and regulatory requirement that the organization be organized and operated for exempt purposes. The regulations are an effort to develop fair, reasonable, and administrable rules concerning sponsorship payment. The proposed regulations clarify that the rules regarding sponsorship apply to broadcast as well as nonbroadcast activities. Thus, the proposed regulations apply uniformly to all sponsorship activities, unless otherwise expressly stated. The proposed regulations also apply uniformly to all sponsorship activities without regard to the local nature of the organization or activities or the amount of the sponsorship payment.

The proposed regulations, in response to public comments, are designed to parallel the statutory and regulatory framework of the Federal Communications Commission (FCC) rules currently in effect. *See,* In the Matter of Commission Policy Concerning the Noncommercial Nature of Educational Broadcasting Stations, Public Notice FCC 86-161, April 11, 1986. The amendments to the regulations are proposed to be effective with respect to amounts received after January 19, 1993, which is the date the proposed regulations were filed with the Federal Register. The same rules, however, will be applicable to open tax years prior to that date.

A. Differences Between the Proposed Regulations and Announcement

92-15's Proposed Examination Guidelines

The proposed regulations diverge from Announcement 92-15 in several significant respects. The proposed regulations focus on the nature of the services provided by the exempt organization rather than on the expected benefits to the sponsor. As suggested by numerous public comments on the proposed guidelines, the term advertising is defined in the proposed regulations. The proposed regulations distinguish between advertising that is unrelated, and acknowledgments, which are the mere recognition of a sponsor's payment and do not result in unrelated business taxable income. The proposed regulations apply uniformly to all sponsorship activities, broadcast as well as nonbroadcast, without regard to the local nature of the organization or activities or the amount of the sponsorship payment. To the extent possible, the proposed regulations are designed to parallel the Federal Communications Commission's enhanced underwriting credit rules. They clarify that the allocation rule governing exploitation of exempt activities applies to sponsorship income.

B. Advertising v. Acknowledgment

Advertising has been defined in Prop. Reg. 1.513-4(b) with respect to sponsorship activities of exempt organizations, as any message or other programming material which is broadcast or otherwise transmitted, published, displayed or distributed in exchange for any remuneration, and which promotes or markets any company, service, facility or product.

Advertising does not include acknowledgements. Acknowledgments are the mere recognition of sponsorship payments and may include the following, provided that the effect is identification of the sponsor rather than promotion of the sponsor's products, services or facilities: sponsor logos and slogans that do not contain comparative or qualitative descriptions of the sponsor's products, services, facilities, or company; sponsor locations and telephone numbers; value-neutral descriptions, including displays or visual depictions, of a sponsor's product-line or services; and sponsor brand or trade names and product or service listings. Logos or slogans that are an established part of a sponsor's identity are not considered to contain comparative or qualitative descriptions. *See* Prop. Reg. 1.513-4(c).

Messages or other programming material that include the following constitute advertising: qualitative or comparative language; price information or other indications of savings or value associated with a product or service; a call to action; an endorsement; or an inducement to buy, sell, rent or lease the sponsor's

product or service. Distribution of a sponsor's product by the sponsor or the exempt organization to the general public at the sponsored event, whether for free or for remuneration, is not considered an inducement to buy, sell, rent or lease the sponsor's product for purposes of this regulation. If any activities, messages or programming material constitute advertising with respect to a sponsorship payment, then all related activities, messages or programming material that might otherwise be acknowledgments are considered advertising.

The mere existence of a sponsorship contract does not necessarily mean that a sponsorship payment is income from advertising. The terms of the agreement, not its existence or degree of detail, are relevant to the determination. Similarly, the terms of the agreement and not the status of those negotiating the agreement are relevant. Exclusivity arrangements do not, in themselves, mean that a sponsorship payment is advertising income.

Contingent payments are not always considered advertising income. Where the amount of the sponsorship payment is contingent, by contract or otherwise, upon factors such as attendance at an event or broadcast ratings, the sponsorship payment is considered advertising income. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast does not, in itself, mean that the payment is advertising income.

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

Prop. Reg. 1.513-4 describes circumstances when income from certain sponsorship payments received by organizations subject to the UBIT imposed by IRC 511 are derived from a trade or business. This section does not apply to qualified convention and trade show activity. This section also does not apply to income derived from the sale of advertising in exempt organization periodicals. The term "periodical" includes regularly scheduled and printed material that is not related to and primarily distributed in connection with a specific sponsored event.

Whether an activity constitutes advertising or acknowledgements does not determine whether a sponsor may deduct its payment under IRC 162 or IRC 170. The test is not, as was suggested in the guidelines and the earlier rulings, whether there is a quid pro quo. Rather, the test is whether there is advertising or

acknowledgment.

The proposed regulations follow the rule in Rev. Rul. 67-246, 1967-2 C.B. 104. As a general rule, where a transaction involving a payment is in the form of a purchase of an item of value (e.g. advertising), the presumption arises that no gift has been made for charitable contribution purposes, the presumption being that the payment in such case is the purchase price. If a sponsorship payment contains an advertising component, the entire payment is considered advertising income. In computing the tax, however, the proposed regulations permit an exempt organization to demonstrate that there is an amount in excess of the fair market value of the advertising benefit. UBIT will then be computed only on the amount of the sponsorship payment that represents the fair market value of that advertising benefit.

In addition, the proposed regulations do not preclude a showing that income received by an exempt organization is from dividends, interest, or royalties, or is otherwise excludable under IRC 512(b) from the computation of unrelated business taxable income.

C. Expense Allocation

There was a significant expense allocation issue underlying the corporate sponsorship debate that was a matter of concern and which had not been addressed in the proposed guidelines. The proposed regulations amend the regulations under IRC 512(a) by adding examples to clarify that the allocation rule governing exploitation of exempt activities that applies to sponsorship income. Under this allocation rule, exempt function expenses in excess of exempt function income may be used to offset net unrelated business income from an activity that exploits the organization's exempt function and is an activity normally conducted by taxable organizations.

In addition, the exploitation regulation permits the deduction of expenses directly connected with the exploited activity. However, the proposed regulations do not amend the requirements of Reg. 1.512(a)-1(d)(2) that, for the allocation rule governing exploitation to apply, the unrelated trade or business activity must be of a kind carried on for profit by taxable organizations and the exempt activity exploited by the business must be a type of activity normally conducted by taxable organizations in pursuance of such business. The Service requests comments regarding the desirability of amending these rules in view of the rules adopted in the proposed regulations.

D. Examples of the Application of the Regulations

(1) Exploitation Allocation

Prop. Reg. 1.512(a)-1 gives an example of X, an IRC 501(c)(3) organization, which conducts an annual college football bowl game featuring the conference champion and another prominent nationally-ranked college team. In addition, X sells to commercial broadcasters the right to broadcast the bowl game on television and radio for $3,000,000 and receives $1,500,000 in admission and other fees. A major corporation agrees to be the exclusive sponsor of the bowl game and pays X $2,500,000. X acknowledges the sponsorship payment by adding the corporation's name to the title of the event. This does not constitute advertising within the meaning of Reg. 1.513-4 because it does not promote the sponsor's service, facility or product. In an activity distinct from the sponsorship agreement, X earns gross income of $800,000 from its design, manufacture and marketing of various items of wearing apparel featuring the name and logo of the bowl game. This activity constitutes unrelated trade or business that exploits X's exempt function. Expenses associated with this activity total $250,000.

The computation of unrelated business income is as follows:

REVENUE

Television and radio rights $3,000,000
Admission and other fees 1,500,000
Sponsorship (acknowledgments) 2,500,000
Income from unrelated trade or business 800,000
Total Revenue $7,800,000

EXPENSES

Directly connected with bowl game 4,750,000
Overhead costs allocated to bowl game 1,000,000
Payment to event participants 2,000,000
Directly connected with the unrelated trade or business 200,000
Overhead cost allocated to unrelated trade or business 50,000
Total expenses $8,000,000

UNRELATED TRADE OR BUSINESS (Wearing Apparel Activity)

Revenue 800,000
Expenses 250,000
Total unrelated business taxable income $550,000

EXEMPT FUNCTION (Bowl Game)

Revenue 7,000,000
Expenses 7,750,000
Total exempt function income (loss) ($750,000)

Exempt function expenses exceed revenues by $750,000. Because the unrelated income exploits the bowl game and is an activity normally conducted by taxable organizations in pursuit of similar businesses, this excess is allowed as a deduction from unrelated business taxable income to the extent of the net gain from unrelated business taxable income. Accordingly, there is no unrelated business income tax because the excess exempt function expenses of $750,00 more than offset total unrelated business taxable income of $550,00.

(2) Acknowledgment/Advertising

(a) P Conducts an annual college football bowl game. P sells to commercial broadcasters the right to broadcast the bowl game on television and radio. A major corporation agrees to be the exclusive sponsor of the bowl game. The sponsorship payment includes amounts to be paid to the colleges participating in the bowl game. The detailed contract between P and the corporation provides that the name of the bowl game will include the name of the corporation. The contract further provides that the corporation's name and a special logo will appear on players' helmets and uniforms, on the scoreboard and stadium signs, on the playing field, on cups used to serve drinks at the game, and on all related printed material distributed in connection with the game. The sponsorship agreement is contingent upon the game being broadcast on television and radio, but the amount of the sponsorship payment is not contingent upon the number of people attending the game or the television ratings. The contract provides that television cameras will focus on the corporation's name and logo on the field at certain intervals during the game. P's activities are acknowledgments of the payment and not advertising.

(b) S is a noncommercial broadcast station that airs a program sponsored by a local record shop. In recognition of that sponsorship, S broadcasts

the following message: "This program has been underwritten by the Record Shop, where you can find all of your great hit music. The Record Shop is located at 123 Main Street. Give them a call today at 555-1234. This station is proud to have the Record Shop as a sponsor." S's activities constitute advertising.

5. The Public Hearing

A public hearing was held on July 8, 1993. Eleven speakers appeared at the hearing, representing the American Heart Association, International Festivals Association, Coconut Grove Arts Festival, America's Public Television Stations, National Public Radio, American Arts Alliance, Coopers & Lybrand, The Football Bowl Association, the American Institute of Certified Public Accountants, U.S. Olympic Committee, and the Section of Taxation of the American Bar Association. In general, the commentators felt that the FCC rules are an excellent source of precedent for the proposed regulations. The America's Public Television Stations and National Public Radio stated that any underwriting credits that are consistent with the FCC rules should not constitute advertising. These speakers also recommended that an individual in the National Office be designated to serve as a resource within the Service on the FCC rules and that the Service defer to FCC interpretations of the application of these rules to public broadcasters.

Several speakers were concerned about the effective date of the proposed regulations. These speakers requested that the Service provide guidance regarding payments received prior to issuance of the proposed regulations. Several speakers believed that the regulations should be retroactive. However, other speakers felt that the effective date should be changed to the date that the regulations become final.

Speakers also suggested clarification of such terms as "promotion" and "logos". Many of the speakers requested further clarification of the examples used to explain the difference between acknowledgments and advertisements. A number of speakers also felt that the phrase "or markets any company," which is not in the FCC definition of "advertising," should be eliminated or clarified in order to make the Service definition identical to the FCC definition. These speakers also believed that the phrase "offered by a person who is engaged in such offering for profit," which is in the FCC definition, should be added to the regulations to allow promotional announcements for nonprofits.

Most of the speakers were critical of the "tainting rule" in general. Several speakers proposed a "de minimis" provision where the advertising is insignificant.

Other speakers requested that the regulations specifically refer to Rev. Rul. 67-246 (as does the preamble) to clarify that an organization may exclude the portion of a sponsorship payment that can be shown to be in excess of the fair market value of the advertising benefit received by the sponsor.

The speakers also requested further guidance on the exploitation of exempt income provisions. Several speakers requested that the Service eliminate the exploitation regulation's "commercial counterpart" requirement. The speakers felt that the "commercial counterpart" requirement was difficult to administer because the events are traditionally and almost exclusively conducted by exempt organizations. Finally, speakers responded to the Service's request for comments regarding the desirability of amending the "regularly carried on" rules. A number of speakers felt that the Service should consider amending the regulations to provide a safe harbor and examples of activities that will not be considered regularly carried on.