



Cause Marketing: *The Charity's Perspective*

Prepared by:
Ed Chansky
Greenberg Traurig, LLP

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The Charity's Perspective

Cause-marketing programs can take many forms, including the following:

- Sponsorships
- Licensing
- Coupon and Product Tie-ins
- Affinity Programs
- Seals of Approval
- Commercial Co-Venture Sales
- Cooperative Marketing Efforts
- Direct Solicitation of Donations

All forms share two basic elements: money flowing to a charity, plus use of the charity's name in connection with a commercial company's goods or services. Seemingly small changes in form can have large effects on the charity. In this section we look at some of the options a charity might consider and the consequences of choosing those options.

A. Licensing Use of Charity's Name

A "license fee" is a common way to characterize the payment from a co-venturer to a charity. This characterization is consistent with the facts of the underlying deal: the business pays the charity for the right to use the charity's name. The payment might also be characterized as a "donation," but the fact that it is made in the context of a contract between the parties suggests that the "license fee" characterization makes as much sense as the "donation" characterization, especially if there are any duties on the charity which might be deemed inconsistent with an outright "donation" or where the context of the transaction is clearly commercial.

1. Simple Licensing of Name/Logo

The classic example is a credit card affinity program where the charity's name appears on the card and a percentage of all purchase amounts gets donated to the named charity.

- a) "Active" vs. "Passive". A licensing deal involving the charity's name/logo will not jeopardize the charity's tax-exempt status, and the license fees generally will not be deemed taxable income to the charity, so long as the charity's role is "passive" as a licensor rather than "active" as an agent or promoter rendering services in support of the commercial company's marketing efforts. See Rev. Rul. 81-178, 1981-2 C.B. 135, and Rev. Rul. 69-430 1969 C.B. 129.

- b) UBIT. If the charity takes on contractual duties to distribute promotional materials as part of a licensing deal or otherwise actively helps promote or market the commercial company's products or services, then any amounts paid to the charity in connection with such "active" services may be deemed "unrelated business income" (*i.e.*, unrelated to the charity's non-profit mission) and subject to the unrelated business income tax (UBIT). Passive "royalty" income (with no services) is generally exempt from UBIT. Rev. Rul. 81-178. While not fatal, most charities do not like to incur UBIT if it can be avoided.

2. Addition of "Approval" Message from Charity

What if the charity goes beyond simply allowing its name/logo to be used by a commercial party in a licensing deal and also allows the commercial party to display on its products an "approval" message, a favorable review, or some other positive statement from the charity?

- a) If it's a very simple statement of "approval" of the product or acknowledging the support of the sponsor, it probably shouldn't trigger UBIT. (NOTE: depending on the type of product and charity – medical device and medical organization, for example – "approval" might be inferred by many consumers anyway from the mere presence of the charity's name or logo without any other statement.)
- b) How far beyond a simple statement of approval can the charity go? It's unclear. The more that is said, the greater the risk that the charity might be deemed to be rendering a taxable advertising service to the commercial party. See next section discussing the IRS rules on "Sponsorship Benefits."

3. Self-Dealing

Some transactions between a private foundation and a "disqualified person" can be subject to tax. The definition of a "disqualified person" includes any grantor of over 2% of the foundation's income, plus parties closely related to such a grantor, for example major shareholders (and their family members), controlled subsidiaries, and foundation officers and directors. A corporation that forms a foundation is almost always a "disqualified person" for its own foundation.

- a) The basic worry in self-dealing is when value or money flows from the foundation to the disqualified person. There is much less concern when the value or money flows in the other direction (though it can sometimes be an issue).
- b) In a standard charitable sales promotion, the foundation licenses the use of its name to the commercial party, and the commercial party pays a fee in the form of the "donation" (*e.g.*, "\$1.00 for every box of cereal purchased."). Is there a problem? Maybe. The foundation is giving the commercial party the right to use the foundation's name, which clearly has some value. But there is an exemption in the law for furnishing of goods, services or facilities to a disqualified person on the same terms available to the general public. While this exemption normally applies to parks, museums or other similar services offered to the general public, the rationale for the exemption would support a finding of no self-dealing where the license terms are fair, reasonable, and comparable to the terms the foundation would offer to any other sponsor to conduct a similar promotion. Approval of the deal by independent board members is another precaution that can help reduce risks.

B. IRS "Sponsorship Benefits" Regulations

1. The IRS has issued a set of rules governing the forms of benefits that charities can provide to "sponsors" while still allowing both parties to characterize the sponsorship money as a "donation" and without triggering UBIT. The rules focus primarily on the kinds of signage and other exposure that the charity can provide the sponsor in connection with an event or other public activity. Examples of the types of charity-run events and activities addressed in the rules include college football bowl games, major museum exhibitions, symphony orchestra concerts, public radio broadcasts, walkathons, etc. See Treas. Reg. 1.513-4.
 - a) "Acknowledgment" vs. "Advertising". The purpose of the rules is to distinguish between appropriate forms of "acknowledgment" of the sponsor's support and inappropriate forms of "advertising" for the sponsor that are so commercial in nature that they (a) do not qualify as "donations," and (b) may possibly also be subject to UBIT (unless they are exempt under some other provision of the tax laws, such as the "passive royalty" exemption). The distinction is different from the "active vs. passive" test described above, because it is assumed that the charitable organization must take some active steps to provide acknowledgment for the sponsor's support. The inquiry focuses on the nature of the statements that are being made and whether they cross the line from being mere "acknowledgments" of support and become instead forms of "advertising."
 - b) The line between "acknowledgement" and "advertising" is not always clear. The following kinds of statements would be risky and would have to be reviewed carefully before they were made:
 - i. Comparative advertising claims
 - ii. Quality or claims about the product
 - iii. Affirmative "endorsement" of the product
 - iv. Active encouragement to buy the product
 - v. Price claims
 - c) How about if the charity mentions on its web site the fact that it is making a donation with each purchase of a designated product? Is that an "acknowledgment?" Is it an "inducement" to buy the product? It's not clear. The exact wording and context may affect how such a statement is viewed.
 - d) Special care must be taken when mentioning a sponsor in a "periodical." The sponsorship benefit regulations do not apply. Almost any form of recognition can be deemed "advertising."
 - e) A charity also should monitor the messages a sponsor may post on the charity's Facebook or other social media pages. An overtly commercial message tacitly tolerated (or expressly encouraged) could tempt the IRS to find UBIT.
2. Other Activities by the Charity

In general, the more the charity does, the more likely UBIT may apply. Therefore, it is important for a charity to review any sponsorship deal very carefully and try to (a) minimize the amount of activity it is obligated to undertake for the benefit of the

business, and (b) in the case of sponsorship benefits make sure they take the form of permissible "acknowledgments" rather than taxable "advertising" (or that they fit into some other UBIT exemption). The examples set forth in Treasury Regulation 1.513-4 are a good place to start for general guidance.

C. Charity Distributes/Sells Product

Sometimes the parties want the charity to distribute or sell a special product. This situation can raise many potential complications for both parties as follows:

1. **UBIT.** If the product is not sufficiently related to the charity's mission, the charity's sales will be subject to UBIT. The question is how to determine what is sufficiently related. Sales of art reproductions by an art museum are generally OK, as are science kits by a science education organization, and music-decorated clothing items by a symphony orchestra. But sales of general merchandise by any of these organizations could trigger UBIT – for example, calendars at the museum with illustrations unrelated to art, toys from the science group that are not "scientific," or neckties from the symphony that don't have musical-motif decorations.
2. Even if the product is sufficiently related to the charity's purpose to avoid UBIT, one has to look at the transactions between the commercial party and the charity to determine what role the commercial party is playing. If the goods are donated to the charity, there is no problem. If the goods are sold to the charity, then there is a question whether the commercial party may be acting as a professional fundraiser or fundraising counsel. NOTE: Anytime money flows from the charity to the commercial party, you should review the situation carefully and try to avoid such payments unless the commercial party is simply acting in its normal capacity as a vendor of its regular products in the ordinary course of business and not benefiting from any special advertising of the arrangement.

D. Special Product Created by Charity

What if the commercial party commissions the charity to produce a special item – for example, an educational toy or workbook for children – for distribution to the public?

1. If the charity is paid for the work, then you have to determine whether the income is subject to UBIT – *i.e.*, was the project sufficiently related to the charity's main purpose to qualify as tax-exempt income? (A one-time project is relatively unlikely to trigger UBIT problems; repeated transactions are riskier.) A safer approach would be to position the money as a grant to the charity for the purpose of creating the special item, again making sure that the item is related to charity's mission.
2. If the commercial party wants to distribute the items to the public, it should either buy them from the charity (yes, that means paying for the items a second time), or make clear in the contract that its distribution efforts will be as a volunteer to assist the charity in the mission of bringing the items to a wider audience. The commercial party should not be paid anything for the distribution.
3. There generally is no problem having the charity distribute items it has created, but be careful if the items include any promotional information about the commercial sponsor. If they do, then the contract should not impose any affirmative distribution obligations on the charity; affirmative duties might be viewed as marketing efforts on behalf of the business partner that could trigger UBIT. Moreover, the "promotional" information should be limited to a "proud sponsor" message and avoid overt sales messages; otherwise, the whole project could be subject to UBIT as a form of "advertising" for the commercial party under the "sponsorship benefit" rules discussed in Part B. above.

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