

# Tax-Exempt Advisory

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## Common Pitfalls for Exempt Organizations Using the Internet

A wide range of issues arise when a tax-exempt organization has a Web site. This advisory highlights some areas which should be reviewed on a regular basis to ensure that your organization is complying with applicable laws and protecting its intellectual property.

### Fundraising

For organizations described in Section 501(c)(3) of the Internal Revenue Code (the "Code"), the rules applicable to fundraising conducted through other means such as direct mail or by telephone, may also apply to fundraising through a charity's Web site. For example, the organization must provide a contemporaneous written acknowledgment to a donor, which can include an email acknowledgment, for gifts over \$250. Moreover, solicitations for gifts of \$75 or more for which the donor receives a *quid pro quo*, must include a good faith estimate of the value of the goods and services received in exchange for the donation. Finally, certain organizations that are not eligible to receive tax-deductible contributions must state in an online solicitation that gifts are not deductible as charitable contributions.<sup>1</sup>

### State and Local Registration for Charitable Solicitation

Forty states and certain local jurisdictions require that an organization register with the charity official of the jurisdiction prior to soliciting funds. Since the Internet can be accessed in

every state, organizations must determine if their activities in states that require registration, rise to a level in which the state could invoke jurisdiction. According to guidelines published by the National Association of State Charity Officials,<sup>2</sup> an organization should register with a state if (i) it is domiciled there; (ii) its non-Internet activities require registration; (iii) it specifically targets persons physically located in the state for solicitation; or (iv) it receives contributions from the state on a "repeated and ongoing basis" or a "substantial basis" through its Web site. A review of specific activities and the jurisdictions involved is required to determine if your organization should be registered with a particular state.

### Lobbying

No substantial part of the activities of a public charity may be dedicated to lobbying, whether the charity elects to calculate its lobbying activities based on its expenditures, under Section 501(h) of the Code, or not. (We note that private foundations may not lobby at all.) Since the IRS has not provided any guidance that would indicate that the lobbying rules differ in regards to Internet activity, we generally recommend that charities that conduct lobbying via a Web site, file the lobbying election, so that their lobbying is measured under the numerical safe-harbor standards of Section 501(h). The Internet provides a low-cost means for such grass roots lobbying efforts as sending emails and posting a discussion of legislation that an organization supports or opposes. However,

it is important to note that a charity should carefully consider whether or not to provide hyperlinks to Web sites of other organizations that engage in lobbying, including related organizations such as those described in Section 501(c)(4) of the Code, as discussed below.

### Political Activity

Section 501(c)(3) of the Code prohibits a public charity or private foundation from engaging in any political activity, i.e., they cannot participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.

In regard to hyperlinks from a charity's Web site to a Web site containing information about a political candidate, in the last election cycle of 2008, the IRS released an internal memorandum in connection with its Political Activities Compliance Initiative. In that memorandum, the IRS distinguishes between organizations related to a charity and those that are not. For **unrelated** organizations, the memorandum provides that the IRS will pursue cases where a Section 501(c)(3) organization is "promoting, encouraging, recommending or otherwise urging viewers to use the link to get information about specific candidates and their positions on specific issues." The analysis will consider the electronic proximity or the number of "clicks" that separate the charity's Web site from one favoring or opposing a candidate. The memorandum further provides that, at that time, the IRS would not pursue cases involving links between the Web site of a Section 501(c)(3) organization and the Web site of a related Section 501(c)(4) organization. However, we would caution that in TAM 200908050, it was determined that a Section 501(c)(3) public charity intervened in a political campaign by distributing campaign endorsements on its Web site. In the ruling, the public charity had a related Section 501(c)(4) organization, whose Web site was a subset of the charity's Web site. The IRS determined that, even though the logo and address of the Section 501(c)(4) were at the bottom of its page, the visual presentation of the Web site made it impossible to distinguish the pages of the charity from those of the related Section 501(c)(4), which contained the political endorsements. Therefore, campaign intervention occurred.

### On-line Auctions

Some charities conduct on-line auctions using donated goods. The IRS has indicated that if the charity retains **control** over the publicity, marketing and exercise of the auction, the

income could be deemed as being raised through a fundraising event.<sup>3</sup> However, if the auction is on a Web site of an outside service provider that operates auctions for individuals and for-profit businesses, in addition to charities, the charity should examine whether its activities are segregated from the for-profit auction activities. If the for-profit auction activities are not sufficiently segregated, the IRS could view the income as being generated from classified advertising, which may generate unrelated business income tax ("UBIT").<sup>4</sup> Moreover, the service provider could be deemed a professional fundraiser and required to register as such with one or more states.

### Sale of Goods

As with registration for the purpose of charitable solicitation, an organization that sells products through its Web site must determine whether there is a sufficient nexus with one or more states to warrant collection of sales tax and whether the merchandise being sold could qualify as exempt from such taxes because of its relationship to the exempt purposes of the organization.

In addition to the collection of sales taxes, an organization must determine whether UBIT applies to income from goods sold on its Web site. Under Section 511 of the Code, gross income derived from an unrelated trade or business, which is regularly carried on by the organization, less deductions, is taxed at regular corporate tax rates. An unrelated trade or business is any trade or business the conduct of which is not substantially related (aside from the need for income) to the performance of the exempt organization's exempt purposes. An organization must consider each item for sale to determine if selling the item furthers the organization's exempt purpose. For example, the sale of a replica of a piece of art which is part of a museum's collection could be considered related to the museum's exempt purpose, but the sale of a coffee mug with the museum's logo would likely not be considered related to its mission.

### Charity Malls and Commercial Co-Ventures

When a customer purchases an item through a commercial Web site and the vendor makes a donation of a portion of the purchase price, this is often referred to as a commercial co-venture. Some Web sites, known as "charity malls," offer the customer a variety of charities from which to choose to designate the contribution of the purchase price. Whether the customer can claim a deduction for the contribution depends upon the arrangement with the Web site and participating

charities. In discussing the issue, the IRS refers to Rev. Rul. 85-184,<sup>5</sup> which held that customers who paid an additional amount on their utility bills for a charity, were entitled to a charitable deduction because the utility company was designated as the charity's agent to collect the contributions, on its behalf.

### Advertising Income vs. Qualified Sponsorship Payments

"Advertising" income generated by a charity's Web site would be subject to UBIT but a "qualified sponsorship payment" would not.

According to the regulations, "advertising" is any message or other programming material which promotes or markets any trade or business, or any service, facility or product. Advertising includes 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 any company, service, facility or product.<sup>6</sup>

Section 513(i) of the Code specifically exempts "qualified sponsorship payments" from UBIT. A "qualified sponsorship payment" is one whereby the sponsor receives no "substantial return benefit" other than the use or acknowledgment of the name or logo of the sponsor's trade or business in connection with the activities for which the payment is being received.

The regulations provide two examples that illustrate the difference. In one example, a symphony lists its sponsors on its Web site and provides a hyperlink to the sponsors' Web

sites. Since the posting of the name and hyperlink does not promote, endorse or otherwise advertise the sponsors' merchandise, the payment received from the sponsors is a qualified sponsorship payment and not subject to UBIT. In the other example, a health-based charity provides a hyperlink to a pharmaceutical company, which sponsored the charity's year-long initiative to educate the public about a particular medical condition. The pharmaceutical company manufactures a drug that is used in treating the medical condition. On the pharmaceutical company's website, there is statement indicating that the charity endorses the use of the drug and suggests that patients should ask their doctors for a prescription. The charity reviewed the endorsement before it was posted and gave permission for the endorsement to appear. The endorsement is advertising.<sup>7</sup>

### Intellectual Property

Tax-exempt organizations should monitor the Web to ensure that there is not any unauthorized use of the organization's name, logo or other intellectual property. Likewise, any use of intellectual property owned by individuals and other organizations that is on your organization's Web site must be authorized by the rightful owner.

If you would like to discuss the issues raised here or other issues regarding your organization's Web site, please contact an attorney in our exempt organizations practice, listed below. ■

1. IRC 6113. Notice 88-120 provides the requirements for complying with IRC 6113.
2. *The Charleston Principles: Guidelines on Charitable Solicitations Using the Internet*, approved by the NASCO Board as advisory guidelines on March 14, 2001.
3. See, 2000 IRS Exempt Organizations Continuing Professional Education Text.
4. Id.
5. Id.
6. Reg. § 1.513-4(c)(2)(v).
7. Reg. §1.513-4(f), Examples 11 and 12.

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