

PROFITABLE SOLUTIONS FOR NONPROFITS



Knowing whether income is sponsorship or advertising

Are your programs working
as well as you think?

Get up to speed on transparency,
governance and accountability

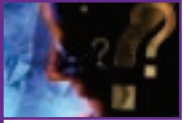
Newsbits

PLUS!

Joy to your not-for-profit

FALL 2006

Knowing whether income is sponsorship or advertising



Do you know if corporate sponsorships are taxable or what activities are considered advertising? Like many not-for-profits, your organization may supplement its usual income-producing activities with sponsorships or advertising programs.

Although your nonprofit is allowed to receive such payments, they are subject to unrelated business income tax (UBIT) unless the activities involved are substantially related to your organization's tax-exempt purpose or meet another specific exemption. So it's important to understand the possible tax implications of income from sponsorships and advertising.

What is sponsorship?

Qualified sponsorship payments are those made by a person — that is, a sponsor — engaged in a trade or business with no arrangement or expectation of receiving any substantial benefit from the nonprofit in return for the payment. Sponsorship dollars aren't taxed.



In recent years, the IRS has liberalized rules pertaining to sponsorships. It now allows exempt organizations to use information that is an established part of a sponsor's identity, such as:

- ✓ Logos,
- ✓ Slogans,
- ✓ Locations,
- ✓ Telephone numbers, and
- ✓ Internet addresses.

For example, an exempt health-related organization can recognize a hospital sponsor by displaying the hospital's logo and tag line, "Smart Medicine, Better Care," on signs and literature at a health fair. The hospital's payment would be considered a qualified sponsorship and, therefore, not subject to UBIT.

What are the exceptions?

Beyond the general description of qualified sponsorship payments above, some exceptions occur. The IRS doesn't consider these instances to be sponsorship if the payment amount:

- ✓ Is contingent upon the level of attendance at an event, broadcast ratings or other factors indicating the quantity of public exposure received, or
- ✓ Entitles the payor to the use or acknowledgment of the business name, logo or product lines in an organization's periodical, defined as a monthly journal or other regularly printed material. (It doesn't include material that is primarily distributed in connection with a specific event conducted by an organization, such as an event brochure.)

In addition, providing facilities, services or other privileges to a sponsor — such as complimentary tickets or admission to golf tournaments — doesn't automatically disallow a payment from being a qualified sponsorship payment. Generally, if the privileges provided aren't what the IRS considers a "substantial benefit" or if providing them is a related business activity, the payments won't be subject to UBIT.

But when services or privileges provided by an exempt organization to a sponsor are deemed to be substantial, part or all of the sponsorship payment may be taxable. The determination of what is "substantial" can be complicated, so it's best to ask your tax advisor about it.

What is advertising?

As the name suggests, advertising involves an exempt organization advertising a sponsor's products or services. Payment for this benefit is considered unrelated business income, so it's subject to tax. According to the IRS, advertising includes:

- ✓ Messages containing qualitative or comparative language, price information or other indications of savings or value,
- ✓ Endorsements, and
- ✓ Inducements to buy, sell or use products or services.

Key distinctions

Sponsorships:

- ✓ Allow the use of established product logos and trademarked phrases,
- ✓ May include Internet links to the sponsor's Web site, and
- ✓ Can entail product display or distribution.

Advertisements:

- ✓ Carry qualitative or comparative language, price information or other indications of savings or value,
- ✓ Offer endorsements, and
- ✓ Utilize inducements to buy, sell or use the products or services.

Source: IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*

Activities are often misclassified as advertising. As previously noted, using logos or slogans that are an established part of a sponsor's identity is not, by itself, advertising.

And when a nonprofit distributes or displays a sponsor's product at an event, whether for free or remuneration, it is considered use or acknowledgment, not advertising.

Let's look at an example. Suppose an exempt performing-arts organization accepts a sponsorship payment from a store that sells musical instruments and related items. The arts group notes on its Web site, next to information about upcoming performances, that the music store is a sponsor and posts a link to the store's Web site.

Because there was only the link between the two organizations — and no language exhorting patrons to buy the store's products — the payment from the music store to the arts nonprofit is considered sponsorship, not advertising.

How can you be sure you're within the rules?

As with most tax matters, the rules pertaining to qualified sponsorships, advertising and unrelated business income are complex and contain numerous exceptions and situation-specific determinations.

So you'll want to tread carefully and seek professional advice in sorting through the sometimes-blurry distinction between nontaxable sponsorships and taxable advertising. Your accountant can develop guidelines specific to your organization's activities in this complex area. ✦

Are your programs working as well as you think?



Every nonprofit must pay careful attention to how efficiently they're delivering their programs and the results the programs are achieving. But while certain standard measures are useful in gauging organizational efficiency, outcome measures can fill in the performance picture by helping nonprofits determine how well they're carrying out their mission and the impact their work is having.

Measure outcomes

An outcome describes a desirable change, benefit or impact that occurs as a result of an organization's programs or services. For instance, a nonprofit dedicated to fighting drug addiction might measure success not only by how many clients are served, which is considered an output measure, but by how many clients stay off drugs for one month, three months, a year and so on.

Such information enables nonprofits to identify areas where attention may be needed. Resources can then be reallocated or service approaches redesigned to achieve better outcomes.



Let's suppose a drug prevention agency has outcome measures showing that a high percentage of former clients relapse into drug use after six months. As a result, the organization might develop a new program to target clients for follow-up support before the six-month mark.

For examples of program measurement, visit BBB Wise Giving Alliance (www.give.org), Charity Navigator (www.charitynavigator.org) and Combined Federal Campaign (<http://www.opm.gov/cfc/>).

Follow general guidelines

Outcome measures are often unique to an organization or, at least, to types of nonprofits. For example, charities that provide food or shelter to the homeless could probably use some of the same measures. But all organizations can follow certain guidelines when developing and using outcome measures. They include:

Examining your mission and goals. Involve your board and key staff members in selecting a small number of meaningful measures that truly reflect your mission and goals. It may be enough to have just one outcome measure for each program or service offered.

Keep in mind that you want to move away from simply tracking *outputs*, such as the number of individuals counseled. Focus instead on creating measures that will illustrate how well your efforts are succeeding.

Deciding how and when to gather results. Determine when you'll collect data to measure outcomes. To track long-term results, data is often gathered immediately after services are provided, and then again some time later.

Try to elicit both quantitative and qualitative information to determine the outcome clients have experienced, as well as their satisfaction with programs and services. It may be necessary to interview multiple people to gain an overall understanding of an outcome.

Analyzing information in different ways. Once you've collected first-time data, you'll have a baseline to serve as a point of comparison. Your organization may also want to establish goals for each outcome measure. A job-training program, for example, might aim to place 80% of its clients in full-time jobs within three months of completing training.

By tracking results over time and comparing your outcome measures against different benchmarks, you'll be better able to detect troublesome patterns.

By tracking results over time and comparing your outcome measures against different benchmarks (such as program goals and baseline data), you'll be better able to detect troublesome patterns, which will allow you to intervene earlier and possibly reverse negative trends.

Incorporate standard measures

Because of the heightened interest in how not-for-profits spend their funds, certain metrics that gauge organizational efficiency have also become widely



used to analyze how well nonprofits administer their programs. Common measures include:

Percentage spent on program activities. Divide program service expenses by total functional expenses. (Functional expenses entail the costs of program services and supporting activities, which typically include management and general activities, fund raising, and membership development.) Many watchdog groups, such as the BBB Wise Giving Alliance, are satisfied with 65%, but 75% is required to participate in the Combined Federal Campaign.

Percentage spent on fund raising. Divide fund-raising expenses by total expenses. According to the BBB Wise Giving Alliance, the standard benchmark is no more than 35%, though many organizations aim for a lower percentage.

Fund-raising efficiency. Divide fund-raising expenses by total contributions received as a result. This tells you how much your not-for-profit spends to generate \$1 in contributions.

Current ratio. Divide current assets by current liabilities for an indicator of your organization's ability to pay its bills at any given time — the higher the ratio, the better its financial position. This ratio generally should be at least 1:1.

Be prepared

With not-for-profits being held to ever-higher operational standards, the need to measure program outcomes and overall operational efficiency will likely become more of an imperative, especially for organizations that rely on grants and public funding. More than ever, stakeholders want to know not only how nonprofits are spending their dollars, but what kind of bang they're getting for their buck. ✦

Get up to speed on transparency, governance and accountability



The Panel on the Nonprofit Sector, a group convened by the Independent Sector to explore the need for greater oversight of charitable organizations, has more to say on the subject. In April 2006, it issued a supplemental report to *Strengthening the Transparency, Governance and Accountability of Charitable Organizations: A Final Report to Congress and the Nonprofit Sector*, which was issued in June 2005.

The nonbinding recommendations contained in the two reports are intended as guidance for federal lawmakers, who continue to consider new regulations aimed at the not-for-profit sector. Let's look at the highlights of the supplement.

Areas to regulate

The supplemental report generally advises against additional regulation pertaining to these areas of concern:

- ✓ International grant-making,
- ✓ Charitable solicitation,
- ✓ Compensation of trustees of charitable trusts,
- ✓ The prudent investor standard,
- ✓ Nonprofit conversion transactions,
- ✓ Taxation on sales of donated property,
- ✓ Consumer credit counseling organizations,
- ✓ Disclosure of unrelated business activities, and
- ✓ Federal court equity powers and standing to sue.

There is, however, one exception: The Panel recommends that Congress authorize funding to create a national charitable solicitation registration system to be administered by the Federal Trade Commission. The registry would replace state-operated systems, but, as the report suggests, state regulators would continue as the primary regulators of solicitation activities and consult on the registry's design.

Nonprofits and regulators should also work together to update the Model Charitable Solicitations Act and encourage states to adopt it or similar legislation aimed at curbing solicitation abuses.

UBIT

The Panel also advises that the unrelated business income tax (UBIT) return, IRS Form 990-T, shouldn't be subject to the public disclosure required for some public forms.

Although this recommendation seems to run counter to the trend toward greater transparency, the panel says that requiring disclosure would "destroy the level playing field" created by the UBIT. Moreover, requiring a nonprofit or its for-profit affiliates or subsidiaries to disclose their Form 990-T is "contrary to the longstanding U.S. tax policy of preserving the confidentiality of taxpayers' returns."

According to the report, such disclosure would give for-profit competitors an unfair information advantage over exempt organizations and could cause negative ramifications, such as jeopardizing an exempt organization's ability to recruit joint venture partners who might object to disclosure of sensitive information, limiting investment opportunities or causing the market to undervalue taxable subsidiaries when put up for sale.

The Panel recommends, however, that the IRS amend Form 990 to increase the information it requires about unrelated business activities and mandate public charities to report to the IRS any situation in which an officer, director or trustee owns 10% or more of any entity in which the charity also has at least 10% ownership — for example, joint ventures that allow insider investment.



The Panel recommends that Congress authorize funding to create a national charitable solicitation registration system to be administered by the Federal Trade Commission.

Income from the sale of donated assets

Although Congress should strengthen requirements for substantiating the value of donated property as recommended in the Panel's final report, the supplemental report urges lawmakers not to enact legislation that would treat income from the sale of donated assets as taxable unrelated business income. Proposals to tax capital gains on sales of donated property conflict with current policy and would constitute a new and highly detrimental tax on exempt organizations, according to the Panel.

Tax law enforcement

Limiting tax law enforcement to actions brought by the federal government is necessary to protect charities from nuisance lawsuits and to prevent charitable assets from being wasted defending such suits. The panel notes that existing mechanisms for enforcing fiduciary requirements are sufficient and that expanding the Tax Court's jurisdiction would do little to improve compliance.

The Panel's ongoing efforts

In releasing its supplemental report, the Panel announced it will continue working in two areas: 1) self-regulation of the charitable sector, and 2) improvement of financial reports issued by public charities and private foundations.

The group will also help nonprofits strengthen governance practices by identifying sample policies pertaining to ethics, conflicts of interest, record retention, reporting of misconduct, executive and board compensation, and audit committees. To view the final and supplemental reports, go to www.nonprofitpanel.org. ✦

Joy to your not-for-profit

How to maximize donors' generosity around the holidays

People are naturally inclined to give around the holidays. With year end fast approaching, prepare now to take advantage of donors' generosity. Here are some tips for making the most of this season:

Strike early. Plan events or solicitations for early December or sooner. By being one of the first to appeal to givers' seasonal generosity, you increase the odds of securing an early commitment and avoiding the donor fatigue that may set in later as solicitations and holiday financial demands mount.

Target qualified prospects. Rather than blitz every prospect in your database, identify the best prospects among current donors. Why? Past donors are more likely to give again and in larger amounts than someone who has never donated before. Consider factors such as how often individuals have given in the past, how recently they've given, their likely ability to give and their degree of attachment to your organization. You can then craft meaningful, personal appeals that encourage a greater commitment.

Make it personal. Fund-raising experts say that the more personal a solicitation, the more effective it's likely to be — face-to-face appeals are especially powerful. The holiday season is the ideal time for executive directors and board members to solicit past supporters and promising new ones. Often, some of the best prospects are personal friends and colleagues of board members.

"Missionize" late-year events. Attendees are already inclined to give; it's just that most need to be inspired to give more. So don't allow an event to take place without making a brief but carefully crafted pitch (also known as "missionizing") for your nonprofit. Make your mission come alive through your remarks or a short video presentation. When telling the audience about the great work you're doing, mention how much more you could do with their help and talk about specific needs for cash, in-kind goods and services. People are more likely to give when they clearly understand the difference their gifts can make.

The holiday season is an opportune time to raise funds for your nonprofit. All you have to do is ask — but in the right way.



Newsbits

Survey says: Many executive directors plan to leave



Three-quarters of executive directors plan to leave their current jobs within five years and 9% are in the process of leaving, according to a study by CompassPoint Nonprofit Services and the Meyer Foundation.

Daring to Lead 2006, a comprehensive national survey of nearly 2,000 nonprofit executives in eight metropolitan areas, provides current data on executive turnover, burnout, compensation, career plans and retirement. Among the key findings:

✔ Small organizations with fewer than 10 employees are more likely than larger organizations to experience transition in the next five years.

✔ Approximately one-third of respondents were dissatisfied with their compensation.

✔ Only half of those surveyed said their organizations are actively developing a future executive director.

The report delves into these findings, identifying professional development needs for executive directors, and offering recommendations to help executives, boards and funders find future leaders. You can get a copy at www.compasspoint.org — type in “Daring to Lead” in the search field. ✧

Are you complying with election law?



With the 2006 campaign season in full swing, the IRS has released a fact sheet to help 501(c)(3) organizations comply with federal tax law at election time. The fact sheet, FS-2006-17, addresses political intervention activities that came under scrutiny during the 2004 election and reflects the IRS interpretation of Treasury regulations, tax laws enacted by Congress and court decisions. Keep in mind that you may need to comply with state election guidelines, which could be significantly different.

The IRS considers the fact sheet a “living” document that will be revised to take into account future developments and feedback. It’s part of an effort to increase the educational material available to the tax-exempt community. To obtain the fact sheet, go to the charities and nonprofits section of the IRS Web site, www.irs.gov, and click on the heading “Tax-Exempt Organizations and Political Campaign Intervention.” ✧

Proposed postal rate hike would affect charities



A proposed rate increase by the U.S. Postal Service would increase postage rates for charities by as much as 9% on average. If approved, May 2007 is the earliest the new rates would take effect.

Under the proposal, the cost of a first-class stamp would increase from 39 cents to 42 cents. Other proposed rate changes would cause increases in some mailing categories and reductions in others.

Organizations that rely on mass mailings may be able to reduce the effect of the proposed increase by taking advantage of postal discounts based on the weight and shape of mailings, according to the Postal Service. For example, you may be able to mix periodicals and standard letter-size mail to qualify for some bulk mailing discounts.

Nonprofit advocates are concerned the proposed rate increase would force charities to spend more time and money on mailings. But with postal rate increases likely to occur annually, many not-for-profits hope to increase donor comfort with online solicitation and giving. For more information on the changes, visit www.usps.com/ratecase/welcome.htm. ✧