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"Making Use of the Internet--Issues for Tax-Exempt Organizations":

ALICE M. ANDERSON & ROBERT A. WEXLER
Adler & Colvin

ALICE M. ANDERSON is an associate, and ROBERT A. WEXLER is a principal, in the San Francisco firm of Adler & Colvin.

The characteristics of the Internet combined with the specific rules governing exempt organizations give rise to unique issues not previously faced by commercial enterprises. Policies should be adopted and, through effective monitoring, enforced so that inadvertent linking to other sites or dissemination of protected information does not cause an entity's exempt status to be put at risk.

Like commercial entities, tax-exempt organizations (EOs) are positioning themselves to maximize the benefits of the Internet's rapid evolutionary effect on economics, politics, and society. Nevertheless, in the rush to optimize an organization's use of the Internet's instantaneous information access and distribution, many tax issues can be overlooked, including the following:

- Taxation of unrelated business activities from an organization's own website or from participation in other Internet activities.
- Proper substantiation of charitable contributions.
- Jurisdictional issues-compliance with state statutes.
- Using the Internet to lobby.
- Using the Internet to satisfy an EO's public disclosure requirements.

UBIT ISSUES

Most organizations that are exempt under Section 501(c) nonetheless pay an unrelated business income tax (UBIT) on their net income from any activity that is regularly carried on for the purpose of producing income, and which is not substantially related to the

performance of their exempt functions.[1] Where an organization engages in several related activities, one or more of which generate unrelated business income (UBI), the IRS will apply the "fragmentation rule" in order to separately impose UBIT on the applicable income-generating activities.

Although the Service has stated that its existing UBIT rules will apply to activities involving the new technology, the current Regulations do not always fit neatly in the context of the Internet. In its year 2000 work plan, the IRS has indicated that some level of formal guidance is forthcoming. To date, however, most of the practical guidance has come from the continuing professional education (CPE) text[2] that the Service publishes for its field agents (and makes available to the public) or from informal, albeit thoughtful, comments presented by IRS officials at EO tax conferences.

- Internet activities of EOs giving rise to UBIT questions may include the following:
- Hosting advertising or sponsorship statements on an EO's own website, including links to sponsors' and advertisers' websites.
- Various merchandising transactions.
- Transactions involving mailing lists.
- Endorsement of companies' products or services.
- For trade associations, the operation of virtual trade shows.

Advertising and Sponsorship Statements

Although it does not specifically mention the Internet, websites, or computer technology, Section 513(i) provides a framework for distinguishing between advertising and corporate sponsorship transactions. The IRS recently issued a set of Proposed Regulations that further interpret Section 513(i).[3] These proposals generally define advertising as programming material that is "broadcast or otherwise transmitted, published, displayed or distributed, and which promotes or markets any trade or business, or any service, facility or product."[4] Promotional communications will be considered to be corporate sponsorship, however, rather than advertising where no "substantial return benefit"[5] is received by the payer.

Income that is considered to be from corporate sponsorships is not UBI, whereas income from advertising is UBI. Currently, the corporate sponsorship rules specifically exclude income from convention and trade show activities and from advertising in periodicals, and

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[1] Sections 511(a)(1), 512; Reg. 1.513-1(a).

[2] Internal Revenue Service, *Fiscal 2000 CPE Text for Exempt Organizations*.

[3] REG-209601-92, 2/29/00. The IRS had issued corporate sponsorship Proposed Regulations before Congress enacted Section 513(i) as part of TRA '97. The recently released guidance replaces the old Proposed Regulations. An Article discussing the new guidance in more detail will be published in an upcoming issue of THE JOURNAL

[4] Prop. Reg. 1.513-4(c)(2)(iv).

[5] Prop. Reg. 1.513-4(c)(2)(i).

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there is separate IRS guidance and some case law on how to treat advertising income from journals and periodicals that are published by EOs.

Corporate presence can take several forms on a nonprofit's website. Among these forms are banner advertisements, sponsorship statements, and hypertext "hot" or "clickthrough" links. Like their print counterparts, these forms likely will receive different tax treatment.

Banner advertisements. Many websites have prominent rectangular banners that typically are located at the top of the website. Usually banners move or contain changing text or graphics, but sometimes they are static. In addition to the attention engendered by movement, moving banners generally contain links to the website of the advertiser. Usually, banners will contain actual advertisements, as opposed to mere acknowledgments or sponsor logos. Consistent with the treatment of hard-copy advertising, income from banner advertisements that, like other advertisements, include (1) comparative or qualitative language, (2) price, savings or value information, (3) an endorsement, or (4) an inducement almost certainly will be deemed to be UBI.[6] It is hoped that the anticipated IRS guidance will focus primarily on the content of the banner, rather the fact that it moves or contains links, to determine whether UBIT applies.

Corporate sponsorships. In contrast, corporate sponsorships in any form that include no substantial benefits other than the use or acknowledgment of the sponsor's name, logo, or product lines, will be excluded from UBI under Section 513(i).[7] Typically, acknowledgments of corporate sponsors appear either in a separate section of a charity's website or are sprinkled throughout the more substantive pages, although they also may appear on a banner. They may include a simple statement thanking the sponsor and showing the sponsor's name or logo, or they may contain more information about the sponsor.

In some cases, however, a sponsor's payment to the EO may be based on the number of times web viewers visit the website. Because payments that are contingent on audience exposure levels *are* subject to UBIT under Section 513(i)(2)(B)(i), corporate sponsorship agreements that track visitor "hits" and base the sponsor's payment on the extent thereof would likely be deemed to generate UBI.

The new Section 513(i) Proposed Regulations identify sponsorship communications and other benefits that will be deemed not to be substantial return benefits' and therefore not advertising. If finalized in its current form (and assuming that these rules apply to websites), Prop. Reg. 1.513-4(c)(2)(iii) would permit the following as corporate sponsorship acknowledgments:

1. Logos and slogans not containing qualitative or comparative descriptions.

[6] Section 513(i)(2)(A).

[7] The corporate sponsorship exclusion does not apply to periodicals, or to "qualified" convention and trade show activities, as defined in the Code.

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2. Payer locations, telephone numbers, and address information, including Internet addresses.

3. Value-neutral descriptions, which may include displays or visual depictions, of product lines or services.

4. Brand and trade names and product or service listings.

With respect to Internet usage, activities that may be sponsored also would include activities of extended or indefinite duration, continuing support, and a series of related events. Exclusive sponsorship agreements also would be approved. In a break with present practice, however, an exclusive *provider* arrangement would result in a "substantial return benefit" to the payor. Finally, if a sponsor's payment includes both advertising and sponsorship, the advertising portion of the payment would be treated as a separate payment.

The Preamble to REG-209601-92, 2/29/00, specifically requests comments on the application of the existing Section 513(i)(2)(B)(ii) rules governing periodicals and trade shows to Internet activities, and regarding whether provision of a link to a sponsor's website should be deemed to be advertising. It also states that the Proposed Regulations do not "specifically address" Internet activities and that existing tax laws-including the UBIT rules-are being reviewed with respect to Internet activities. At present, however, neither Section 513(i) nor the Proposed Regulations provide guidance on how to apply the corporate sponsorship rules, or how the periodical advertising rules would apply, to sponsorships or advertising on the Internet. Until the IRS publishes more formal guidance, we can only make logical assumptions in an attempt to apply existing law on these issues in the context of the Internet.

Links. The treatment of links is still evolving. Links may be automatically created by browser software used to navigate the Internet or by some word processing software, and allow a viewer to jump from the nonprofit's website directly to another web page such as that of a sponsoring corporation.

The presence of a link to a corporate sponsor on a nonprofit's website has been analogized to listing a telephone number,[8] which is permitted under the corporate sponsorship rules. One private ruling, however, indicated that a link may convert a sponsor's message into an advertisement.[9] Nevertheless, the IRS in its CPE text stated that a link that was related to the EO's purposes or activities may not be advertising, and one IRS official has indicated that unless a link generates income it probably would not be deemed to constitute advertising.[10] Finally, yet another IRS official has since stated a refined view, indicating the agency may differentiate between a link that takes the user directly to the main page of the sponsor and a link that takes the user to the sponsor's e-

[8] See "D.C. Bar Internet Discussion Featured IRS's Bob Harper," 5 EO Tax J. 36 (December 1999/January 2000).
[9] Ltr. Rul. 9723046
[10] Jay Rotz, Executive Assistant-Technical, IRS Exempt Organizations Division, 4 EO Tax J. 26 (July/August 1999).

commerce page, which services transactions. [11]Absent clearer IRS guidance, structuring links on a website in a manner that avoids UBI and attribution issues presents the most difficult task for EOs.

In addition to UBIT concerns, links should be closely monitored for more detrimental implications. As discussed below, an improperly structured connection to the wrong type of political website may possibly result in the revocation of the organization's tax exemption. Finally, as a general rule EOs should avoid establishing links to other sites unless and until permission is obtained from the destination site, and should adopt policies reflecting the concerns discussed below, regarding links by other organizations to their own site.

Applicability of periodical advertising rules to on-line periodicals. The exemption from UBIT for qualified sponsorship payments under Section 513(i) will not apply to acknowledgments or advertising that appear in on-line periodicals, just as the corporate sponsorship rules cannot be used to analyze whether income from advertising or acknowledgments in periodicals constitutes UBIT.[12] Instead, the IRS and the courts have developed a different set of criteria to evaluate the taxability of income from periodicals.[13] As a consequence, it is usually more difficult for an EO to claim that income from periodical advertising is exempt from UBIT.

At the same time, where an EO does have taxable income from journal advertising, Reg. 1.512(a)-1(f) provides a favorable method for allocating expenses against advertising income. It is not clear whether these rules would apply to on-line periodicals.

One IRS official has indicated that the agency is skeptical that the special periodical treatment of income and expense under Reg. 1.512(a)-1(f) would apply to on-line publications, stating that "editions" of on-line publications are generally not true replications of printed publications and that on-line publication economics differ completely from that of print periodicals.[14] Further, the CPE text states that IRS will not allow the application of the periodical advertising rules to on-line periodicals unless the organization sufficiently segregates periodical materials so that their production and distribution methods are clearly ascertainable and their income and costs independently determinable, and the EO "can clearly establish that the on-line materials are prepared and distributed in substantially the same manner as a traditional periodical." The CPE text also stated that the Service would require that the editorial staff, marketing program, and budget of such periodicals be independent of the organization's webmaster.

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[11] See note 8, *supra*. Mr. Harper also cleared up a long-standing question regarding an earlier IRS statement that "moving" banners likely would be considered advertising, noting that "[m]ost moving banners are hot links."

[12] "Periodicals" are "regularly scheduled and printed material published by or on behalf of the payee organization that [are] not related to and primarily distributed in connection with a specific event conducted by the payee organization." Section 513(i)(2)(B)(ii)(I).

[13] See, e.g., American College of Physicians, 475 U.S. 834, 57 AFTR2d 86-1182 (1986).

[14] See note 8, *supra*.

The Preamble to the Proposed Regulations requests comments on application to the Internet of the rules governing the treatment of periodical and trade show income under Section 513(i)(2)(B)(ii).

Merchandising

Merchandising refers to the participation by EOs, at some level, in the income from the sale of actual merchandise.

Individual merchant affiliation. Certain retailers (such as Amazon.com) offer percentage referral fees to participating EOs that send purchasers (usually through links) from their website to that of the retailer. The purchaser in such a transaction is probably not able to claim a Section 170(c)(2) deduction, as he or she in theory is purchasing an item and receiving full value. Further, at least one IRS official has expressed reservations as to whether the intervening merchant would have any right to a charitable deduction for the percentage paid to the EO.[15] Thus, there may be no donor deductibility available from such an arrangement.

The next question is, of course, how the IRS would characterize the revenue that the EO receives from the merchant. In most cases, EOs would seek to structure the relationship so as to characterize the receipts as royalty income, which is exempt from UBI. In its CPE text, the IRS has indicated that such revenue usually may be viewed as royalty income.

If, however, these fees to the EO are properly characterized as compensation for a referral service, rather than as a royalty, whether UBIT will be imposed likely would depend on the relationship between the referral and the exempt purposes of the organization. For example, if an environmental EO recommends a particular text for program-related reasons, such as a book on the environment, the referral is arguably related to its exempt purposes and should not be subject to UBIT. If the referral is a straight percentage for any merchandise purchased by the customer, however, the exempt-purposes argument would not prevail under this analysis.

On-line "charity malls." In an arrangement similar to affinity credit cards,[16] many commercial websites that act as intermediaries between on-line buyers, retailers, and EOs provide on-line purchasers with the option to donate a percentage of their purchase price back to charity. As long as the on-line purchasers initiate the contribution and the EO is not involved in sales that are unrelated to its exempt purposes, these monies should be treated by the charity as donations rather than UBI.

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[15] *Id.*

[16] For more on this topic, see Jones, "Drafting Affinity Card Agreements After the Ninth Circuit Exempts the Income as Royalties," 91 JTAX 306 (November 1999).

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The charity mall arrangement requires that EOs remain vigilant. Many charity mall sites are operated by for-profit entities that retain a percentage of each donation, and certain sites have reportedly used charity names without permission. Charities should vigorously object to any unauthorized use of their names, logos, and other indicia of identification in order to preserve their credibility, reduce the risk of appearing to engage in UBI sales activity, and preserve their rights in their intellectual property.

Another issue is the deductibility of the donation for the donor. The Service's CPE text has noted that many such sites (apparently to avoid state and local registration requirements) claim that they are not actually engaged in soliciting donations, although it is unclear that such a disclaimer would have any legal effect. More to the point, the CPE text has stated that whether the purported donor in such an arrangement may claim a deduction will in large part depend on the terms of the agreement between the retailer and the mall operator, citing two analogous rulings in which the IRS found that the collecting party exercised no dominion and control over the donated funds. Rev. Rul. 85-184, 1985-2 CB 84, found that donations were deductible when made by utility customers to a charity through their utility company, where an agreement designated the utility as the charity's agent to collect contributions, the donated funds were segregated at all times from the utility's funds and were transferred to the charity on a weekly basis, and no donated funds were used for administration expenses.[17] Nevertheless, where there is no agreement between the mall operator and the charitable beneficiary, which reportedly is often the case, it is unclear whether the contribution will be deductible at all. The CPE text adds that the EO may not be entitled to any record of the transaction, which at the least could lead to donor relations issues if contributions are represented as being deductible.

Substantiation is another question, although for donations of less than $250-which may constitute the majority of Internet charity mall contributions-no acknowledgment will be needed. For donations in excess of $250, some charity malls are sending an immediate e-mail acknowledgment of the gift. Such an e-mail, however, will be invalid as substantiation for the donor where the charity mall is not the authorized agent of the charity. Technically, such an e-mail also would not constitute the required "written" acknowledgment of the donation. Although at least one official has suggested that adding a unique identifier such as a serial number might render an e-mail receipt sufficient,[18] the IRS in the CPE text has indicated continuing uncertainty whether an e-mail transmission alone would qualify to substantiate a contribution of $250 or more.

There are additional concerns with charity mall arrangements. Credit card factoring (which violates the merchant's agreement with the credit card company and has been criminalized in at least one state) and state fundraising registration issues appear to be prevalent for such sites.

Virtual storefronts. As indicated by its CPE text, the Service's approach to traditional sales activity of EOs, such as museum gift shops, also will apply to the sale of merchandise

[17] See also Ltr. Rul. 9335022 (funds transferred weekly to charitable agency found deductible as not within utility's dominion and control).
[18] See note 8, *supra*.

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from a website address that presents itself as an Internet store, or "virtual storefront." Generally, the IRS will look to the primary purpose of such sales, reviewing the nature, scope, and motivation for the sales activities in question. Under the fragmentation rule of Section 513(c), each item of merchandise would be evaluated separately as to whether its sale merely generates revenue or instead furthers the organization's exempt purposes.

On-line auction activities. Typically, charities that conduct annual fundraising auctions do not pay UBIT on the amounts that donors pay for items. This is in part because the auctions are not "regularly carried on," one of the requirements for UBIT, and also because in many cases the goods that are being auctioned are all donated, one of the exceptions to UBIT.

Charities that conduct their own on-line auctions may avoid UBIT if they are able to follow the usual charity-auction fact pattern wherein the auction activities are not regularly carried on or the merchandise is donated, or both. In the Internet context, however, auctions are more likely to involve purchased goods, in addition to donated goods, and on-line auctions are more likely to be carried on regularly, or even continuously, rather than just once a year at the annual fundraiser. If charities want to avoid UBIT from on-line auctions, they need to take special care to structure the auctions correctly.

Another potential difficulty arises where an EO relies on an outside provider for Internet auction services and the outside provider does not sufficiently segregate its charitable from its noncharitable auction activities. The IRS has indicated in the CPE text that auction revenues may be viewed as resulting from classified advertising rather than from fundraising because no "fund-raising event" is involved. In determining whether UBIT applies, the IRS will review the charity's arrangement with the service provider for indicia of continuing control by the charity over the marketing and auction activities. Such indicia will likely include:

1. Whether the event is segregated from noncharitable auction activities.

2. Whether the EO retains primary responsibility for publicity and marketing.

3. The nature of the relationship between the charity and the service provider, and particularly facts that indicate inurement and private benefit, viewing the service provider as a professional fundraiser.

One commentator has noted that these issues are avoided by some auction sites that have the donor, rather than the charity, conduct the auction, and that contributions received by the charity should not then be subject to UBIT.[19]

Finally, the quid pro quo disclosure requirements (discussed in more detail below) often arise in the charity auction context.

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[19] Nooney, "Tax-Exempt Organizations and the Internet," 27 Exempt Org' n Tax Rev. 33 (January 2000).

Mailing List and Membership Issues

In the UBIT context, mailing list and membership issues include privacy and security concerns, exchanges of links or banners, and the consequences of "associate" membership.

Privacy and security issues. Two practices in particular bring the issues of privacy and security to the forefront for EOs. The first, accepting credit card contributions over the Internet, requires that the organization use a secure server in order to protect its donors' financial information and to protect itself from liability that otherwise may arise.

The second, known as "data mining," is the classification, storing, and often the marketing of information regarding donors, whether done by a charity directly or by fundraising contractors. This common practice may be affected very shortly by the growing public concern regarding the ready availability of digitized information about individuals. In response to this concern, legislators and regulators in the past few months have introduced various measures protecting the privacy of consumer information, which would include donor information.[20]

Although donor information is not currently protected by federal law, the Federal Trade Commission recommends that EOs gathering donor information through the Internet develop and post such policies on their websites. In particular, the FTC provides four standards, known as "fair information practices", which would require:

1. Notification regarding which information is being gathered, how it is used, and what third parties it will be shared with.

2. An option for the donor to choose that his or her information not be shared with third parties.

3. Information about the security method safeguarding the information.

4. Access for the donor to review and correct information.

The enactment of consumer privacy legislation is likely to affect common collection and marketing practices regarding donor information. Accordingly, EOs should ensure that they stay informed of any further developments in this area.

Link/banner exchanges. EOs appear to be exchanging link authorizations frequently, as well as the right to place banners on each other's sites. The IRS in its CPE text has stated

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[20] See Hall, "Donors Raise a Red Flag Over Privacy," Chronicle of Philanthropy, http://philanthropy.com/free/articles/v12/i11/11000101.htm.

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that it is unclear as yet whether link or banner exchanges will be more likely to be treated as similar to a mailing list exchange (which is not taxable), or instead will be considered to generate UBIT. In analyzing such exchanges, the Service will look to whether the exchange furthers the organization's exempt purposes and activities.

Creation of associate members for password purposes. Under Rev. Proc. 95-21, 1995-1 CB 686,[21] and subsequent case law,[22] the IRS will treat dues from associate members of an EO as UBIT if the principal purpose for creating the associate membership was to raise revenue. Many EOs, however, may create nonvoting memberships in order to restrict portions of their website (such as political content) to password access only. Accordingly, care should be taken in board resolutions and other corporate documents to clearly reflect this intent, as opposed to a primary intent to raise revenue, as being the principal purpose of such actions. In TAM 9742001, facts that were found to support this primary intent included the active participation of "allied members" in the EO's activities and governance, and that their dues did not exceed (and often were less than) the dues of regular members.

Endorsements

Endorsements by EOs must be carefully reviewed both for their potential for affecting the organization's credibility, and for the possibility that they may result in the revocation of exempt status due to a determination that the organization was being operated for private benefit. Generally, cases resulting in such revocation have been based on an exclusive relationship between the EO and the business or other private entity.[23]

Another concern regarding endorsements is their potential for UBIT. If the agreement can be structured so that the EO is compensated for the use of intellectual property, rather than for an endorsement by the organization or key personnel, the payment will be exempt as a royalty. If the payment is for an endorsement but the endorsement itself furthers the organization's exempt purposes, it should not be subject to UBIT. At least one IRS official has indicated that endorsement income probably would be considered royalty income.[24]

Virtual Trade Show Income

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[21] Modified by Rev. Proc. 97-12, 1997-1 CB 631, to exclude agricultural and horticultural organizations.

[22] National League of Postmasters of the U.S., 86 F.3d 59, 77 AFTR2d 96-2558 (CA-4, 1996), aff'g TCM 1995-205.

[23] See, e.g., American Campaign Academy, 92 TC 1053 (1989) (campaign school using Republican materials and primarily Republican materials and primarily Republican teachers, and placing majority of graduates in Republican campaigns, found to operate for the benefit of the Republican party); P.L.L. Scholarship Fund, 82 TC 196 (1984) (scholarship fund was operated for benefit of lounge that created, sponsored, and funded it through bingo games.)

[24] See note 8, *supra*.

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Income from certain traditional convention and trade show activities, such as display space rental, conducted by a Section 501(c)(3), (4), (5), or (6) organization will not be subject to UBIT under Section 513(d) and Reg. 1.513-3(b), if the organization as one of its substantial exempt purposes regularly conducts such an activity. Whether the rental of nontraditional, Internet display space at "virtual trade shows" similarly would avoid UBIT is not resolved.

One IRS official has indicated that since the Code's trade show definition requires a "traditionally-conducted type of show," the Service may consider that the trade-show analysis would not apply at all unless the virtual trade show were held in conjunction with a traditional, physical trade show.[25] If a virtual trade show does pass the threshold definition test, the Service's CPE text indicates that IRS would strongly consider whether the displays in question are substantially similar to those at traditional trade shows, and would likewise consider all surrounding facts and circumstances, including the character of the exhibits.

The CPE text further indicates that because a traditional "trade show" is a finite event, exclusion from UBIT for a year-round virtual trade show would not be likely. Finally, the CPE text noted that the corporate sponsorship safe harbor under Section 513(i) would not apply to convention or trade show corporate sponsorship payments, which therefore would be subject to UBIT.

CHARITABLE CONTRIBUTIONS

In order to claim a charitable deduction, donors generally must be able to document the amount of their donation and the recipient organization's charitable status. For donations of $250 or more, the donor must have contemporaneous written documentation from the charity. Where the donor receives goods or services in exchange for a donation, the written acknowledgment must set forth a good faith estimate of their value.[26] In addition, for such a "quid pro quo contribution" in excess of $75, the organization must include a written disclosure that the donor's contribution is limited to the excess of the donation over the value of the provided goods or services. Finally, donations that exceed $5,000 in value and are neither money nor readily marketed securities must be documented by a qualified written appraisal.

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[25] Id.

[26] See IRS Publication 1771, discussing the substantiation requirements created by RRA '93. See also Gorrin and Honigfeld, "New Substantiation and Disclosure Rules Increase Burden on Charities and Donors," 81 JTAX 310 (November 1994).

As noted above, EOs or their agents have in some instances tended to respond to donations received over the Internet with e-mail acknowledgments. Such acknowledgments, however, technically do not yet comply with Section 170(f)(8) and the applicable Regulations, which require that the acknowledgment be in writing. The suggestion of one IRS official-that serial numbers on the acknowledgments may help prove that the e-mail was sent and thus satisfy the requirements of Section 170(f)(8) remains only a suggestion, as discussed above.[27] Until the IRS indicates its approval, donors who cannot provide hard-copy acknowledgments may lose the deduction, resulting in donor-relations problems for the charities.

JURISDICTIONAL ISSUES

The Internet inherently challenges concepts of jurisdiction by transmission of interactive communications to unlimited and unknown users, across every border and boundary. Several jurisdictional questions arise, including: Under what circumstances can states tax commerce conducted over the Internet? Must EOs register as "doing business" or as fundraisers in every state due to the fact that their websites are available to users in every state? Less tax-relevant but also of interest, under what circumstances can an EO be haled into court based on its website activities?

These questions are not yet resolved, but the Internet Tax Freedom Act imposed a moratorium through 10/21/01 on state taxes that discriminate against electronic commerce or are imposed on Internet access.[28] In the interim, a project by a private organization, the National Tax Association, is reportedly attempting to structure national standards for exemption, and potentially a unified system for state taxation of electronic commerce. At present, some states require tax registration or the filing of tax returns, regardless of whether state tax is owed. Thus, EOs using the Internet to market goods or services should continue to be sure that they are informed of any significant developments in this area.

State registration requirements are an area of concern: according to the CPE text, it has been estimated that the costs to a charity of compliance with all state and local solicitation laws could easily exceed $100,000 a year. A number of states require that organizations register with state authorities before engaging in activities in that state that are defined as "doing business" under its laws. These requirements, as well as state registration requirements for charities and commercial fundraisers, are particularly easy to overlook. Fundraisers and EOs with a website often include donation information on their sites without necessarily considering whether they are "soliciting" under the laws of their own or other states. A potential issue raised by one IRS official is that noncompliance with a state charitable solicitation statute, such as failing to register, may adversely affect an organization's tax-exempt status due to a violation of public policy.[29] Like state taxation, whether state registration laws will be held to apply to organizations conducting Internet

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[27] See note 8, *supra*.

[28] See Hellerstein, "Internet Tax Freedom Act Limits States' Power to Tax Internet Access and Electronic Commerce," 90 JTAX 5 (January 1999).

[29] See note 8, *supra*.

operations in other jurisdictions is a developing area to which EOs with multistate activities should stay attuned.

Finally, federal and state courts are addressing the thorny area of personal jurisdiction by state courts, based on "minimum contacts" over the Internet. Not surprisingly, the developing standards show some disparity. A trend, however, may be emerging: the level of interactivity between consumers and sellers may determine personal jurisdiction by a state, except where the act of publication alone infringes on trademark or other rights. Under this analysis, commerce-and fundraising-conducted entirely over the Internet almost certainly would create jurisdiction over the seller or charity by the consumer's or donor's state. A passive website that merely provides advertising or solicitation and no actual exchange of information probably would not create personal jurisdiction. Whether jurisdiction would be found for a site that provides only some interactivity likely would depend on the level of activity and the exact nature of the exchange of information.[30] Alternatively, the Ninth Circuit has required that the defendant "purposefully avail" himself of the privilege of doing business in the state, such as deliberately directing efforts toward state residents, that the claim arise out of the defendant's state-related activities, and that the exercise of jurisdiction by the state be reasonable.[31]

LOBBYING AND ELECTIONEERING

Federal and state restrictions on lobbying and electioneering by EOs are extensive and complex, and generally beyond the scope of this article.[32] Nevertheless, a few tax-related observations on Internet political activities may be useful.

Generally, it is best if entities organized under different sections of the Code maintain different websites, as this may be one of the least-expensive indicia of operational separation between the entities. As many practitioners are aware, lobbying constraints for Section 501(c)(3) organizations are different from those of other EOs. Certain EOs not organized under Section 501(c)(3) can engage in legislative lobbying activities without expenditure limitations, as long as these activities are not inconsistent with their exemption requirements. For example, a Section 501(c)(4) organization may engage in unlimited legislative lobbying as long as such activity is consistent with its exempt purposes. Likewise, an organization formed under Section 527 will be tax exempt only for its expenditures that constitute intervention in candidate election campaigns.

A Section 501(c)(3) organization, on the other hand, will be limited to no more than "insubstantial" legislative lobbying as compared to its other activities, unless it makes the election to be measured under the dollar standards of Section 501(h). Under that section, an electing organization with annual exempt purpose expenditures of up to $500,000 may make lobbying expenditures of up to 20% ($100,000), and within that amount may make

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[30] Mink v. AAAA Development LLC, 190 F.3d 333 (CA-5, 1999); Mid City Bowling Lanes & Sports Palace, Inc. v. Ivercrest, Inc., 35 F.Supp.2d 507 (DC La., 1999); Zippo Mfg. Co. v. Zippo Dot Com, Inc., 952 F.Supp. 1119 (DC Pa., 1997).

[31] Panavision Int'l, L.P. v. Toeppen, 141 F.3d 1316 (CA-9, 1998).

[32] See generally Kingsley, Harmon, Pomeranz, and Guinane, *E-Advocacy for Nonprofits: The Law of Lobbying and Election-Related Activity on the Net* (The Alliance for Justice, 2000).

Adler & Colvin
235 Montgomery Street, Suite 1220
San Francisco, CA 94104
Telephone: (415) 421-7555
Fax: (415) 421-0712
www.adlercolvin.com

grass roots lobbying expenditures of 5% of its total annual budget ($25,000).[33] With the advent of the Internet, the Section 501(h) election appears even more desirable than ever for smaller Section 501(c)(3) organizations, as it measures activity strictly by dollar expenditures and the Internet has made possible an extraordinary level of dissemination at an often phenomenally low distribution cost. For organizations whose volunteers perform lobbying work that may be considered "substantial" either in quantity or content, making the Section 501(h) election also ensures that such work will not be considered as a possible basis for revoking their exempt status.[34]

Whether the Section 501(h) election is made or not, Section 501(c)(3) organizations must track their lobbying expenses. Because of its ease of use, the Internet requires a higher level of vigilance on the part of Section 501(c)(3) entities to ensure that their lobbying expenditure limits are not exceeded. For example, for a webpage that contains a view on legislation, including a link to a voting legislator's e-mail, will be considered a "call to action" that may convert content that otherwise would not be lobbying into lobbying. An organization that is already near its Section 501(h) expenditure ceiling on grass roots lobbying must bear in mind that if Internet grass roots lobbying content is created and posted by an employee or an independent contractor, that staff time must be included in its grass roots lobbying expenditures. In particular, EOs sharing staff and resources with affiliates must ensure that such costs are correctly allocated and reported. Similarly, an EO that has not made the Section 501(h) election will need to take care that its Internet, as well as its non-Internet, lobbying activities do not appear "substantial" in proportion to its non-lobbying activities.

With respect to electioneering in particular, EOs should ensure that they are aware of the many federal and state constraints on their activities under tax and election laws. Among the most basic points to consider are the following:

1. A candidate is any individual who volunteers or is proposed by others as a candidate for an elective public office, whether national, state, or local.

2. Any activity whatsoever that constitutes intervention in a political candidate campaign is sufficient for a Section 501(c)(3) organization's tax-exempt status to be revoked, in addition to the imposition of tax liability under Section 4955.

3. Private foundations cannot make grants that have been earmarked, by an oral or written agreement regarding the specific use of the grant, for development of a website that

[33] "Grass roots" lobbying is a communication by the organization urging the public, or a segment of the public, to communicate a position on a specific legislative proposal to a government official (or his or her staff). In "direct" lobbying, a representative of the organization, rather than the public, communicates the position directly to the official or staff. Sections 4911(c) and (d).

[34] Some Section 501(c)(3) organizations whose annual budgets exceed $500,000 and who do not use volunteers extensively for lobbying work may prefer not to make the Section 501(h) election. For those organizations, Section 501(h) lowers the allowable lobbying percentages, resulting in grass roots lobbying ceilings of less than 5%. If a larger Section 501(c)(3) entity with an emphasis on grass roots lobbying chooses not make the Section 501(h) election, the applicable "insubstantial" standard is viewed by many practitioners as allowing lobbying expenditures of up to 5% of the budget, which-unlike the Section 501(h) standard-may consist entirely of grass roots lobbying.

includes political or lobbying materials, or for development of those materials[35] the foundation's tax exemption will be subject to revocation and it will also owe a 10% excise tax on the amount of the grant.

4. Publication of legislators' voting records and voter guides require care, as special constraints apply.[36]

5. Material regarding issues that are closely identified with individual candidates or heavily publicized as to a particular election should be viewed as electioneering materials, as the IRS may deem them to be such.

Cyberlink vigilance is also key to compliance, as evidenced by the restoration of one organization's revoked tax-exempt status after it took steps that included removing a link to a partisan site.[37] All EOs should regularly check their sites for links that may have been added inadvertently or without authorization, and should establish a policy with standards for screening proposed links in order to:

1. Ensure that they further the organization's exempt purposes and comply with its requirements for exemption (for instance, avoiding the appearance of selectively endorsing candidates or individual businesses).

2. Consider the other organization's Section 501(c) status and the potential for attribution of the other's lobbying, electioneering or UBIT activities.

3. Ascertain any other potential issues regarding the other organization's Internet use.

4. Consider other legal concerns.

Links can be particularly dangerous to the tax-exempt status of Section 501(c)(3) organizations if they include biased or partisan content regarding the election of individuals to public office, as Section 501(c)(3) organizations are absolutely prohibited from engaging in activity that constitutes intervention in election campaigns. Thus, Section 501(c)(3) organizations may link only to either the sites of all candidates' campaigns in an election, or to none of them.[38] If links to all candidate sites are made, the context in which the links are found also must be unbiased.

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[35] Regs. 53.4945-3(a)(1) and -2(a)(5).

[36] Voting records may be published regularly to members of the organization if the manner and volume of distribution is not varied for elections. Publication to the general public or beginning in an election year requires caution, however, and should be overseen by knowledgeable counsel. To ensure compliance in publishing voter guides, charities must solicit a brief statement from each candidate for a given office on a wide range of issues chosen solely for their importance and interest to the electorate as a whole. No evidence of bias or preference regarding the views of any candidate is permissible, and all responses must be published. Rev. Rul. 78-248, 1978-1 CB 154; Rev. Rul. 80-282, 1980-2 CB 178.

[37] See "IRS Restores Exempt Status to Freedom Alliance," 1999 TNT 220-20 (11/16/99).

[38] Advisory Opn. 1999-25, 1999 TNT 218-53, a Federal Election Commission ruling that a website not favoring one candidate or party but including links to candidates' web pages, candidate profiles and opinions, candidate participation in e-mail debate, ballot initiative information, political news, and newspaper endorsements would not result in a candidate election "contribution or expenditure". Although a former IRS

Section 501(c)(4) organizations also should scrutinize their links to candidate sites. Generally, such organizations whose websites show a bias or preference for a candidate and provide a link to that candidate's site may be found to have engaged in prohibited express advocacy of, or an in-kind contribution to, that candidate under federal or state election laws. Section 501(c)(4) entities also are subject to quantitative limitations on election activity, as their primary activities cannot consist of participation or intervention in political campaigns.[39]

Affiliated organizations must be especially careful. Because Section 527 political action committees are often set up in tandem with or by Section 501(c)(4) organizations, care must be taken to avoid the attribution of the Section 527 entity's website content to the Section 501(c)(4) organization. Even more care must be taken if, as is sometimes the case, the Section 501(c)(4) organization with which the Section 527 organization is affiliated, is in turn affiliated with a Section 501(c)(3). In the absence of definitive authority from the IRS on the permissibility of linkage, organizations should at the least establish a "two-click minimum" policy: that is, material intended to be distanced, such as a Section 501(c)(4) entity's electioneering material being separated from a Section 501(c)(3) entity's webpage, must remain a minimum of two clicks away. Thus, if affiliated Section 501(c)(4) and Section 527 organizations include such material on their websites, a user should not be able to connect to those webpages directly from any webpage of the Section 501(c)(3) entity, but instead should be required to enter through an intervening home page or other page of the Section 501(c)(4) organization that contains no lobbying or political content. This will assist in correcting any user perception that, for instance, the Section 501(c)(4) message originates with the Section 501(c)(3). There is no guarantee that this degree of separation will suffice to sever any attribution, but a frequently used telephone metaphor may be applied to analogize the home page of each organization to its telephone receptionist. Thus, it would seem that information received after the routing function of the "receptionist" home page should be attributable to that organization and not to another.

Finally, EOs also must bear in mind that sponsorship of chat rooms, bulletin boards, and other interactive forums may routinely involve lobbying or electioneering communications by participants. Until the IRS indicates otherwise, to be on the safe side organizations should assume that these communications will be attributed to the sponsoring organization, together with any resulting lobbying costs, and establish and post policies and police their sites accordingly. For example, Section 501(c)(3) organizations must prohibit any partisan or biased communications related to candidate elections, as endorsement by one participant to another may be attributed to the organization and result in revocation of the tax exemption.

Organizations also may wish to consider restricting participation in interactive forums to members only, through the use of passwords. In addition to providing more substantial

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official has indicated his approval of this FEC opinion, it is nonetheless possible that the IRS may view some of these activities differently.

[39] By definition, the primary purpose of a Section 501(c)(4) organization is limited to the promotion of social welfare. See Rev. Rul. 81-95, 1981-1 CB 332.

control of content, this would enable any lobbying costs for such a site to be categorized as "direct" lobbying for cost allocation purposes, because communications asking members to lobby their legislators on specific legislation are categorized as "direct" rather than "grass roots" lobbying. Because the direct lobbying expenditure ceiling for organizations making the Section 501(h) election is four times as high as the grass roots lobbying ceiling, such an allocation can be highly advantageous.

DISCLOSURE OF TAX INFORMATION OVER THE WEB

Under Section 6104(e), most EOs are required to provide copies of their three most recent federal tax returns, except for their lists of contributors, and their exemption applications on receiving in-person or written requests. They need not comply, however, if the information already has been made "widely available." In response to numerous comments received on Proposed Regulations issued in 1997, the final Regulations on this issue allow organizations to post their documents in any format that "exactly reproduces the image" of the application or return as it was originally filed with the IRS, excepting only any information permitted to be withheld.[40]

Because the information to be disclosed includes information such as the compensation paid to the organization's five most highly compensated individuals, many organizations are reluctant to post such information on the Internet, which permits broad and instantaneous public access. At least one website, however, has been established with the goal of posting such information for every EO regardless of whether an organization itself chooses to do so.[41] Thus, EOs should adopt a new perspective on these filings. In addition to screening their information for unnecessary personal contact details about individuals, organizations should consider their applications and tax returns to be not only public information but also a valuable means of communicating their programs and capabilities to the public.

CONCLUSION

The Internet offers EOs an unprecedented opportunity to convey their message to the public, and to raise revenue in various ways. By maintaining vigilance on applicable issues regarding UBIT, charitable contributions, state jurisdictional power, lobbying, and information functions that are inherent to the Internet, organizations will enhance their ability to steer clear of potential difficulties and focus on maximizing this opportunity.

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[40] See Reg. 301.6104(d)-2(b)(2). See generally Mayer, "Minimizing Risk and Maximizing Benefits Under the Final Disclosure Regs. for Exempt Organizations," 91 JTAX 45 (July 1999).

[41] www.guidestar.org, established by Philanthropic Research, Inc.

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San Francisco, CA 94104
Telephone: (415) 421-7555
Fax: (415) 421-0712
www.adlercolvin.com

Practice Notes

Whether an EO already has a website or is contemplating one, certain steps should be undertaken to protect its tax-exempt status. These include:

- Reviewing the general corporate sponsorship and periodical advertising rules (in the absence of specific Internet guidance from IRS) in the context of commercial references on the EO's website.
- Avoiding the establishment of links to other sites unless and until permission is obtained from the destination site.
- Segregating income and costs of on-line periodicals in order to justify application of the same special UBIT rules that apply to income from traditional print periodicals.
- Structuring affiliations with e-retailers so that any "referral fees" are properly categorized as royalty income exempt from UBIT.
- Vigorously objecting to any unauthorized use of its name, logo, and other indicia of identification in connection with an on-line charity mall, in order to preserve credibility, reduce the risk of appearing to engage in UBI sales activity, and preserve its rights in its intellectual property.
- Determining whether on-line charity auction activity is sufficiently similar to real auctions so as to qualify for the UBIT exception.
- Implementing specific policies with regard to donor information obtained over the Internet, in line with FTC guidelines, while keeping an eye on pending consumer privacy legislation.
- Providing hard-copy acknowledgments to donors who make contributions via the Internet.
- Considering the exposure to state jurisdiction that might occur as a result of interactive transactions over the Internet.
- Having separate websites for entities exempt under different Code sections, in light of the different lobbying, etc., rules that may apply to each; possibly making the Section 501(h) dollar-standard election (for smaller entities); and carefully tracking lobbying expenditures.
- Screening information for unnecessary personal contact details about individuals.

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San Francisco, CA 94104
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