Internet Guidance Should Reconcile Old Law With a New Medium

The IRS has requested guidance on whether to issue guidance, and on many issues the answer is "yes."

ROBERT A. WEXLER and ALICE M. ANDERSON

On 10/16/00, the IRS published Ann. 2000-84, 2000-42 IRB 385, giving notice that the Service is "considering the necessity of issuing guidance that would clarify the application of the Internal Revenue Code to the use of the Internet by exempt organizations." The Announcement states that the Service "has made no final decision concerning the need for additional guidance," and that the it may conclude that no further guidance is necessary. In short, the IRS is asking for guidance about whether to issue guidance.

The Announcement is unique because it seeks guidance on the application of a variety of different Code provisions to a single technological medium—the Internet. The authors are not aware of any other situation in which the Service has focused its inquiry on a specific method of conveying information as opposed to a particular Code section or sections. This Announcement is testament to the dramatic influence that the Internet has had on the work of exempt organizations.

In the Announcement, the IRS asks for guidance in each of the following areas:

- Whether guidance is required at all.
- General considerations about how we think about a Web site.
- Political and lobbying activities.
- Unrelated business income tax (UBIT).
- Solicitation of charitable contributions and disclosure by charities.

In each of the substantive areas, the Service identifies some specific questions, but also asks the public to pose questions and consider issues that the Service has not asked.

This article will consider all of the areas mentioned by the Announcement except for political and lobbying activities, which will be covered in a second article in a future issue of *The Journal of Taxation of Exempt Organizations*.

IS GUIDANCE REQUIRED?

"Yes," with respect to some of the questions asked and "no," with respect to others. Specifically, the authors recommend that the Service issue at least two detailed Revenue Rulings, one in the area of lobbying and political activity and one in the area of UBIT. These rulings would include helpful examples as well as safe harbors. The IRS should also issue some type of formal guidance clarifying situations in which statements conveyed over the Internet will satisfy the substantiation and disclosure requirements of Sections 6113, 6115 and 170(f)(8). Ideally, the Treasury would amend the Regulations

ROBERT A. WEXLER is a principal and ALICE M. ANDERSON is an associate with Silk, Adler & Colvin in San Francisco. Mr. Wexler is the editor of the Exempt Organizations Department of The Journal of Taxation.
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under these sections, but in the absence of such amendments, it is incumbent on the IRS to issue formal guidance. Significantly less helpful because organizations cannot rely on it (although always more welcome than not) would be some form of informal guidance in the form of advice to field agents or an article in the CPE Text. We would also request that the IRS be particularly receptive to fact-specific private letter ruling requests that explore the nuances in this area.

The Internet is a different kind of medium, and in some situations may need an entirely new set of rules.

Practitioners and nonprofit organizations have been struggling for several years now to understand the Service's position on these subjects. Particularly in the areas of lobbying and political activity and UBIT, it is difficult for nonprofit organizations to shape and develop their Web sites and to negotiate the many different types of arrangements offered by commercial and non-commercial Internet service providers without first knowing what impact these decisions will have on their tax-exempt status. It is also difficult for exempt organizations to feel comfortable soliciting charitable contributions using the Internet without some more direct guidance.

The IRS has already made attempts to provide some informal guidance. Senior IRS officials have been very receptive to discussing these issues, and the IRS has published several helpful CPE Text articles, including one in the edition for fiscal year 2000 ("2000 CPE article").[1] In large part, this CPE article seemed to ask many more questions than it answered, although it is always more helpful than not to read the Service's thinking about any of these issues. We urge the IRS to take the next logical step and to start answering some of these questions by providing formal guidance.

House Republican Majority Leader Dick Armey (R. Tex.) has urged the Service not to issue guidance, noting among other things, that "[t]he idea of turning the tax man into a Net cop would have a chilling effect on free speech on the Internet." Mr. Armey added, "We will be watching what they do, and we will not tolerate any backdoor attempt to regulate the Internet."[2] In truth, however, as exempt organizations conduct their operations more and more over the Internet, the Service necessarily will be reviewing and auditing communications on the Internet. Accordingly, exempt organizations and their representatives need clearer guidance about what rules apply.

GENERAL CONSIDERATIONS ABOUT WEB SITES

It is necessary to establish some working definitions and concepts before reviewing the Service's questions because any IRS guidance will have to include some working definitions. The 2000 CPE article also provides a good discussion of some of the applicable terms.[3]

- *The Internet.* The Internet is a giant computer network that connects other computer networks. It has been analogized to a giant octopus with more than a million tentacles. Each tentacle grasps another octopus (a smaller computer network), and at the end of each tentacle on the smaller networks is a personal computer. The Internet supports several kinds of services.[4]
- *The World Wide Web.* The World Wide Web ("Web") is one of the various services supported by the Internet. It is like a giant net that connects an infinite number of points. The Web enables any user sitting at a personal computer with a modem or other access to view all of the points (or pages) on the Web.
- *Web page.* A Web page is a point on the Web that can be accessed from any other point. It consists of a single document, but can include text, graphics, and multimedia, including interactive text. Normally, once a Web page is on the user's screen, it can be scrolled from top to bottom, using the arrow keys on the keyboard or the

[1] Chasin, Ruth, and Harper, "Tax Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet," *Continuing Professional Education, Exempt Organizations—Technical Instruction Program for FY 2000* (1999), page 119.

[2] Williams, "GOP House Leader Slams IRS on Internet Issue," By Grant Williams, *Chronicle of Philanthropy*, 11/16/00.

[3] Chasin, et al, *supra* note 1. See also Moore and Harper, "Internet Service Providers Exemption Issues Under Section 501(c)(3) and 501(c)(12)," *Continuing Professional Education, Exempt Organizations—Technical Instruction Program for FY 2000* (1999), page 55, and Chasin and Harper, "Computer-Related Organizations," *Continuing Professional Education, Exempt Organizations—Technical Instruction Program for FY 1996* (1995), page 3, for a discussion of how the Internet operates.

[4] See Smith and Bebak, Creating Webpages for Dummies (IDG Books Worldwide, 2000).

scroll bar and the mouse. It can also usually be printed from top to bottom with a single print command. A user who knows the URL ("uniform resource locator") of a Web page can type in the URL and go directly to the page. Otherwise, pages can be located through searches conducted on one of the many available search engines.

- *Web site.* A Web site describes a series of Web pages that are linked together, usually through a home page. The home page usually is identified by the main URL, and the other pages are accessed like subdirectories of the main URL.
- *Link.* A link (or "hyperlink") is computer code in the HTML programming language (below) that takes a user from one place on the Web to another, through a single mouse click on some portion of the page. With current technology, the user typically clicks the mouse to complete a link. As technology changes, there will, no doubt, be other ways to execute a link. A link can take the user to another place in the same page, to another place in the same site, or to a completely different site. A Web site can include a link to anyone else's site without the knowledge of the operator of the linked-to site. Links also can be structured so that the operator of the linked-to site knows from which site a particular visitor came.
- *HTML.* HTML ("hypertext markup language") is a very simple computer language that enables even those with virtually no computer knowledge to set up a simple Web site that includes links. It is not uncommon for fifth- and sixth-grade students to learn basic HTML. The authors found that they were able to establish a basic site in less than an hour—it is very simple.

There are many ways to design and structure a Web site. A simple site can consist, for example, of a single long page with internal links taking the user from one spot on the same page to another (even though the user could also scroll from top to bottom). On the other hand, a site could consist of multiple pages (each one of which is technically a separate document) accessed from a "home page." The user who sees a home page does not know whether the home page is creating links to a single Web page, multiple pages within a site, or entirely different sites, although a savvy user could tell by viewing the code.

Basic principles. The authors urge the Service to adopt some basic working principles:

1. Exempt organizations should be encouraged to take advantage of new technologies and tools that enable them to carry out their exempt purposes in a more efficient and effective manner. The Internet and the Web are clearly such tools.
2. Although many principles of current law will apply to activities on the Internet, the Service must recognize that the Internet is a different kind of medium, and in some situations may need an entirely new set of rules. The Introduction to the 2000 CPE article on the Internet states that "the use of the Internet to accomplish a particular task does not change the way the tax laws apply to that task. However, the nature of the Internet does change the way in which these tasks are accomplished."[5] We suggest that in some situations, the fact that the Internet does change the way in which tasks are accomplished may, by necessity, require a change in the way tax laws apply to those tasks.
3. Technology is changing very rapidly, and the Service must be careful to articulate rules that can be applied to evolving technology. For example, if the Service is to develop a rule based on the number of mouse clicks it takes to get from point A to point B, it has to realize that we may not even be using mice to move through the Internet in a few years.
4. Even though the Internet enables users to move quickly from one organization's Web site or Web page to another's, the Service should continue to respect the separate rights and boundaries of legal entities. As a general rule, therefore, and absent other circumstances, the activities of one organization should not be attributed to another.

IRS questions. The Service has posed four general questions.

One or many? Does a Web site constitute a single publication or communication? If not, how should it be separated into distinct publications or communications? To discuss this question, one must first consider how a Web site dif-

[5] Chasin, et al, *supra* note 1, page 119.

fers from other types of publications or other media:

- *Scope.* Unlike existing media, a Web site allows an organization to combine many different facets of its work in one location. For example, a single site—complex, but not atypically so—could contain general information about a charity, an on-line version of a printed periodical, information about pending legislation, donor solicitation materials, interactive forums, other interactive educational activities, an on-line virtual store, a virtual auction, corporate sponsorship, advertising, and multiple links to the Web sites of other organizations.
- *Boundaries.* Anyone who holds a book or a magazine, or views a film or television program, knows when the "publication" begins and when it ends. The book, magazine, show, or film is usually identifiable as a single publication. This is true even though a single publication may contain some advertising and some substantive content (hopefully more of the latter), or some educational content and some lobbying. While the costs of the publication may have to be allocated among its different components, it is at least fairly easy to tell the beginning and ending of the publication involved. In contrast, because of links and the ease of movement through the Web, the beginning and end of a Web site is not always clear.
- *Timing.* A Web site can be updated often without the user knowing, unless the Web pages are dated. Unlike paper or film, the Web is not a fixed-in-time medium.
- *Access.* A Web site can be accessed from any computer, anywhere in the world, that has an Internet connection.
- *Interactivity.* Organizations can build interactive features into their web sites; features that, for example, allow users to order products, make charitable contributions, or take written text, such as an on-line voter guide and sort and search it.

Links should not alter the basic presumption that one organization's activities are not attributable to another.

Taking these differences into account, asking whether a Web site constitutes a single publication may, to some extent, be like asking "what kind of radio is this television," because Web sites are not merely "publications." Some sites may contain a myriad of activities that function as a combination of one or more publications or communications (such as a periodical or a solicitation page). At the same time, they may also contain areas that substitute for actual physical space (such as a virtual store or an on-line storage room for handouts).

Accordingly, the answer to whether a Web site constitutes a single publication or communication depends on the site, and some sites may be more than mere publications. The authors have concluded, therefore, that it is not possible to answer the Service's question in the abstract, without reference to a specific legal issue, and the Service need not provide an answer to this question in the abstract. Rather, the IRS should discuss the issue in general terms, but should develop rules only in the context of specific Code sections, such as those dealing with lobbying communications, the allocation of expenses, and periodicals.

Allocations. When allocating expenses, what methodology is appropriate? For example, should allocations be based on Web pages (which, unlike print publications, may not be of equal size)?

Under current law, there are many situations in which an organization must allocate expenses between two different types of activities. Among the examples are unrelated and related businesses, lobbying and non-lobbying activities, and private foundation investment and program activities. In each situation, the law typically requires only that the organization adopt a reasonable method for allocating the expenses—for example, Reg. 1.512(a)-1(c) with respect to UBIT allocations and Reg. 53.4940-1(e)(1)(i) allocations of private foundation expenses. The authors believe that the IRS should continue to follow this general principle of reasonableness and not spend its time developing complex allocation rules for web sites.[6]

Updating vs. maintaining. Unlike other publications of an exempt organization, a Web site may be modified on a daily basis. To what extent and by what means should an exempt organization maintain the information from prior versions of its site?

Exempt organizations are cur-

[6] This issue is discussed in great detail in a 48-page article titled "Tax Accounting for Costs of Developing or Modifying Internet Websites," *California Tax Lawyer*, by Douglas W. Schwartz, Volume 9, Number 2 (2000).

rently required to maintain, and make available for public disclosure, copies of their tax exemption applications, including all attachments and correspondence, forever, and their Form 990 or 990-PF tax returns for three years.[7] Other than this specific requirement, exempt organizations follow the same rules applicable to all organizations: they need to maintain adequate records to substantiate their activities in the event of audit, but there is no requirement that specific documents be retained or preserved.

The authors believe that the same general guidelines should apply to the Internet. Exempt organizations should establish a reasonable method for documenting their Internet activities. In our judgment, this probably includes maintaining copies of relevant portions of their Web sites, which should be updated periodically. Exempt organizations should be able to maintain these records either in printed form or on some other medium, such as diskette, hard drive, or "zip" (high-capacity diskette) drive, as long as the records can be produced in the event of audit. It is unrealistic, however, to expect exempt organizations to maintain copies of every version of everything published on the Internet, particularly for those organizations that make frequent changes to their sites.

Responsible for chat? To what extent are statements made by subscribers to a forum, such as a listserve or newsgroup, attributable to an exempt organization that maintains the forum? Does attribution vary depending on the level of participation of the exempt organization in maintaining the forum (e.g., if the organization moderates discussion, acts as editor, etc.)?

Exempt organizations may sponsor ongoing dialogues through chat rooms or listserves. They might also host on-line public forums or debates. Some events occur in real time, like a live public meeting or debate, while some may occur over an extended period through ongoing written commentary. Some exempt organizations may choose to edit the remarks made, particularly those that are made other than in a live forum.

There are at least two major tax issues with respect to these activities: (1) When might something that is said in one of these venues jeopardize the tax-exempt status of the sponsoring organization, and (2) when might something that is said in one of these venues constitute lobbying or electioneering that might be attributable to the sponsoring organization?

We suggest that the IRS adopt the following principles:

1. There is no obligation on the part of the sponsoring organization to edit comments. If an organization does not edit comments and makes it clear, through a disclaimer, that the comments of those participating are not necessarily those of the organization, nothing that is said should in any way be attributed to the organization.
2. An organization may choose to edit comments for reasons that further the organization's basic Section 501(c)(3) status, or for non-tax reasons. For example, an organization should be able to adopt a policy that it edits remarks to remove obscenity, racist or other inappropriate statements, or statements that might constitute libel. As long as that organization does edit remarks only for those reasons, and not for content concerning lobbying or political activity, statements made by participants that might constitute lobbying or political electioneering should not be attributed to the exempt organization. It would be helpful to participants, but should not be required as a matter of law, for the exempt organization to state its editorial policy clearly.
3. If an organization takes the further step of editing content to eliminate statements that might constitute lobbying or electioneering, the statements of participants might be attributable to the organization, but only if it has failed to screen material in a reasonable and diligent manner. An exempt organization should be able to adopt any reasonable method to screen comments, recognizing that occasionally some comments may be missed. The IRS might provide examples of reasonable screening techniques.

Links. The IRS asks about links in some of the above questions, but asks no overriding question about the treatment of links. The authors discuss this issue in the context of UBIT (below), political activity and lobbying (in the subsequent article). In each of these areas, the authors suggest that the IRS adopt some general guidelines:

1. There should be a basic presumption that the activities of one organization are not attributable to the other, as is the case in the law generally. Simply linking to an-

[7] Section 6104.

other organization's Web site should not alter this basic presumption.

2. The Announcement indicates the Service's belief that, in some cases, the electioneering, lobbying, or advertising of one organization might be attributable to another organization because of a link. Exempt organizations need some certainty in structuring their affairs. We believe, therefore, that the IRS should adopt what we will refer to below, for lack of a better term, as a "one-link" safe harbor. Under this proposal, if Organization A links to a Web page of Organization B, and if that linked page itself does not contain electioneering or lobbying, A has, per se, not engaged in those activities solely because of the link. Similarly, if A's Web site contains a corporate sponsorship acknowledgment with a link to the sponsor's Web site, and if the link goes to the sponsor's home page or another page that is not used for making purchases, the link does not adversely affect the characterization of the corporate sponsorship. If it takes more than one link to go from A's Web page to the "offending" page of B, the proposed safe harbor would apply.
3. If the link takes the user to a Web page of another organization that involves electioneering, lobbying, or advertising, the proposed safe harbor would not apply. Instead, the Service should apply a test that considers two factors—what has the first organization said in connection with the link, and where does the link takes the user (i.e., how close to the electioneering, lobbying, or advertising content on the linked-to page). In many situations that would not be covered by the one-link safe harbor, a link would still not be sufficient to attribute the electioneering or lobbying of one organization to another, or to convert an acknowledgement into advertising. It is simply that if the safe harbor did not apply, the Service would have to consider the relevant facts and circumstances, particularly the two key factors described above.

The IRS should adopt a 'one-link' safe harbor.

We understand that the proposed safe harbor is somewhat arbitrary, but by definition, all safe harbors involve line-drawing, and the Service's informal comments indicate that it is inclined to consider the number of links it takes to go from one Web page to another. We believe that a workable safe harbor would provide certainty to exempt organizations.

UBIT

UBIT on the Internet is perhaps the issue that has received the most discussion to date, both inside and outside of the Service.[8] In the CPE text for fiscal year 2000, the IRS raised many issues related to UBIT and the Internet. Ironically, the Announcement only sets forth three specific UBIT questions. Perhaps this is because the Service has already asked for guidance on Internet activities in the context of corporate sponsorship, or perhaps it is because the Service was very much focused on the lobbying and political issues at the time it posed its questions.

Regularly carried on. To what extent are business activities conducted on the Internet regularly carried on under Section 512? What facts and circumstances are relevant in determining whether these activities on the Internet are regularly carried on?

One of the fundamental requirements for UBIT is that the unrelated activity be regularly carried on.[9] The analysis of whether a particular activity is regularly carried on depends, of course, on all of the facts and circumstances, but the following guidelines can be drawn from the cases and rulings (although they are by no means always consistent), and the regulations.[10]

- It is important to compare the frequency and continuity of the activity with comparable activities being carried on by commercial entities. For example, if an activity is inherently seasonal, such as horse racing, the regularity must be determined by examining the normal time span of comparable commercial activity.
- An activity carried on one or two weeks a year is not likely to be regularly carried on, especially if other tax-

[8] See, e.g., Anderson and Wexler, "Making Use of the Internet—Issues for Tax-Exempt Organizations," 92 J. Tax'n 309 (May 2000); Chasin, et al, *supra* note 1; Livingston and Segal, "Exempt Organizations on the Internet Face Exemption and UBIT Issues in New Contexts," 11 JTEO 63 (Sep/Oct 1999); Nooney, "Tax-Exempt Organizations and the Internet," 27 Exempt Org. Tax Rev. 33 (January 2000).

[9] Reg. 1.513-1(c).

[10] See Regs. 1.513-1(c)(1) and (2)(i).

able entities engage in the same activity on a more regular basis.

- An activity carried on once every week of the year, such as the operation of a commercial parking lot, is regularly carried on.
- Annual or semi-annual fundraisers typically are not regularly carried on, even though they occur every year.
- In *NCAA*, 914 F.2d 1417, 66 AFTR2d 90-5602 (CA-10, 1990), the court held that advertising in the program for the NCAA Final Four tournament was not a regular activity because the tournament had a very limited two- to three-week duration, even though the NCAA spent much of the year selling the advertising space. The IRS does not follow this case, and it is probably not prudent to rely on it, especially outside of the Tenth Circuit.

A Web site presents an exempt organization with the unique opportunity to "regularly carry on" an activity without exerting a great deal of additional effort, once the initial development of the site is finished. Once something is posted on a Web site, it remains there until removed. On this question, the authors see no reason why the IRS should apply different rules in the context of the Internet. The basic rule from the regulations is that the frequency and continuity of the activity be compared with comparable activities being carried on by commercial entities. This should be the standard for the Internet as well.

The Service should take the position that the mere presence of a potentially unrelated business activity on a Web site for an extended period does not amount to regularly carrying on the activity. Rather, the Service should look to the effort expended by the exempt organization in maintaining the site, as compared to comparable efforts put into "live" activities. In practice, most income-generating activities that continue for a period of time on a Web site *will* require regular updating and maintenance and will be regularly carried on. There are probably not many real-life examples in which an exempt organization puts an income-generating activity on a Web site and then does not have to work to maintain it on a regular basis.

For example, a charity might operate a virtual storefront, on which it sells items to the public, much like a gift shop that a museum would operate. If the storefront remains on line on an ongoing basis, it will almost always be an activity that is regularly carried on. In these situations, the issue will likely turn on whether the items sold are substantially related to the organization's exempt purpose. The IRS should apply the same analysis that it currently applies in the context of brick-and-mortar museum and other gift shops, including application of the fragmentation rule to determine whether particular items sold in a virtual storefront generate unrelated business taxable income (UBTI).[11]

Another example is that of charities that traditionally hold annual auctions to raise funds. Some of these charities are now conducting their auctions on line and on a continual basis. An on-line auction should be considered regularly carried on if, when comparing the frequency and continuity of the activity, it is comparable to activities being carried on by commercial entities.[12] If a charity really holds an auction for a limited number of days, it might not be regularly carried on. If a charity operates an ongoing auction, year-round or for some extended period each year, it probably would be regularly carried on.

The mere presence of an activity on a Web site for an extended period should not amount to 'regularly carrying on' the activity.

Because the same rules that apply in the non-Internet context could apply to Web sites, the IRS does not necessarily need to offer specific guidance in this area. If the IRS intends to issue a Revenue Ruling dealing with the UBIT issues and the Internet, it should at least discuss the fact that the same rules will apply, and perhaps give some examples.

Payment for customer referrals. Are there any circumstances under which the payment of a percentage of sales from customers referred by the exempt organization to another Web site would be substantially related under Section 513?

In order for income to be taxable, it must be from an activity that is a trade or business, regularly car-

[11] See TAMs 9550003 and 9720002 discussing the UBTI characterization of items sold at a museum gift shop. "While the Service has yet to address any cases specifically addressing on-line merchandising issues it is useful to review how the Service has traditionally addressed sales activities of exempt organizations. The treatment of museum gift shops was discussed in the 1997 CPE Text at 257 and the 1999 CPE Text at 286. See particularly the discussion of TAM 9720002 (11/26/96)." Chasin, et al, *supra* note 1 at 137.

[12] Reg. 1.513-1(c)(1).

ried on, that is not substantially related to the organization's exempt purpose.[13] Even if these tests are satisfied, exceptions and modifications under Sections 512 and 513 (such as the royalty exception or the corporate sponsorship safe harbor) can apply to except the income from UBIT.

A link embedded in an otherwise valid acknowledgment of a corporate sponsor should not alter the character of the sponsorship.

The Announcement poses a single narrow question, and the answer to the narrow question is "yes." If an exempt organization refers customers to another Web site and receives a payment from the owner of the other site based on a percentage of sales from the referred customer, the payment should be substantially related if the product purchased by the customer is substantially related to the referring organization's exempt purpose. If environmental charity X sends its users to Amazon.com to buy a book on clear-cutting practices, and receives a percentage of the sales price, the income should be substantially related to X's exempt purposes, even though the income to X is based on a percentage of gross sales.

Many exempt organization Web sites feature books related to their mission and inform the user that the books may either be purchased in the organization's book store (if it has one) or on line through an "e-retailer" such as Amazon.com. If an exempt organization could sell a book directly, in its own bookstore, it should be able to sell the same book through an Amazon.com because if the book is substantially related, it is always substantially related.

Other, more complicated questions are raised by such merchant affiliation agreements, however. As new types of arrangements evolve, still other issues will be raised. It is incumbent on the Service to provide exempt organizations with some guidance on these arrangements that is not only clear but also reasonable and consistent with the law, thereby allowing the exempt organization community to avoid the years of litigation and uncertainty it experienced in the 1990s over affinity credit cards and mailing lists.

It is beyond the scope of this article to address all possible situations on which guidance would be helpful, and many of these have been discussed in other articles.[14] There are, however, two common examples on which guidance would be particularly useful

Example 1. A retailer, such as Amazon.com, offers a "referral fee" to participating organizations—including but not limited to all categories of exempt organizations—who send purchasers, through links, from their Web sites to that of the retailer. The links are developed using software that allows the retailer to determine which organization referred the customer. The exempt organization displays the logo of the retailer on its site, and it informs users that the retailer pays it a percentage of all sales (typically 5% to 15%) from users who "click over" from the exempt organization's site. The exempt organization can feature specific books that are directly related to the organization's mission, but regardless of the books that are featured, the exempt organization receives a percentage of the sales price for customers who have linked over from the exempt organization's site.

Example 2. A Section 501(c)(3) charity enters into an arrangement with Fundraiser, which could be either an exempt or a non-exempt organization. Fundraiser works with for-profit retailers or "e-tailers." For-profit retailers agree to list several charities on their Web sites and permit customers to select a charity to receive a percentage of purchases that the customer makes. Fundraiser takes some fee from the retailer for matching the charity and the retailer, but typically no fee from the charity. The charity describes and promotes this arrangement on its site, and provides links enabling the user to make the purchases that will benefit the charity. Arrangements similar to this are currently offered by organizations such as CharityMall.com and 4Charity.com. At least one other organization, Igive.com, offers a similar service, but it gives the buyer the right either to donate to charity or take a rebate of the same amount.

The income from these types of arrangements can be characterized in various ways, and the consequences of such characterization affects not only whether the income is subject to UBIT, but also how the income is treated for purposes of the Section 509(a)(1) and 509(a)(2) public support tests. (The latter issue will be relevant only for certain types of exempt organizations, and is also beyond the scope of this article).

Income in Example 1 that is specifically from the purchase of books or other items that are substantially related to the exempt organization's mission and purpose should be characterized as exempt program service income.

[13] Reg. 1.513-1.

[14] See, e.g., Anderson and Wexler, *supra* note 8.

The more complex analysis involves income from the sale of unrelated titles in Example 1. The Service could characterize the referral fee as a fee paid to the organization for the service of referring users to the commercial site. In that case, the income is likely to be UBTI. Alternatively, the Service could treat the income as a nontaxable royalty, which we believe is the correct characterization. The authors would hope that organizations such as Amazon.com could develop a term that is more accurate than "referral fee" to describe these arrangements.

In Example 1, the amount of effort that the exempt organization expends in setting up the link and promoting the arrangement is typically minimal, and the effort has very little to do with the amount of income that the charity receives from the link. It is not appropriate, therefore, for the exempt organization to have to treat the referral fees as UBIT simply because of these minimal services. The authors believe that such a characterization would be inconsistent with the royalty treatment afforded to affinity credit card arrangements under a series of cases, all of which found against the Service.[15]

It would be more accurate to treat the referral fees as royalties. Example 1 is reasonably analogous to the affinity credit card cases. In both situations, the retailer is exploiting charity's name and goodwill to sell books or other products. The buyer typically comes to the exempt organization's Web site for reasons other than buying products. The buyer either is already a member of the organization, is otherwise involved with organization, or wants to learn something about the organization or the issues important to it. In Example 1, all of the buyers that reach the retailer, and for whom the retailer makes a payment to the exempt organization, have come to the buyer because of their connection with the exempt organization. It is precisely because the retailer is using the reputation and goodwill of the referring organization that the retailer is willing to pay the exempt organization a fee based on a percentage of sales.

There clearly is no fee for service issue in Example 2, because the charity does nothing more than sign an agreement with the fundraiser and provide a link to the fundraiser's or retailer's Web site. This charity may be receiving charitable contributions from the retailers, even though these facts do not fit within the corporate sponsorship safe harbor because the amount paid to the charity is based on the actual purchases, and because, in many cases, the charity's Web site will encourage the user to visit the retailer's site and make a purchase. Igive.com has structured its rebate policy to give the buyer, rather than the retailer, a direct charitable contribution. If the charity is not receiving charitable contributions from the retailers, it is certainly receiving royalties for the use and exploitation of its good name. In this Example, even more than in Example 1, the buyer is induced to purchase products with the prospect of benefiting one or more charities.

Whether the IRS proposes to treat the income in Example 2 as a charitable contribution or a royalty, exempt organizations could all benefit from a clear articulation of the Service's position through a Revenue Ruling.

Virtual trade shows. Are there any circumstances under which an online "virtual trade show" qualifies as an activity of a kind "traditionally conducted" at trade shows under Section 513(d)?

Section 513(d) exempts certain trade shows from UBIT. Some Section 501(c)(6) trade associations and other exempt organizations are attempting to replicate the trade show in a virtual format.

A Web page confirmation or a confirming e-mail from the charity should qualify as a valid acknowledgment.

These organizations typically receive income from virtual exhibitors as well as from other corporate sponsors of the event.

Section 513(d) and Reg. 1.513-3(b) provide that certain traditional convention and trade show activities carried on by a qualifying organization in connection with a qualified convention or trade show will not be treated as an unrelated trade or business.

A qualifying organization is one described in Section 501(c)(3), (4), (5), or (6) that regularly con-

[15] See e.g. Sierra Club, 86 F.3d 1526, 78 AFTR2d 96-5005 (CA-9, 1996), *aff'g* 103 TC 307 (1994). While the Ninth Circuit found for the Club on the mailing list issue, it remanded the affinity credit card portion of the case to the Tax Court for a finding as to whether the Club had provided too much in the way of services. The Tax Court found for the Club on remand, and the case was not appealed by the Service. Sierra Club, TCM 1999-86. See also Oregon State University Alumni Association, Inc., and Alumni Association of the University of Oregon, 193 F.3d 1098, 84 AFTR2d 99-6515 (CA-9, 1999), *aff'g* TCM 1996-63 (University of Oregon) and TCM 1996-34 (Oregon State). The IRS has now indicated that, having lost several key court battles, it is no longer likely to challenge affinity credit card arrangements. See Stokeld, "IRS Memo Tells Area Managers to Stop Litigating Affinity Card, Mailing List Cases," 28 Exempt Org. Tax Rev., pages 18-19 (April 2000).

ducts, as one of its substantial exempt purposes, a qualified convention or trade show activity. A qualified convention or trade show activity is any activity of a kind traditionally carried on by a qualifying organization in conjunction with an international, national, state, regional, or local convention or annual meeting or show that meets two conditions:

- One of the purposes of the organization in sponsoring the activity is promoting and stimulating interest in, and demand for, the products and services of that industry, or educating the persons in attendance regarding new products and services or new rules and regulations affecting the industry.
- The show is designed to achieve its purpose through the character of the exhibits and the extent of the industry products that are displayed.

If these requirements are satisfied, rental income from exhibitors at a trade show is not UBTI. Qualified convention and trade shows are specifically excepted from the Section 513(i) corporate sponsorship safe harbor because this separate set of rules applies. Presumably, an "unqualified" trade show could still have elements, such as pure sponsorships, that satisfy the corporate sponsorship safe harbor.

Any virtual trade show that satisfies the above criteria should qualify for the UBIT exemption under Section 513. The current law, however, simply does not contemplate a virtual trade show. The rules were drafted with a view towards the traditional live trade show that is conducted annually or periodically. The Code even refers to an "activity of a kind traditionally carried on...."

Ideally, Congress would amend Section 513(d) to conform with the current reality of on-line trade shows. Tradition is changing, and income received during these types of shows should be exempt. Even working within the current legal framework, however, the authors believe that the IRS could provide some guidance on when a virtual trade show might be similar to a traditional trade show. For example, a virtual trade show of limited duration that coincides with an annual meeting or an annual live trade show might satisfy this definition.

Sponsorships. The IRS had previously requested comments concerning the application of Section 513(i), which governs the treatment of qualified sponsorship payments, to Internet activities in connection with the proposed corporate sponsorship regulations.[16]

The IRS has issued proposed regulations on corporate sponsorship, and is currently considering comments and testimony in order to adopt final regulations.[17] The law creates a safe harbor from UBIT for corporate sponsorship acknowledgments. Acknowledgments are distinguished from advertising, the income from which is not covered by the safe harbor. The very nature of the Service's question affirms its acknowledgment that an exempt organization's on-line corporate sponsorships are eligible for the safe harbor exemption.

Links. Corporate sponsorship on the Internet is a broad topic, but within it, the most significant ongoing question seems to involve links. Specifically, when does a link that is included within an on-line acknowledgment, which otherwise appears to be corporate sponsorship, take the acknowledgment out of the corporate sponsorship safe harbor? Links may be located in the logo of the corporate sponsor, in a banner atop the Web page, or in the text itself.

Many practitioners, including the authors, believe that a link embedded in what otherwise constitutes a valid acknowledgment of a corporate sponsor should not alter the character of the sponsorship. A printed sponsorship acknowledgment may legitimately contain a phone number of the sponsor, which requires the reader to dial the telephone and contact the sponsor. A link, although easier to access, is conceptually just like a phone number. The user must take the affirmative step of contacting the sponsor.

The IRS has indicated, at least informally, that it does not agree with this conclusion because it is easier for a user to click on a link than to pick up the phone and dial. Therefore, the IRS will likely focus instead on the nature of the link. If the link, for example, takes the user to the corporation's home page, the link will not change the nature of the sponsorship. If the link takes the user directly to a page on the sponsor's Web site that is used for buying products, the IRS feels the link is more akin to advertising.[18]

In addition, the IRS had at one time informally indicated that moving banners might, per se, be advertising. The IRS position now seems to be that one must look to the content of the banner to see if

[16] REG-209601-92, 2000-12 IRB 892.

[17] Section 513(i) and Prop. Reg 1.513-4.

[18] See Harper and Chasin, "Update on Internet Tax Issue for Exempt Organizations," presented 10/20/00 at "Advising Nonprofit Organizations in Colorado," sponsored by the Colorado and Denver Bar Associations.

it satisfies the corporate sponsorship safe harbor. If it does, the fact that it moves is irrelevant. Links in moving banners would be treated in the same way as links in other sponsorship statements, as discussed above.

The authors suggest that if the IRS decides to adopt this position, it also should adopt a one-link safe harbor to give exempt organizations some certainty in structuring their affairs. If the exempt organization's Web site takes the user to a page of the sponsor's that is a general description of the sponsor, rather than a page at which the user can purchase products, the link does not affect the character of the acknowledgment. Such an acknowledgment remains valid under the corporate sponsorship rules and does not give rise to UBTI.

If the link does take the user to a Web page that allows the user to purchase products, but contains other information as well, the other facts and circumstances should be examined. Among these are what the exempt organization has said about the link on its Web site and the proximity of the order form or purchase information on the linked to site to the point where the user is taken via the link. This one-link safe harbor should be articulated in a Revenue Ruling, with examples.

This type of safe harbor will require that exempt organizations be diligent in their contracts with sponsors. Since charities cannot continually monitor a sponsor's Web site, the sponsor should be obligated to notify the exempt organization, within a reasonable notice period, if the sponsor changes its site so that the link from the exempt organization's site might somehow fall outside of the safe harbor.

Periodicals. Periodicals, defined as "regularly scheduled and printed material," are specifically excluded from the corporate sponsorship safe harbor of Section 513(i). This gives some importance to the words "regularly scheduled and printed."

Any printed journal that is replicated and published on a Web site should be considered a periodical. This is true even if the format appears slightly different from that of printed periodicals. If a portion of a Web site looks and feels like a periodical, but the rest of the Web site does not, the periodical portion should be treated separately, so corporate sponsorship on the other portions of the Web site can be treated as such. Thus, the IRS should develop a facts-and-circumstances test to determine whether e-magazines that are not published in printed form, or other portions of a Web site that look like and feel like periodicals, will be considered as such. Factors to consider might include:

- Whether the periodical has a regular staff of editors.
- Whether articles are solicited for the periodical from authors outside of the organization (to distinguish it from a newsletter) or, in the alternative, whether the periodical maintains a regular staff of authors who work full time on the periodical.
- Whether the periodical is published on a regular basis (e.g., monthly or quarterly).
- Whether the periodical is treated separately for budget purposes and on the organization's books and records.
- Whether the periodical has subscribers and is otherwise marketed.
- Other facts that go to the overall look and feel of the periodical.

No single factor should be dispositive of this issue.

CHARITABLE SOLICITATIONS

The Service poses three specific questions about soliciting charitable contributions over the Internet.

Disclosure format. Are solicitations for contributions made on the Internet (either on an organization's Web site or by e-mail) in "written or printed form" for purposes of Section 6113? If so, what facts and circumstances are relevant in determining whether a disclosure is in a "conspicuous and easily recognizable format?"

Section 6113 requires organizations that are ineligible to receive tax-deductible charitable contributions to disclose to potential donors that contributions are not deductible. Organizations with annual gross receipts that do not normally exceed $100,000 are exempt from this requirement. Unlike some of the disclosure rules discussed below, Section 6113 has been in place for some time.

Notice 88-120, 1988-2 CB 454, provides additional guidance on how to comply with Section 6113's requirements. The Notice provides safe harbors for various forms of solicitations, including print media, telephone, television, and radio solicitation. The Notice pre-dated the use of the Internet by exempt organizations (and just about anyone else), however.

It would be helpful to exempt organizations if the Treasury could incorporate Notice 88-120 into regulations, and in addition provide the following:

- An extension to e-mail of the safe harbors for letter solicitations.
- An extension to a fundraising Web site of the same safe harbors that apply to printed fundraising.
- Clarification that the disclosure text would need to appear on the actual Web page in which the solicitation is made, and not via a link to another site.

The IRS will also have to struggle with how to enforce the penalties. Section 6710 bases penalties, in part, on how many days an organization fails to comply with the rules.

Section 6710(d)(3) provides that written or printed solicitations (other than those sent by mail) are treated as taking place when the solicitation is distributed. This Section clearly did not contemplate a Web site that remains "on" all the time, and thus could result in extremely large penalties. Congress may need to amend Section 6710(d)(3) to provide a different kind of penalty for Web-based solicitations. In the interim, the authors would hope that the IRS would be reasonable in assessing penalties in these situations.

Quid pro quo. Does an organization meet the Section 6115 requirements for "quid pro quo" contributions with a Web page confirmation that may be printed out by the contributor or by sending a confirmation e-mail to the donor?

Section 6115 requires charities to disclose to donors who contribute more than $75, and who receive a quid pro quo, the portion of the donor's contribution that is not tax deductible. Typically, a charity can satisfy this requirement by including the disclosure on the fundraising materials or by sending the donor a letter. A Web page confirmation that may be printed out by the donor or an e-mail to the donor should satisfy this requirement. The regulations under Section 6115 should be amended to make this point clear. Until it is practical to amend the Regulations, the IRS should provide notice that it will honor Web page and e-mail confirmations.

Written acknowledgment. Does a donor satisfy the requirement of Section 170(f)(8) for a written acknowledgment of a contribution of $250 or more with a printed Web page confirmation or a copy of a confirmation sent by e-mail from the donee organization?

Section 170(f)(8) requires that donors who make charitable contributions of $250 or more to a charity have, in hand, contemporaneous written acknowledgments of their contributions at the time they file their tax returns as a condition to claiming charitable deductions under Section 170. The acknowledgment must include basic information identifying the gift, including the donor's name, the date of the gift, and the amount of the gift or a description (but not the value) of property donated. There is no requirement that the acknowledgment be signed by the charity.

A Web page confirmation or a confirming e-mail from the charity should qualify as a valid acknowledgment, as long as the donor can print out the page. Doing business over the Internet is now commonplace, and charities should not be disadvantaged or forced to waste charitable dollars by continuing to mail out written receipts when such receipts are not necessary. The regulations under Section 170(f)(8) should be amended to make it clear that an e-mail receipt or Web page confirmation, if retained either electronically or in printed form, is sufficient evidence of a charitable gift. Here, too, until it is practical to amend the Regulations, the IRS should provide notice that it will honor Web page and e-mail confirmations.

Other issues. There are a series of other charitable solicitation issues that might be the subject of additional consideration. For example, exempt organizations raise funds over the Internet, both through their organization Web sites and through agents who have their own sites. The Service could be helpful in providing some formal guidance on when contributions that are not made directly through a charity's own Web site are considered to be valid charitable contributions to the charity and when other organizations are considered to be acting as legitimate agents of a charity.

CONCLUSION

The discussion above illustrates the breadth of the Announcement, which in turn reflects the breadth of the Internet's growing presence in American life. Not discussed above, however, is an area that is as broad and troublesome as any, and was also the subject of Congress' most well-publicized tax legislation during 2000. What guidance the IRS should offer on the effect of the Internet on political and lobbying activity will be discussed in a future issue of *The Journal of Taxation of Exempt Organizations.* ■