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Legal Traps of Internet Activities for Nonprofits

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October 6, 2009



Today's Focus

- Introduction
 - Trends
- Tax Issues
 - Unrelated business income
 - Affiliated entities
- Fundraising
- Social media
 - Trademark
 - Defamation
 - Labor and Employment
- Other Issues
 - E-mail Marketing



Online Trends

- For organizations with fewer than 250,000 email addresses on file, the number of unique web visitors over the past year **grew 10.8 percent**
- Traffic **soared 34 percent** for groups with more than 250,000 addresses on file
- Overall, **3 percent of those unique visitors became subscribers**, up slightly from 2.8 percent the year before
- Across all clients, **email files grew 32 percent**, a rate that provides nonprofits an opportunity to engage with more of their constituents

Philanthropy Journal - April 23, 2008



Online Trends

- **Revenue** from online sources, including e-commerce activities, is **up 25 percent**
- The average gift size among nonprofits in the study grew from **\$56 to \$60**
- Online gifts higher than the average gift from traditional channels



Tax Issues

“Organizations and web designers must be aware that the traditional rules with respect to prohibitions on providing particular services, treatment of advertising income, sales activity, as well as lobbying restrictions still apply to website activities.”

2000 EO CPE at 140.



Tax Issues

- Unrelated Business Income (UBI)
 - General
 - Royalty
 - Advertising & Sponsorship

- Affiliated Entities
 - General exemption issues
 - Political activities and lobbying



Unrelated Business Income Tax — Generally

- Unrelated Business Income (UBI)
 - Tax-exempts are **not exempt from all taxes**, only from those taxes that would otherwise apply to income received from activities that are substantially related to their exempt purposes.
 - Income from the **sale of advertising is almost always taxable**.
 - Income may be **offset by directly-connected expenses**.



Unrelated Business Income Tax — Royalty

- Royalty
 - The IRS has not specifically addressed this issue with respect to internet activities.
 - As a general rule, passive royalty income is excepted from the definition of UBI.
 - To be characterized as a royalty:
 - The payments must be for the use of valuable intangible property rights, i.e., use of a name or logo; and
 - The organization must be passive, i.e, the organization cannot:
 - Provide additional services or
 - Lease a membership or mailing list.



Unrelated Business Income Tax — Royalty

- Royalty Examples
 - Payments for use of organization logo on another website.
 - License payments for use of intangible property.



Unrelated Business Income Tax — Advertising & Sponsorships

- IRS treatment of internet advertising

“The Service has yet to consider many of the questions raised by web advertising, merchandising, and publishing, however, it is reasonable to assume that as the Service position develops it will remain consistent with our position with respect to advertising and merchandising and publishing in the off-line world.”

2000 EO CPE at 131.



Qualified Sponsorship Payments

- “Qualified sponsorship payments” are excepted from the definition of UBI.
- A “qualified sponsorship payment” is a payment in exchange for which the corporate sponsor **neither gets nor expects any return benefit** other than:
 - Goods or services, or other benefits, the total value of which does not exceed **two** percent of the sponsorship payment; or
 - **Recognition**, i.e., use or acknowledgment of the sponsor’s name, logo, or product lines in connection with the nonprofit’s activities



Advertisement

- Unlike sponsorship payments, payments received for advertising are characterized as UBI.

- Characteristics of advertisements include:
 - Comparative or qualitative language
 - Price, savings or value information
 - Endorsements
 - Inducement to buy



Corporate Presence on Website

- Banners
- Hyperlinks
- Online Periodicals
- Virtual Trade Shows
- Online Charity Malls
- Virtual Storefronts
- Online Auctions



Unrelated Business Income Tax — Advertising & Sponsorships

■ Banners

- The IRS has not specifically ruled on this issue; however, in 2000 EO CPE, the IRS stated that “a moving banner is probably more likely to be classified as an advertisement.”
- The IRS indicated that banners are more likely than hyperlinks to be characterized as advertising.
- Fees based on “pay-per-view” or “pay-per-click” measures are also likely to be characterized as advertisements.



Unrelated Business Income Tax — Advertising & Sponsorships

- Hyperlinks
 - The IRS has not ruled on this issue, however, in 2000 EO CPE, the IRS stated that:
 - There is support for the position that hyperlinks retain a passive character associated with corporate sponsorship, but
 - A hyperlink may **convert** acknowledgment to advertising
 - Hyperlinks should not lead to a website that features the nonprofit's endorsement of the sponsor's products
 - Be certain that when hyperlinks are provided in exchange for payment to have **written agreement** (for tax and general liability reasons).
 - Exercise **oversight** over the location of the hyperlink (both on the relevant tax-exempt web page and on the "linked-to" page).



Application

- Periodical Advertising –
 - IRS provides a favorable method for allocating expenses against advertising income
 - Online version sufficiently like hard copy periodical?
 - Sufficient segregation of online periodical income and costs?



Exclusions to Safe Harbor Internet Periodicals

- Unavailable for acknowledgments of corporate support appearing in a nonprofit's “regularly scheduled and printed material,” such as newsletters and magazines.
- For these purposes, “printed material” presumably includes materials that are published electronically.



Unrelated Business Income Tax — Advertising & Sponsorships

■ Virtual Trade Shows

- In the 2000 EO CPE, the IRS stated that it will need to consider all facts and circumstances regarding virtual trade shows in making a decision:
 - Whether the virtual trade show consists entirely of links to sponsors;
 - Whether the virtual trade show includes educational information;
 - Whether the virtual trade show is timed to coincide with an actual trade show or annual meeting; and
 - Whether the virtual trade show is available on the internet year round.



Unrelated Business Income Tax

- On-line Charity Malls
 - % of purchase price goes to charity
 - Structure as payment of royalty fees, rather than referral
- Virtual Storefronts
 - Section 513(c) **Fragmentation Rule**
 - IRS will review each piece of merchandise
- On-line Auctions
 - Regularly carried on?
 - Conducted by outside vendor?
 - Must be “continually controlled” by charity



Affiliated Entities — Multiple Tax-Exempt Entities

- **Affiliated Organizations:**
 - With multiple sites, need different entry points
 - “Tab” for 501(c)(3) entity and any PACs
 - Gives indicia of operational separation
 - Possible to “attribute” activity – important both for political and for non-charitable operations
 - IRS TAM 200908050 — suggests the IRS will look for significant “separation” between related entities
- **Reasonable Apportionment** of Site Costs



Affiliated Entities — General Exemption Issues

- Affiliation through hyperlinks
 - “When an organization establishes a link to another web site, the organization is responsible for the consequences of establishing and maintaining that link, even if the organization does not have control over the content of the linked site.” Rev. Rul. 2007-41.
 - To avoid risks of UBI, private benefit, private inurement, and political intervention, organizations must monitor their hyperlinks for:
 - Advertising;
 - Political statements and campaign activities;
 - Non-exempt activities.



Affiliated Entities — General Exemption Issues

- Affiliation through co-ventures
 - The IRS has not issued guidance on this issue, but there are several precautions necessary to avoid risks of UBI, private benefit, private inurement, and engaging in non-exempt purposes:
 - The organization must have a passive role in the relationship;
 - Do not transfer organization assets to a non-exempt “partner” or affiliate;
 - Do not refer to the activity as a “partnership” or “joint venture;” and
 - Monitor the use of the organization logo and trademark to ensure the appropriateness of their use.
 - Be aware of state regulations – co-venture participation may be require various state filings, even where the organization engages in no other activities in the state.
 - Be aware of the use of the organization logo and trademark and the potential use of such in campaigns that may be offensive to the public.



Political Activity & Lobbying – Generally

- 501(c)(3) tax-exempts are limited to “**insubstantial**” activities attempting to influence legislation
- 501(c)(3) Organizations – ABSOLUTELY prohibited from campaign intervention
- 501(c)(4) Organizations – Primary activity cannot be campaign intervention
- If making a **501(h) election, subject to certain financial limits**
 - With internet communications being so important, 501(h) is more attractive – measures in terms of dollars, not “substantiality,” which is difficult to measure.
 - If no 501(h) election, ensure that “appearance” of lobbying on site if “insubstantial” in proportion to non-lobbying



Lobbying and Political Activity Policies

- IRS issued Rev. Rul. 2007-41 regarding political intervention stating that, “If an organization posts something on its web site that favors or opposes a candidate for political office, the organization will be treated the same as if it distributed printed material, oral statements or broadcasts that favored or opposed a candidate.”



Lobbying and Political Activity Policies

- A link to candidate related material alone will not constitute political campaign intervention.
- Facts demonstrating that the link is not campaign intervention:
 - All candidates for an office are represented;
 - An exempt purpose is served by offering the link; and
 - The link does not directly connect the organization's web site to a web page that contains material favoring or opposing a candidate for public office.



Lobbying and Political Activity Policies

- Carefully monitor content – and links
 - A website that contains a view of legislation, as well as a link to a voting legislator’s e-mail, will be considered a “call to action”

- Check sites for links added inadvertently or without authorization
 - Freedom Alliance – Lost 501(c)(3) status due to excessive lobbying, including link to partisan site



Chat Rooms

- As yet, no IRS guidance:
 - To be safe, assume that chat room discussions involving lobbying or electioneering could be attributed to the organization where the commentator presents herself as an organization representative.
 - Prohibit any biased or partisan communications related to candidate elections.



Fundraising

- Jurisdiction/registration and reporting



Social Media

- Issues include:
 - Trademark
 - Defamation
 - Labor and Employment



Who owns your “intellectual capital?”

- Employee Works
- Site Designers
- Authors and Speakers
 - Articles
 - Speeches, handouts and PowerPoint presentations
- Volunteers & Committees
 - Position papers
 - Articles



Securing Rights

- Applies to **All Intellectual Property**
 - Text, Graphics, Photos, Video
- **Assignment**
 - Transfer of all copyright ownership
 - Tax-exempt may use in any form, at any time
- **License**
 - Limited by scope, but can be very broad



Securing Rights - License

- Define **Future Uses**
 - Particularly important for previously published materials
- Define **Geographic Area**
 - Exclusive or non-exclusive
 - Perpetual or limited in duration
- Define **Payment** (or Non-Payment) Terms
- Obtain Licenses from All Authors and Speakers



What If We Don't Have An Agreement?

- **Implied License**
 - Narrowly Construed and Subject to Interpretation
- If Material Exists Elsewhere, **Link to Source**



Practical Tips

- Strategy
 - License, Assignment, or Shared Ownership?
- Adopt a standard policy and practice for all volunteer and committee work.
 - Volunteers sign from outset of work



Practical Tips

- All **authors** sign standard agreements
 - Obtain right to publish AND post online
- **Speakers** grant rights to post online
- **Paid Contractors** agree to standard assignment



Protecting Your Intellectual Property

- Allowing others to use articles
 - Clearly **define use and duration**
 - **Ensure you have what you give away**
- Hyperlinks by third parties
- Monitoring others' use



Defamation

- Comments made on your website can be attributable to your organization.
- Includes disparaging comments about other companies' products and services.
- Utilizing disclaimers, terms of use and other steps will lessen risks.



Labor and Employment

- What if employees use Facebook, Twitter on “company time”?
- What about organizations that have their own Facebook presence?
- What about employees who talk about their employers on blogs, Facebook (on their own time)?
- Bottom line — clear, reasonable employee policies that are enforced in a consistent manner should serve to minimize risks.



Limiting Liability

■ Assess Your Vulnerabilities

- Antitrust?
- Defamation?
- Contributory Copyright Infringement?
- Political Activity?
- Giving “Professional” Advice?
- Anything Else?



Use Terms

- Require all participants to follow **established rules**:
 - **Affirmative act**, such as “click and accept” to enter
- **Disclaim** all warranties, guarantees, liability
- Prohibit **defamatory**, **infringing**, potential **antitrust**, and **political** discussions (among others, such as no sales, no negative discussion of specific companies or professionals, etc.)



Use Terms

- **Monitor** postings
- **Act** when inappropriate material is posted
- Monitoring on its own does not necessarily create liability, but note the general presumption that the more one acts as an “editor,” the greater potential exposure on liability.
- See 47 U.S.C. § 230 — applicable to tort liability, not antitrust or intellectual property infringement



Email Marketing



Application

- Emails that are primarily intended to **advertise** or **promote a commercial product** or service, such as **membership** in the organization or the sale of organization **publications**
- **Members** generally excluded



General Rules

- Give **clear and conspicuous** notice of the **opportunity to opt-out**.
 - The notice must be in **every email message containing a commercial offer**.
 - **No fee or other obligations** on the message recipient before processing the recipient's opt-out request
- Provide a **functioning opt-out** in every commercial email message. This can be a return email address or other Internet-based mechanism that is capable of receiving opt-out requests for at least 30 days after the transmission of the original message.
- Further, **if the recipient has opted-out**, the sender **may not rent, exchange or otherwise transfer or release the email address** of the recipient.



General Rules

- Provide a **valid physical postal address of the sender.**
- Clear and conspicuous **notice that email is an advertisement or solicitation**
- Make sure the **"from" line accurately and clearly reflects the sender.** Something like "products@nonprofit.org," "programs@nonprofit.org" or "memberservices@nonprofit.org" could be used to identify your organization
- Use a **valid subject line.** There currently are no labeling requirements for the subject line ("ADV" for advertisement, for example).



Questions

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