Tax-Exempt Organizations and the Internet

(Part 1)

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The Internet can be a marvelous way for tax-exempt organizations to further their missions. It can also pose qualification and UBIT traps, among other problems.

AS THE INTERNET BECOMES an increasingly important method for communicating with the world and conducting exempt-purpose activities, tax-exempt organizations are using the Internet more and more heavily. The wide array of uses for the Internet is generating an ever-growing list of tax questions for these organizations. The IRS and Treasury have recognized this development and announced in the winter of 1999 that they intend to solicit public comments on which questions are of concern and how they should be answered.

This article is organized by types of Internet-based activities that an organization may undertake. For each activity, it then presents and analyzes relevant tax issues. It also identifies other pertinent legal issues, especially intellectual property issues, that bear on the organiza-

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tion's capacity to undertake the activity. These non-tax issues can have very significant consequences. Therefore, tax-exempt organizations would be well advised to do a comprehensive legal review of any significant Internet activities that covers not only tax issues but all the legal ramifications of using this new medium.

The tax issues prompted by use of the Internet fall generally into four categories:

Effect on Exempt Status

Does the conduct of the activity affect the ability of the organization to meet the qualifications for tax exemption under the applicable Internal Revenue Code ("Code") provisions, e.g. section 501(c)(3)? If there is international participation in the activity, will other countries assert jurisdiction to tax income generated, and will they recognize a tax exemption for the organization?

UBIT

Does the activity generate a stream of income that is subject to the unrelated business income tax? If so, how is the amount of taxable income to be calculated?

Sales Tax and Tax on Business Activity Outside the U.S.

If the activity involves sales of goods or services, which jurisdictions have authority to tax the income generated from the specific sales? Which jurisdictions have the authority to tax the organization's income generally?

Grant-Related Issues

If a private foundation is funding an Internet-based activity in whole or in part, will the nature of the activity generate either self-dealing or a taxable expenditure for the foundation? Does the activity violate other grant restrictions?

The non-tax issues fall generally into the following categories:

Copyright and Protection of Intellectual Property

How can organizations protect their original work appearing on the World Wide Web from infringement, as well as avoid using the copyrighted materials of others without proper authorization?

Torts, Including Defamation and Invasion of Privacy

The power of the Internet has changed the nature of many office communications and has given many organizations a great deal more visibility and publicity than in the past. What types of actions might an organization engage in, perhaps unwittingly, that could expose it to potential tort liability?

Multistate Operations

The Internet opens up exciting new avenues through which your organization can reach an ever-growing audience. When does taking advantage of these opportunities mean that the organization is subject to regulation in a new jurisdiction? Are you required to register with all 50 states if you raise funds over the Internet?

Contractual Issues

What types of contractual terms might your organization encounter in connection with Internet activities? For example, are you operating under Federal grants or contracts, the terms of which apply to Internet activities? Does your organization have an Internet service provider agreement?

WORLD WIDE WEB SITES • As use of the Internet becomes more widespread, many tax-exempt organizations are discovering that establishing a Web site is a convenient and cost-effective way to provide information about themselves to a broad audience, communicate with their members, conduct research, and raise funds. Obviously, organizations have been communicating with the public and soliciting support for decades using different but analogous tools, including newsletters, direct mail, phone banks, and public forums. Therefore, much of the applicable tax and legal analysis exists and can readily be applied with proper allowance made for the unique flexibility of Internet technology. The IRS recently confirmed this view in its FY 2000 Continuing Professional Education Text, *Exempt Organizations Technical Instruction Program for FY00* (hereafter "FY00 CPE Text"). See the article therein entitled "Tax-Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet."

The fact that a Web site exists in an electronic environment means that individuals both inside and outside the organization may be able to alter its content without the organization's permission. Furthermore, one of the virtues of the Web, the ability to connect sites to one another with great ease, can also increase tax and other legal risks, because the organization may be associated with other individuals or entities in the public mind, not always with the organization's permission (or even its knowledge).

The ability to drastically reduce the cost in time and dollars of conducting certain activities may affect the ability of certain organizations to conduct these activities while remaining tax exempt, and may also challenge assumptions the IRS made when developing existing legal guidance. For these reasons, tax-exempt organizations would be well advised to review the common tax and legal issues that apply when using the Internet to communicate with members, potential donors, and the general public, and consider especially how they can adopt policies that protect them from exposure to tax liabilities or other adverse legal consequences.

POSTING A WEB SITE FOR A TAX-EXEMPT ORGANIZATION • Many tax-exempt organizations have posted a site on the Web with an address and content that is specific to the organization. The site may contain basic descriptive information about the organization, its activities, and its staff and members (if any). It often tells readers how to contact the organization generally or make specific requests, such as grant applications. In these respects, the site is very much like an annual report or newsletter from the organization. Simply making the site available with this basic descriptive content is an administrative function and should be consistent with operation for exempt purposes.

The Web site information must be stored on a computer (known as a server) that is constantly accessible to others searching the Web. The organization may maintain its own server or it may arrange to have the site "hosted" on someone else's server, often for a fee if the host is a commercial operation.

Tax issues tend to arise in connection with the content placed on the Web site, sometimes when it is related to the organization's program and sometimes when it is not program-related but is instead designed to generate income for the organization.

Lobbying Content

Charitable, educational, religious, and other similar organizations that are exempt from tax under section 501(c)(3) of the Code may devote no more than an insubstantial part of their activities to attempts to influence legislation. (All section references are to the Code unless otherwise indicated.) If a section 501(c)(3) organization makes the election provided by section 501(h), its lobbying activities will be measured according to rules set forth in Treasury regulations under section 4911. An electing section 501(c)(3) organization is generally permitted to incur expenditures for direct lobbying of no more than $1 million per year and expenditures for grassroots lobbying of no more than $250,000 per year. Treas. Reg. §56.4911-1(c).

For organizations that do not make the 501(h) election, the IRS has raised an interesting question about how to measure Web-based activity. Its recent CPE article questions whether a Web page is distributed when it is loaded on to a server and becomes accessible to the public or whether it is distributed every time it is accessed. FY00 CPE Text, 127. For purposes of determining whether activity is substantial, there could be a significant difference between the first approach, which has the organization engaging in a single act, and the second, which has the organization engaging in repeated distributions. It seems the more reasonable answer is to treat the posting of the Web site as the organization's activity. Each "hit" is generated by the action of the Web user visiting the site, not by the organization.

If a section 501(c)(3) organization posts content on its Web site that takes a position with respect to specific legislation, the posting may well constitute lobbying. Moreover, for organizations making the section 501(h) election, the posting is likely to constitute grassroots lobbying subject to the lower expenditure limitation because the Web site exists in the public domain and is intended to reach the general public and not just an audience of legislators or government officials. *Compare* Treas. Reg. §56.4911-2(b)(1) and Treas. Reg. §56.4911-2(b)(2). If the Web site contains material that not only refers to specific legislation but also encourages the reader to act with respect to that legislation, that material appears to fall within the definition of grassroots lobbying. *See* Treas. Reg. §56.4911-2(b)(2). More generous rules apply to communications directed only or primarily to members; the rules treat these communications either as not lobbying expenditures at all or as direct lobbying rather than grassroots lobbying. *See* Treas. Reg. §56.4911-5. These rules may apply if the legislative information exists on a part of the Web site accessible only to the organization's members.

"Mass Media" Advertisements

The section 4911 regulations also contain special rules for "mass media" advertisements. A mass media advertisement that would otherwise not be considered grassroots lobbying is presumed to be grassroots lobbying if issued within two weeks before a vote of a legislative body or committee on a highly publicized piece of legislation. Treas. Reg. §56.4911-2(b)(5). The regulations define "mass media" to include television, radio, billboards, and general circulation newspapers and magazines. Treas. Reg. §56.4911-2(b)(5)(iii)(A). Therefore, the recharacterization rule should not apply to communications issued over an organization's Web site unless the IRS and Treasury seek to amend this regulation. However, if a section 501(c)(3) organization pays to include an advertisement in an exclusively Web-based publication, or to in-

clude a link in such a publication to the lobbying message on the organization's Web site, the IRS may argue that "general circulation newspapers and magazines" include those distributed exclusively over the Web and that the mass media rule does apply.

Measured by Expenditures

The standards developed under section 4911 are based on an organization's expenditures: thus volunteer contributions of services are disregarded for this purpose. *See* Treas. Reg. §56.4911-3(a)(1). Messages can be distributed over the Internet to a huge public audience at a fraction of the cost of distribution using direct mail or mass media. Therefore, section 501(c)(3) organizations electing to be subject to the spending limitations may be able to engage in substantially more lobbying activity using the Internet under the limitations. The IRS has given no indication that expenditures for electronic communications will be measured any differently than for the traditional means contemplated when the section 4911 regulations were written.

Other Exempt Organizations

Content relating to specific legislation is of less concern to organizations that are exempt from tax under sections other than section 501(c)(3), such as social welfare organizations that are exempt under section 501(c)(4), labor organizations that are exempt under section 501(c)(5), and trade associations that are exempt under section 501(c)(6). These organizations are permitted to engage in lobbying activities without any limitation on expenditures, provided that their lobbying activities are consistent with the requirements for exemption. For example, a section 501(c)(4) organization may engage in either direct or grassroots lobbying provided that the organization is "operated primarily for the purpose of bringing about civic betterments and social improvements." Treas. Reg. §1.501 (c)(4)-1(a)(2). A section 501(c)(6) trade association may engage in either direct or grassroots lobbying provided that its "activities [are] directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." Treas. Reg. §1.501(c)(6)-1.

However, if a non-section 501(c)(3) organization is affiliated with a section 501(c)(3) organization, the non-charity must take care that its lobbying activities not be attributed back to the charitable organization. For example, see the section below on links between Web sites for a discussion of one way this attribution could arise. In addition, there are specific regulations describing how a transfer from an electing public charity to a noncharity can be treated as a lobbying expenditure if the transfer is not made subject to specific limitations. *See* Treas. Reg. §56.4911-3(c). Finally, for affiliated organizations that share staff and facilities, employee time and other costs related to any lobbying portions of either organization's Web site, or any shared Web site, must be properly allocated.

Political Activity Content

Web site content that relates to political campaigns may also give rise to tax concerns. Charitable, educational, religious, and other similar organizations that are exempt from tax under section 501(c)(3) may not intervene in any campaign for public office and remain exempt from federal income tax. The prohibition is absolute.

In addition, section 4955 imposes a 10 percent excise tax on each expenditure a section 501(c)(3) organization makes to participate or intervene in a political campaign. Section 501(c)(4) organizations must limit their political activities, because direct or indirect participation or intervention in a political campaign does not constitute promotion of social welfare, and a section 501(c)(4) organization must be operated primarily for the promotion of social welfare. Treas. Reg. §1.501(c)(4)-1(a)(2). *See, e.g.*, Rev. Rul. 81-95, 1981-1 C.B. 332 (organization provides financial assistance and in-kind services to political campaigns but not to an extent that would make the assistance its primary activity). Trade associations may engage in political activity without jeopardizing their tax-exempt status provided that their political activity promotes the interests of an entire line of business and does not provide a particular service to members. Treas. Reg. §1.501(c)(6)-1.

One special subcategory of tax-exempt organizations, section 527 political organizations, operates under converse rules that provide for tax exemption on income that is used for activities that are directly related to and support the process of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to public office or office in a political organization. Treas. Reg. §1.527-2(c). Section 527 organizations are taxable on their non-exempt function income. Therefore, to the extent they receive income that they do not use in the same year for political campaign purposes, they will owe tax. These organizations, which are typically candidate committees and party organizations, will want their Web site content to promote candidates for office to maximize their tax benefits.

Political Campaign Intervention

The Service has provided some guidance over the years on how to identify political campaign intervention. For a summary of the guidance, and particularly the guidance relating to section 501(c)(3) organizations, see J. Kindell and J. Reilly, "Election Year Issues," *Exempt Organizations Technical Instruction Program for FY93*, 400. For example, section 501(c)(3) organizations may publish legislators' voting records or issue voter guides under certain circumstances without intervening in a political campaign. *See, e.g.*, Rev. Rul. 78-248, 1978-1 C.B. 154, Situation 1 (publishing voting record with no editorial commentary or structure suggesting opinion on votes); Rev. Rul. 80-282, 1980-2 C.B. 178 (publishing voting record on select issues in regular newsletter without commenting on who is candidate for re-election or timing publication to affect election). Both section 501(c)(3) and 501(c)(4) organizations should be aware that it is unclear whether the IRS will treat advocacy with respect to certain issues that are closely identified with particular candidates as campaign intervention. Therefore, if an organization is considering using its Web site to advocate a position on an issue that is closely identified with a candidate for public office or has been publicized intensively in connection with an election, it should seek assistance from knowledgeable sources before using the Web site in this way.

Unlike the standards for permissible lobbying that apply to section 501(c)(3) organizations making an election under section 501(h), the standards for permissible campaign intervention consistent with exemption under section 501(c)(3) are not tied to expenditures. Therefore, any amount of political campaign activity rep-

resents a potential basis for revocation of exemption for a section 501(c)(3) organization, regardless of whether it is accomplished over the Web at little or no financial cost to the organization. Limiting the expenditure may reduce or eliminate liability for tax under section 4955, but the IRS retains the discretion to seek revocation in combination with tax under section 4955 or separate and apart from any tax owed under that section. Treas. Reg. §53.4955-1(a). Accordingly, tax-exempt organizations that are subject to tax-based restrictions on their political activities should ensure that any information posted on the organization's Web site on the organization's behalf that refers directly or indirectly to a candidate for public office be evaluated as possible campaign intervention. An individual is a candidate if he or she offers himself or herself or is proposed by others as a contestant for an elective public office at the national, state, or local level. *See* Treas. Reg. §§1.501(c)(3)-1(c)(3)(iii); 53.4945-3(a)(2).

Placing political content on a Web site can also have tax consequences for any private foundation that has provided a grant to support development or maintenance of the Web site. If a private foundation makes a grant to support intervention in a political campaign, it makes a taxable expenditure pursuant to 4945(d)(2) and owes a 10 percent excise tax on the expenditure. The connection between the Web site content and the private foundation grant will arise only if the private foundation grant is earmarked for use in connection with the Web site or the political campaign activities. *See* Treas. Reg. §§53.4945-3(a)(1); 53.4945-2(a)(5). A grant is earmarked "if the grant is given pursuant to an agreement, oral or written, that the grant will be used for specific purposes." *Id.*

Advertising and Other Unrelated Trade or Business Content

A tax-exempt organization may accept advertising from other entities for its Web site. The advertising may include text and/or graphic images. It may or may not include a link to the advertiser's Web site. Particularly if the organization's Web site is popular and regularly receives many "hits" from Web users, advertising may be an attractive way to raise funds. Organizations that receive income in return for letting others advertise on their Web sites may owe unrelated business income tax on that income.

UBIT Basics

All organizations that are exempt from federal income tax under section 501(a) as organizations described in section 501(c) are subject to tax under section 511 on their income from unrelated trades or businesses. An activity constitutes an unrelated trade or business if:

- It is carried on for the production of income;
- It is regularly carried on; and
- It is not substantially related to the performance of exempt functions. Treas. Reg. §1.513-1(a).

The fact that the business is carried on in conjunction with other exempt-purpose activities, such as when the Web site is used to conduct core exempt-purpose functions like education of members and the public and also to generate income from advertising, does not affect the characterization of the activity intended to produce the profit as a trade or business. §513(c). This "fragmentation rule" as it is called clearly applies to advertising that appears in publications that are otherwise furthering the organization's exempt purpose. *See* Treas. Reg. §1.513-1(b).

Although the IRS has not directly applied it to Web site advertising, the analogy seems apt if the advertising appears regularly on the Web site.

If the material posted on the organization's Web site constitutes an "acknowledgment" of a corporate sponsor rather than advertising for that sponsor, income received in exchange for that acknowledgment will generally not be subject to UBIT. §513(i). A message is considered an acknowledgment and not an advertisement if it does not include messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services. §513(i)(2)(A). An acknowledgment may include the corporate sponsor's name, logo, or product lines and still not constitute an advertisement. The IRS applied these principles in TAM 9805001 to conclude that the benefits granted to a pet food company in return for its financial support of an animal show that was broadcast to millions of television viewers constituted acknowledgments and not advertising. The company's product and its traditional slogans were used in the pages the company used in the organization's printed materials, and its name appeared on arm bands worn by participants and other signs at the show.

Can a Link Make it Advertising?

It is unclear whether a link to the sponsor's Web page will convert what would otherwise be an acknowledgment into advertising. There is no published authority on this point. According to one private letter ruling, which discussed the issue in passing, providing a link to the sponsor's Web page would cause a message to be an advertisement rather than an acknowledgment. Pvt. Letter Rul. 9723046. However, in an article on Internet Service Providers, the Exempt Organizations Technical Instruction Program for FY 1999 states the following:

"In determining what on the Web page is advertising, a rough rule of thumb is that if it is an active or passive placard, or a running banner and income is being derived, it is advertising. If the Web page shows merely a displayed link, then it may not be advertising, but only if related to activities or purposes of the organization."

The IRS repeated this view in the FY00 CPE Text.

Treasury and the IRS have announced that they intend to publish regulations under the corporate sponsorship rules. Proposed regulations issued in 1993 before section 513(i) was enacted provided that an acknowledgment could include information about a sponsor's location and telephone number. It remains to be seen whether the revised regulations will retain this position and how it might be applied to Web links to corporate sponsors. If the link does convert the message from an acknowledgment to advertising, it is still possible to divide any payment received from the sponsor into a portion attributable to the advertising and a portion that may still be a qualified sponsorship payment. Congress specifically provided for this type of apportionment in IRC §513(i)(3).

The exception for corporate sponsorship payments does not apply if the payment entitles the sponsor to acknowledgment in "regularly scheduled and printed material published by or on behalf of the [sponsored] organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization. ..." §513(i)(2)(B)(ii). The word "printed" appears to limit this exception

to material appearing in hard copy, but the IRS has yet to confirm that it will apply the general exception from UBIT for income received in exchange for acknowledgments (rather than advertisements) when an acknowledgment is provided on a Web site.

Advertising UBIT

If the material appearing on the Web site is advertising under the section 513(i) definition, and the organization has no policy for screening advertisements so that it displays only those that contain a message that advances the organization's exempt purpose, the carrying of that advertising is likely to constitute a trade or business that is not substantially related to the organization's exempt purpose. This position is supported by the Supreme Court's decision in *U.S. v. American College of Physicians*, 475 U.S. 834 (1986), which held that even though the charitable organization limited advertising in its journal to medical products related to the readers' professional activities, the way the advertising was selected did not provide the readers with either comprehensive or systematic analysis of issues or novel information. The Court noted that to be related, the advertising would have to be coordinated with the journal's editorial content or limited to promoting newly introduced products that were objectively determined to be safe and effective. *Id.* at 849-50. For purposes of determining whether advertising activity is regularly carried on, the regulations state that "the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by nonexempt organizations." Treas. Reg. §1.513-1(c)-(2)(ii). However, very infrequent activities, like annual fundraisers, are generally not considered to be regularly carried on. Treas. Reg. §1.513-1(c)(2)(iii).

UBIT and Periodical Advertising

Special rules apply for purposes of calculating the unrelated trade or business income derived from periodical advertising. The Web has its equivalent of periodicals, delivered in electronic form to subscribers on a regular schedule. To the extent tax-exempt organizations produce these, the UBIT rules for calculating periodical advertising income should apply. However, there is a good argument that these special rules should not apply to advertising on Web sites. Although some Web sites may be revised on a regular schedule and made available only to subscribers, many are revised only as needed for accuracy or to serve the organization's programmatic needs. Much of the site is often available to the general public regardless of whether the reader has ever previously asked for access to information from the organization. The Web site functions more as a brochure, catalog, or annual report. (Note that the argument whether a Web site should be treated as a periodical also has consequences under the special rule for acknowledgments and corporate sponsorship described above.)

The FY00 CPE Text takes an interesting, and perhaps controversial, position on whether a Web site should be treated as a periodical. It states:

"Most of the materials made available on exempt organization Web sites are clearly prepared in a manner that is distinguishable from the methodology used in the preparation of periodicals. ... The Service will be unwilling to allow the exempt organization to take advantage of the specialized rules available to compute unrelated business income from periodical

advertising income unless the exempt organization can clearly establish that the on-line materials are prepared and distributed in substantially the same manner as a traditional periodical."

Id. at 138. The benefit of this IRS view is that most Web sites will not be seen as periodicals, meaning that the corporate sponsorship exception to UBTI will be available but the special rules for calculating UBTI—where advertising does occur—will not.

It is unclear how the Service made the leap from the language in section 513(i), which focuses on how often a publication is printed and appears to readers, to its view that the method of production determines whether something is a periodical. The process of writing, editing, and producing publications, in hard copy or electronic form, varies greatly from organization to organization. Content comes from staff, professional writers, members, volunteers, unsolicited submissions, and other sources. Some organizations heavily revise and edit content. Others simply go through the mechanical process of laying out and printing submissions as the author has written them. Therefore, no one can say what methodology an organization must show the Service to prove a Web-based item is or is not a periodical. The common element among periodicals is their regular "periodic" schedule for distribution to the public. Perhaps the IRS will rethink its view on this point.

Costs Offset

If the IRS were to take the position that a Web site constitutes a periodical, the rules of Treas. Reg. §1.512(a)-1(f) would govern in determining how much unrelated trade or business income an organization derives from selling advertising on its Web site. In general, this would mean that gross income from advertising on the site could be offset only by direct costs of that advertising. If the gross advertising income exceeds the direct costs of the advertising, the gross income can be further reduced by editorial costs that exceed circulation income. However, editorial costs cannot be used to generate a net loss from advertising that would offset other unrelated trade or business income.

If the IRS were to accept that a Web site is not a periodical, UBTI generated from advertising on the Web site would be determined by adding the gross income generated to the gross income generated from other unrelated trade or business activities (other than periodical advertising) and subtracting the expenses directly connected with the carrying on of the unrelated trades or businesses. (It is peculiar that the FY00 CPE Text suggests that organizations are hurt by not being "allowed" to use the special rules for advertising. Being freed from the more restrictive UBIT rules for periodical advertising is generally viewed as a benefit.) The expenses must have a "proximate and primary relationship" to the carrying on of the trade or business. Treas. Reg. §1.512(a)-1(a). Expenses should include the allocable portion of expenses for facilities or personnel used both for exempt functions and unrelated trade or business activity. When allocation of dual use expenses is required, taxpayers are entitled to use any "reasonable basis" to make the allocation. Treas. Reg. §1.512(a)-1(c). Under the regulation, allocating expenses based on the time devoted to the relative activities is an acceptable method. *See Rensselaer Polytechnic Institute v. Commissioner*, 732 F.2d 1058 (2d Cir. 1984).

In addition, when the exempt purpose activity involves exploitation of an exempt function, such as when unrelated advertising is included in an exempt organization periodical, special

rules apply that limit the amount of exempt function expenses that can be used to offset unrelated trade or business income. Treas. Reg. §1.512(a)-1(d).

LINKING THE ORGANIZATION'S WEB SITE TO OTHER WEB SITES • A tax-exempt organization's Web site can be linked to a site maintained by another entity of any kind—taxable, tax-exempt, governmental—in one of two basic ways. The first is a simple link. The user clicks on text or an image appearing on the first Web site and is carried over entirely to the new Web site. The point of origin disappears from the screen. The second is a framing link. The user clicks on text or an image appearing on the first Web site, and a new, smaller box appears over the original Web site. The new box contains the linked Web site and can be navigated separately from the original Web site. However, the site of origin continues to appear in the background, and the user can return to it simply by closing the overlay box.

Links have been the subject of much discussion because they distinguish the Internet from other media. They enable members of the public to make connections between pieces of information very easily at their own initiative. Thus, someone could be reading entirely educational material on a section 501(c)(3) organization's Web site, use a link in that material to move to educational material on a site created by a section 501(c)(4) organization, and then move in one more step from that site to a site devoted exclusively to a lobbying campaign. The section 501(c)(3) organization did not connect that series of events even though it invited the reader to take the first step. The browser software that is used to navigate the Web often creates a link between two pages whenever it finds a Web address in the text of a Web site, even if the party posting the address has no intention of creating a link to the address being provided. (In fact, some word processing software programs create links in the same manner, automatically creating links from individual documents that contain Web addresses when viewed on line.)

An organization can elect to be linked to other Web sites by placing links on its own Web site or giving permission, if asked, for another entity to create a link on its Web site to the organization's Web site. However, other Web site sponsors do not always ask for permission to establish links, and there is no sure way to prevent links from being created in the open Web environment. Failure to ask for permission may raise non-tax legal issues. Therefore, tax-exempt organizations should be wary of establishing links on their own Web sites without asking permission from the destination Web site. From a tax perspective, it would be thoroughly unfair to hold an organization responsible for links it did not create and did not give permission to create, regardless of whether the links give the impression that the organization is involved in activities conducted on the linked page that violate the requirements for tax-exempt status. Nevertheless, organizations should be aware of the issues raised by links so that they can adopt policies for the links they initiate and policies to help protect them against attribution of activities from links they did not create and did not approve.

Links Made By the Tax-Exempt Organization

A tax-exempt organization is likely to establish links with a variety of other entities. First of all, it is likely to establish links with sites maintained by affiliates. For example, a corporate foundation may be linked to the corporation's main Web site. A section 501(c)(3) organization

may be linked to the Web site of its section 501(c)(4) or section 501(c)(6) affiliate. The links are unlikely to have an adverse effect on tax-exempt status if they are serving an administrative function, i.e., if the link functions much as a telephone operator would, directing a member of the public with an inquiry to the proper entity to address his/her inquiry. At the other extreme, if the link is provided in a way that accomplishes purposes indirectly that the organization would be prohibited from accomplishing directly, and the link *appears* to be intended to have that effect, having the link may cause the IRS to question the organization's exempt purpose.

Let's take a section 501(c)(3) organization, which can do only a limited amount of lobbying, and which is linked to the Web site of its section 501(c)(4) affiliate, which can do an unlimited amount of lobbying. The context in which this link is provided will become very important. If the section 501(c)(4) affiliate's Web site has portions devoted to lobbying and political activity and portions devoted to educational activity, creating a link to the educational portion—preferably located on a separate page with no lobbying or political content—will reduce the risk of attributing the lobbying activities back to the section 501(c)(3) organization.

Similarly, introducing the link with a statement about how it furthers charitable and educational purposes—such as a statement that says "see the site of our affiliated organization for comprehensive bibliography of recent research on this issue"—will also help the section 501(c)(3) organization build a foundation for arguing that the link does not give rise to a lobbying communication or political intervention. Affiliated section 501(c)(3) and 501(c)(4) entities must be careful to maintain their separate identities and to allocate expenses according to a reasonable method. Thus, if a 501(c)(3) organization and its 501(c)(4) affiliate each has a page on a single Web site, which could be analogized to each having a portion of shared office space or each using a portion of shared staff time, each organization should pay its share of the costs associated with the space it uses.

Consider the Section 501(h) Election

Given the lack of clear guidance on these issues, section 501(c)(3) organizations that have not done so already would be well-advised to make the election under section 501(h). The low cost of most electronic activities means that organizations are likely to remain well under the caps that apply to electing organizations. Furthermore, making the election means that any volunteer activity will not count for purposes of determining whether the organization has complied with the lobbying restrictions.

A tax-exempt organization may also link itself to sites maintained by other, unaffiliated groups, including nonprofits, businesses, governments, or individuals. In general, to avoid an adverse consequence for the organization's exemption, these links should be screened for how they relate to furthering the organization's exempt purpose. Although there is no authority directly on point, the IRS has repeatedly reviewed the subject of listings in exempt organization directories for non-members for purposes of determining whether fees charged for the listings constitute unrelated trade or business income. When listings are provided in an exempt organization's journal, 60 to a page, the Service has taken the position that fees for the listings are not UBIT. *See* Rev. Rul. 76-93, 1976-1 C.B. 170. However, display advertisements, even if they do not make specific reference to

products or services, may still generate UBIT if they are intended to earn goodwill in furtherance of the advertiser's business. *See id.*, Rev. Rul. 74-38, 1974-1 C.B. 144. When an organization initiates a link and does not generate any income from maintaining it, it will not face a UBIT question.

Connections to Supporters

Some links will connect the nonprofit with businesses or other generous supporters of the organization. The consequences of those links will depend largely on whether they constitute advertising or acknowledgments of the sponsors. (See discussion above.) For organizations that seek to promote business, like chambers of commerce, tourist bureaus, or trade associations, links to businesses may well be in furtherance of exempt purposes. For example, a chamber of commerce may promote business generally in its geographic region by providing information on member businesses and how to contact them if you want to partake of their services. If an organization has a policy for selecting which links with businesses it will approve and which it will reject, it should be sure that policy is consistent with the applicable requirements for exemption. A section 501(c)(3) organization must avoid operating for the benefit of private parties, such as the businesses that benefit from links with the charity's page. A section 501(c)(6) trade association must promote an entire line of business, not the particular interests of members who benefit from a link. Selective links, especially links that appear to endorse a business on the other end, will give rise to these concerns.

The same concerns about context for a link arise with links to government Web sites maintained by public office holders. Links to campaign Web sites may be perceived as campaign intervention, regardless of how they are framed. For example, if a link to a campaign Web site was labeled as a way to find information about certain "prominent friends of the organization," it may be perceived by the IRS as campaign intervention even though there is no specific reference on the organization's Web site to any political campaign. It would be far safer to maintain links to the official government sites certain candidates maintain as incumbents rather than to their campaign Web sites. However, depending upon the public visibility of the race and the other context provided by the tax-exempt organization, the IRS might still challenge the mere existence of the link as political campaign intervention. (On a related topic, the Federal Election Commission has recently issued an Advisory Opinion (1999-25), ruling that a joint project between two 501(c)(3) organizations does not violate the Federal Election Campaign Act when it provides non-partisan information on a Web site about federal election campaigns.)

Links Originating at Other Web Sites

Other organizations may wish to link with your organization. Sometimes they will establish a link without your permission or knowledge, and sometimes they may ask for your consent.

Knowing that it may receive requests for permission for a Web site link, a tax-exempt organization would be well-advised to develop a policy for determining which requests it will honor and which it will reject. Considerations should include:

- Connection between the other Web site and the organization's exempt purpose;
- Likelihood that activities conducted through the other Web site would jeopardize exemption

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valuable public exposure and recognition, particularly if the other Web site is very popular and gets a lot of "hits" from individuals using the Internet. Supplying content will also raise the same issues the organization would have if another party were going to publish material the tax-exempt organization authored. From a tax perspective, the tax-exempt organization will care about maintaining editorial control over its material and having some discretion over the context in which it appears. From a non-tax perspective, the tax-exempt organization will care about protecting its intellectual property rights in the material and not having the material used in any way that would create liability for it.

Business Web Sites

Some businesses have realized the marketing value of having an endorsement or affiliation with certain nonprofit organizations or experts who are based in the nonprofit world—such as having a message from the American Heart Association on the package of certain food products or an endorsement of a toy from a nonprofit parenting association. For similar reasons, some businesses have also appreciated the value of using their Web sites as a forum for presenting information developed by nonprofits and their affiliated experts. One example would be child-rearing advice provided by experts on the Web site of a manufacturer of a children's product, like diapers. Typically these experts are well-respected researchers from various universities and medical research facilities.

Organizations affiliated with individuals whose advice or endorsement appears on business Web sites will want to avoid the perception that they are being operated for the benefit of the business. Simply contributing content to a business's Web site as one of many exempt purpose activities is unlikely to cause a section 501(c)(3) organization to be viewed as violating the private benefit restriction, but these relationships with businesses still merit careful review to prevent time-consuming questions from the IRS or a general loss of credibility on the charity's part. Most cases that have led to revocation of charitable tax-exempt status based on operation for private benefit have involved a business or other private party with an exclusive relationship with the exempt organization.

For example, in *American Campaign Academy v. Commissioner*, 92 T.C. 1053 (1989), a campaign school was found to operate for the benefit of the Republican party, featuring Republican materials in its curriculum, using mostly Republican-affiliated individuals as teachers, and placing the vast majority of its graduates in Republican campaigns for office. In *P.L.L. Scholarship Fund v. Commissioner*, 82 T.C. 196 (1984), a scholarship fund was found to operate for the private benefit of the lounge that created it, sponsored it, and hosted the bingo games that were the sole source of its revenue. In *Est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), a nonprofit that offered seminars, lectures, and training was found to operate for the benefit of the for-profit organization that founded it, owned the copyright to the materials it used in its educational programs, and gained the rights to any new materials developed by the nonprofit in connection with its educational program.

UBIT Concerns

UBIT may be more of a concern than private benefit or other conflicts with exemption requirements when a business is paying a nonprofit for the right to use its material, have its endorsement, or offer the views of its most

prominent staff. The payment could be exempt from UBIT as a royalty if it is given in exchange for the rights to use copyrighted material or other protected intellectual property. *See* Rev. Rul. 81-178, 1981-2 C.B. 135; Rev. Rul. 76-297, 1976-2 C.B. 178. However, if the payment is in exchange for an endorsement of the business, its products or services, or for special rights to present the views of prominent staff people or experts from the organization, the payment clearly will be for a service and not be a royalty. Rev. Rul. 81-178. Whether it will be subject to UBIT will depend upon whether providing the endorsement furthers the organization's exempt purposes. If the payment is a royalty, retaining the right to monitor quality control will not change the characterization of the payment. *See id.*, Rev. Rul. 76-297, 1976-2 C.B. 178.

Web Sites of Other Tax-Exempt Organizations

Tax-exempt organizations may also contribute content to Web sites maintained by other tax-exempt organizations. If the contributing and receiving organizations are exempt under the same statutory provisions, *e.g.*, they are both section 501(c)(3) organizations, the contribution of material is unlikely to raise tax issues, assuming the receiving organization is careful in observing the requirements for maintaining tax-exempt status. However, the contribution of material may continue to raise other legal issues, like protection of intellectual property rights. See below.

If the contributing organization and the receiving organization have different bases for exemption, *e.g.*, the contributing organization is exempt under section 501(c)(3) and the recipient is a section 501(c)(4) organization, special attention should be paid to how the information will be used to avoid giving the IRS a basis for arguing that the contributing organization is participating indirectly in activities that violate its requirements for tax exemption. The fact that the use may involve posting the information on the Web should present the same concerns that would arise if a section 501(c)(3) organization contributed material to a section 501(c)(4) organization's publication.

For example, if a section 501(c)(3) organization conducts nonpartisan study or research and provides a report on its results to a section 501(c)(4) organization, and the 501(c)(4) organization posts the report on its Web site in a section otherwise devoted to lobbying on a specific bill currently before Congress, a question may arise whether the expenditures for the research must count as grassroots lobbying expenditures. Subsequent use of research materials that reflect a view on specific legislation for grassroots lobbying may cause the materials to be treated as grassroots lobbying communications. Treas. Reg. §56.4911-2(b)(2)(v). Therefore, section 501(c)(3) organizations in particular should consider carefully how their materials will be used if they are allowing them to appear on another organization's Web site.

NON-TAX LEGAL ISSUES ARISING FROM ORGANIZATION WEB SITES • The non-tax legal issues that arise from Web sites are equally if not more important than the tax issues they pose for many tax-exempt organizations. A discussion of many of these issues is included to illustrate the importance of a thorough legal review when becoming substantially involved in Internet activities.

Intellectual Property Rights

As with many of the tax issues raised by Internet use, the copyright and trademark issues often are analogous to familiar situations that are covered by established intellectual property law. Numerous sources address this area of the law. One of particular value to nonprofits is Marie Malaro, *A Legal Primer on Managing Museum Collections* (Smithsonian Institution Press, 2d ed. 1998). Intellectual property law is, of course, replete with complicated and unresolved issues not related to the electronic environment, which are even further complicated, on a fast-moving basis, by the development of technology in general and the Internet in particular. Organizations should not hesitate to seek specialized legal advice in this area.

Avoiding Liability for Infringement of the Materials of Others

Individuals working at exempt organizations sometimes believe that they can use materials without worrying about copyright and trademark issues. They think that because something is on the Web it is in the public domain and can be used freely. Or that because they intend to use it for "educational purposes" it is subject to "fair use." Many of these beliefs are misconceptions, and all organizations should take steps to educate employees, volunteers, board members, independent contractors, students, etc. about the need to be aware of applicable intellectual property law.

Some copyright issues arise because an action that traditionally has been permissible may constitute infringement in the electronic world. For example, it is perfectly legal to use scissors to cut out a newspaper article and post it with thumbtacks on a bulletin board. However, duplicating a newspaper article in its entirety from the Internet and posting it on a Web page or an electronic bulletin board without proper authorization may constitute infringement. (The same questions arise with respect to e-mail messages containing copyrighted materials.)

Organizations may be held liable for the actions of their employees, depending on the facts of a particular situation. To minimize liability for infringement by employees, an organization can take several steps, including educating its employees:

- By holding regular informational seminars;
- By announcing periodically to employees that information on the topic is available from the organization's legal or human resources departments; and
- By including information on copyright protection in new employee packets and other orientation materials.

Since organizations should be taking similar steps to educate employees on the subject of conflicts of interest, including in these steps copyright protection and infringement information should be relatively easy from an administrative point of view. These education efforts can be extended to volunteers, students, board members, independent contractors, etc.

An organization acting as an Internet service provider ("ISP") faces special challenges to avoid liability for copyright infringement. See below. *See also Exempt Organizations Continuing Technical Instruction Program for FY 99.* A common example is a college or university that provides Internet access to faculty and students. The Digital Millennium Copyright Act, Pub. L. 105-304, 112 Stat. 2860, provides a procedure that permits ISPs to limit liability for infringement caused by materials posted by third parties onto a Web site maintained by the ISP. Note

that an organization that operates an interactive site, for example a chat room, may be seen as an ISP under the Digital Millennium Copyright Act. If your organization makes substantial use of computer networks, you should be sure to consult legal counsel on this issue.

Protecting Your Own Materials

An organization can take various steps to protect its own materials from infringement by others. Naturally an organization should take reasonable steps toward this end, since its intellectual property, including its name and logo, may be seen as a valuable charitable asset.

An organization can issue warnings and disclaimers on its Web site. As with any type of copyright notice, a warning on a Web site cannot ensure that persons will not infringe the copyright, particularly in the electronic environment, where copying and pasting is so easy. However, organizations should post the notice both to deter law-abiding but uninformed users and to show their good-faith efforts to protect copyrighted materials. Warnings can appear on a Web site, usually at the bottom of each page, without affecting a user's ability to navigate the Web site or requiring the user to take steps to acknowledge the warning. Alternatively, interactive warnings and notices can pop up in a box on the screen when the user attempts to access the site or certain portions of the site containing sensitive material. The user must agree to abide by applicable copyright laws as a condition of proceeding beyond the warning to the material he/she is trying to access.

To further deter infringers, an organization establishing a Web site can encrypt its materials to make it difficult for users to copy and distribute original works. Techniques exist to make materials, particularly images such as logos, break down as they are copied without authorization.

Organizations making use of a trade name or logo on a Web site would benefit from getting proper protection for these items so that they can be uniquely identified with the organization. First, the organization needs to determine whether it is economically feasible to enlist the aid of intellectual property counsel (or, if appropriate, include the estimated cost of such aid as part of direct program costs). If the cost/benefit analysis indicates aid is appropriate, you may wish to conduct a copyright registration search and register trademarks and service marks with the Copyright Office. It appears that because of the increased visibility an organization otherwise enjoys from its Web activities, some organizations are receiving increasing numbers of claims that the organization's use of a name or logo infringes that of another entity. This trend argues for the long-term benefits of doing a thorough review of intellectual property concerns at the beginning of an organization's venture into cyberspace.

Tort Liability

Organizations should be aware of tort liability associated with Internet activities, particularly for defamation and invasion of privacy. As discussed above in connection with political and lobbying activity, actions taken by employees and others who may be seen as agents of the organization may be attributed to the organization for purposes of tort liability as well.

Before the Internet, an allegedly defamatory message posted on a bulletin board or sent via regular or inter-office mail reached a very limited number of people, thereby presenting a very limited risk of complaints. However, Web sites (and e-mail and Internet chat room postings)

permit those same types of messages to be broadcast to large numbers of people.

If the organization maintains sensitive data that are subject to statutory privacy protections, such as medical records, credit card information, student, member, and personnel records, social security numbers, and any other personal information people may reveal about themselves, enlist the aid of qualified technical support to ensure security measures are enacted. Also be aware of what records must be kept private and what information is available to the public. For more on this topic, see Elizabeth deGrazia Blumenfeld, *Privacy Please: Will the Internet Industry Act Protect Consumer Privacy Before the Government Steps In?* 54 Bus. Law. 349 (1998).

As described above, organizations would be well-advised to make use of disclaimers, as they would when distributing any written materials, when posting information on a Web site.

Federal Grant Rules

Be aware that if your organization has produced material with federal grant funding, the federal government has a free license to use that material. Therefore, you cannot promise exclusive rights to it to others. Also, federal grant money may not be used for lobbying. Depending on the type of grant support your organization receives, additional restrictions may apply, as set forth in applicable regulations. (For example, certain Centers for Disease Control funds may not be used to carry out gun control activities. *See* Department of Health and Human Services and Related Agencies Appropriations Act, 1997.) These types of restrictions should be considered when adding material developed with Federal grant support to a Web site, particularly if the site will include links to other sites that give rise to lobbying concerns.

HOSTING CHAT ROOMS OR OFFERING BULLETIN BOARDS OR LIST-SERVS • Organizations can host electronic discussions among multiple Internet users in a variety of forms. A chat room is an electronic exchange in real time in which users post comments intended for all others in the chat room at that time to read. Other users are expected to respond as they would in a conversation. A bulletin board works much like its real-life counterpart. Users post messages that are intended to be read immediately and also by others reviewing the bulletin board at a later time. New postings can be in response to the prior postings or can open wholly new topics. A list-serv works by sending a mass e-mailing to all members of the list every time a message is posted. Others can respond by sending further e-mail to the entire list or by responding to another individual list participant.

A chat room, bulletin board, or list-serv can be analogized to a live public forum, but there are a few key differences. First, while the public forum lasts a discrete period of time, the chat room, bulletin board, or list-serv continues indefinitely. Second, if the organization does not edit the postings, there is no one present in the role of the moderator to counteract specific comments attributing views to the organization. Third, in a public forum, the participants respond to questions posed by the audience or an impartial panel. Depending upon who uses the chat room, bulletin board, or list-serv, that separation may not exist. There is no guarantee that participants will be objective or not in collusion. There is existing material reflecting the IRS view on hosting public forums as they relate to the prohibition on campaign intervention. *See* Rev. Rul. 74-574, 1974-2 C.B. 160 (offering free air time to all candidates will not result in impermissible political intervention if proper

disclaimers are made and no endorsements are offered); Rev. Rul. 86-95, 1986-2 C.B. 73 (holding live public forum with all candidates will not result in impermissible political intervention if treatment is even-handed and moderator remains entirely neutral). *See also* FEC Advisory Opinion 1999-25.

This material offers some initial assistance in finding policies that will protect an organization from unwittingly violating requirements for maintaining tax-exempt status and perhaps also prevent it from unintentional liability for UBIT. For example, inviting all legally qualified candidates, providing disclaimers that the organization does not endorse any candidate, and conducting the discussion in a neutral fashion are key factors. However, additional thought needs to be given to how these policies need to be extended or tailored to accommodate the distinct aspects of chat rooms, bulletin boards, and listservs noted above.

As described elsewhere in this article, chat rooms and other interactive Internet activities can be set up to take initial users through a series of messages such as copyright notice, liability disclaimers, and privacy alerts. The most effective are those that require users to accept the terms and conditions of the site by clicking on icons before proceeding.

Monitor, or Hands Off?

Organizations sponsoring interactive sites can choose to edit their content or to stay hands-off. There are, of course, non-legal pros and cons to each method. The primary question is one of administrative burden. Even when administering an unedited site, an organization may wish to retain the right to delete offensive material or to take away a user's ability to access the site. Legally, an organization is less likely to be held liable for content posted on unedited sites if proper notice is given of the unedited nature of the site. Here is an example of one organization's notice on this point:

"User shall be solely liable, and [organization] shall not be liable, for the content of any communications that User may contribute or post to the Web site. [Organization] retains the right, which it may or may not exercise, in its sole discretion, to edit or delete any communication by User from the Web site for any reason. User agrees to indemnify [organization] (and its officers, directors, employees or other agents) for any and all Claims and Costs arising out of the User's contributing or posting any communication to the Web site."

It is not clear whether an organization can effectively disclaim liability for content while retaining the right to edit or delete postings.

The concluding part of this article will appear in the next issue and will cover the tax issues regarding sales of goods and services over the Web, fundraising, and serving as an Internet Service Provider.