



Unrelated Business Income

June 2011

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Agenda

History of UBI

Trade or Business

Regularly Carried On

Not Substantially Related

Exceptions

UBIT Deductions



Unrelated Business Income

What's Wrong with Making a Profit?

- **Taxed at corporate rates (avg. 40% blended Fed & State)**
- **Alternative Revenue Generating Activities, in aggregate, should not become a substantial part of the organization's activity**
- **Understanding the tax consequences of proposed transactions helps the organization make sound business decisions**



Unrelated Business Income



Unrelated Business Income



Unrelated Business Income

Federal

- **Form 990-T, Unrelated Business Income Tax Return, when gross receipts from an unrelated business are \$1,000 or more**
- **Form 990-T is available for public inspection**

State

- **Certain states impose a tax on UBI generated**
- **Additional tax filings may be required**

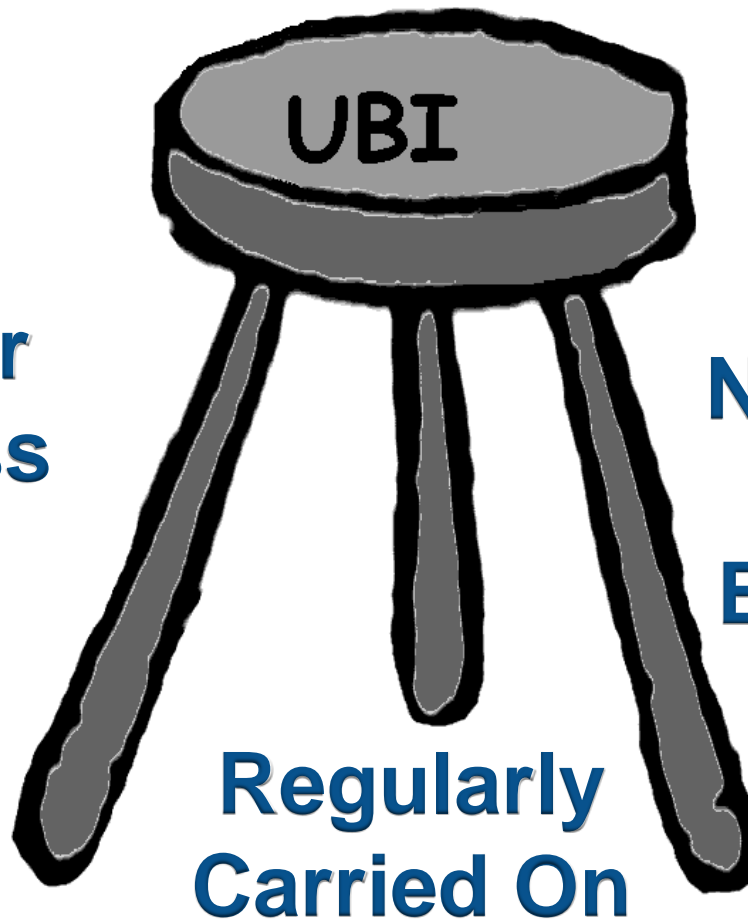
Penalties

- **Failure to file**
- **Failure to pay estimated tax payments**
- **Late payment of tax**
- **Interest**



UBI Defined – IRC § 512(a)(1)

**Trade or
Business**



**Not Substantially
Related To
Exempt Purpose**

**Regularly
Carried On**

TRADE OR BUSINESS

Reg. §1.513-1(b)



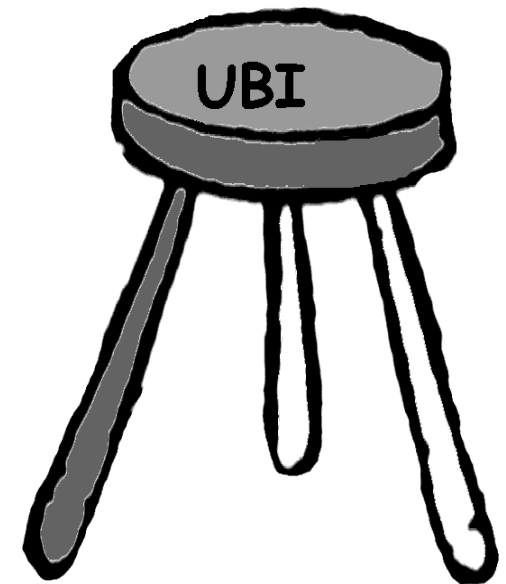
Any activity carried on for the production of income from the sale of goods or the performance of services.

Profit Motive Test

Unfair Competition Test

Commercial Manner Test

Extensive use of resources

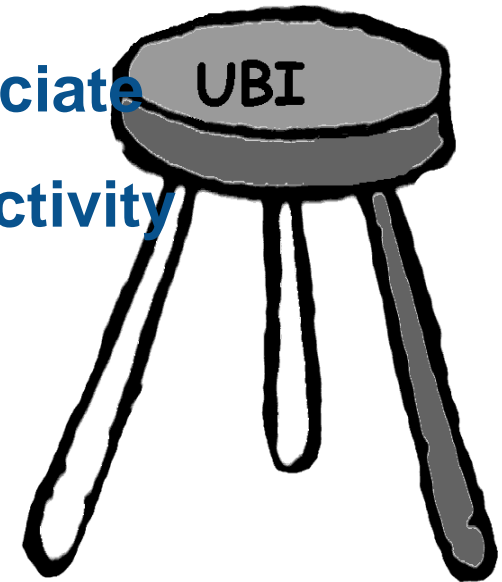


TRADE OR BUSINESS

Reg. §1.513-1(b)

Profit Motive Test – Reg. 1.183-2(b)

1. Manner in which the activity is carried on
2. Expertise of taxpayer and advisors
3. Time and effort expended
4. Expectation that activity assets will appreciate
5. Success experienced in carrying on the activity
6. History of income or losses
7. Amount of profit earned
8. Financial status of the taxpayer
9. Elements of personal pleasure or recreation

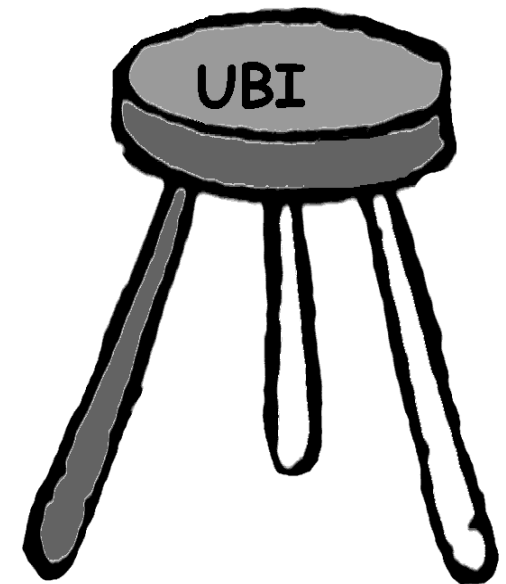


TRADE OR BUSINESS

Reg. §1.513-1(b)



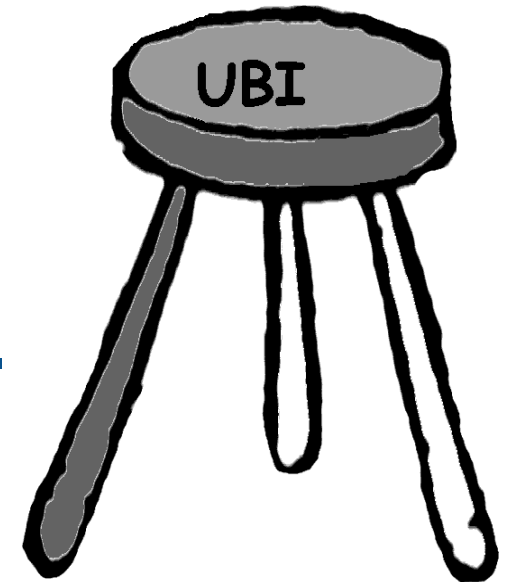
A charitable organization publishes a monthly journal containing articles and material related to its exempt purpose as well as advertising. Ad rates are not always sufficient to offset direct and indirect costs, therefore the charity occasionally experiences a loss from the activity for the year.



TRADE OR BUSINESS

Reg. §1.513-1(b)

A charitable organization publishes a monthly journal containing articles and material related to its exempt purpose as well as advertising. Ad rates are never sufficient to offset direct and indirect costs, therefore the charity has experienced a loss from the activity for the last 10 years.

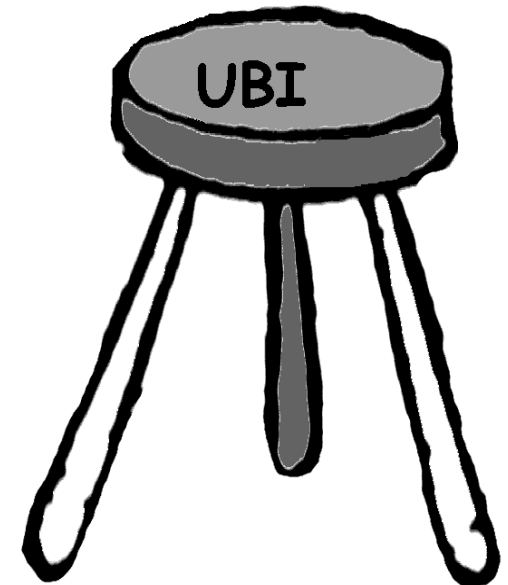


REGULARLY CARRIED ON

Reg. §1.513-1(c)

Is the activity's frequency, continuity and manner of conduct comparable to commercial operations of similar for-profit organizations?

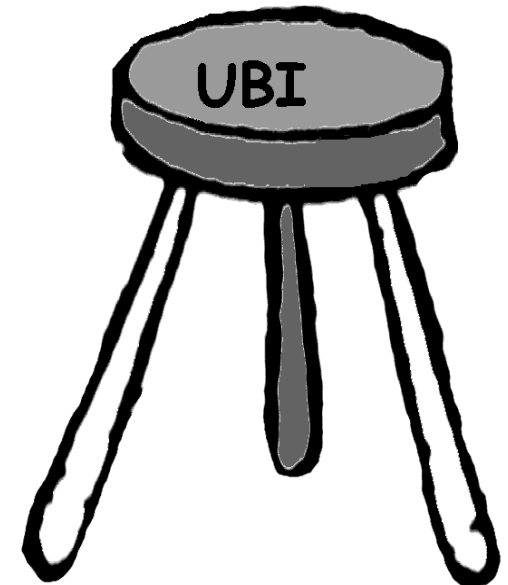
- **Annually?**
- **Quarterly?**
- **Intermittently?**
- **Sporadically?**



REGULARLY CARRIED ON Reg. §1.513-1(c)

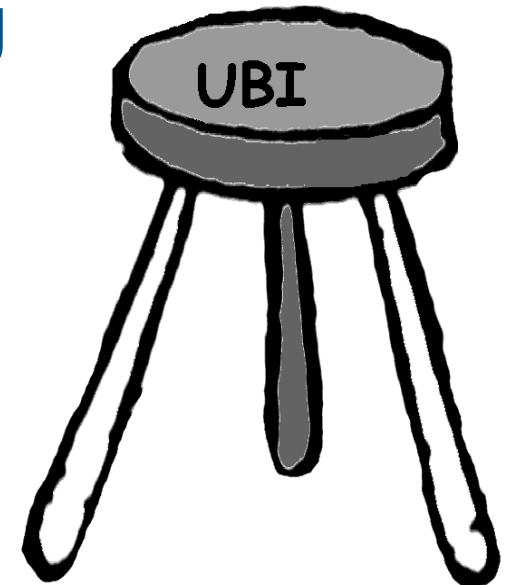
A charitable organization with a mission of serving children and giving their issues a voice holds two conferences annually. At each conference a small booth displays & sells t-shirts, mugs, bags and other paraphernalia bearing the organization's name.

The conference is attended by employees and other interested parties.



REGULARLY CARRIED ON Reg. §1.513-1(c)

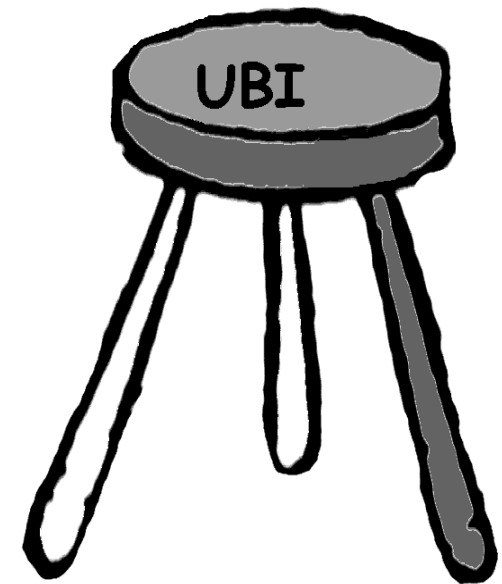
A charitable organization has an annual yearbook prepared and distributed to its entire membership. An independent commercial firm under contract throughout the year sells advertising space and collects advertising fees.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

- What is the relationship of the activity to the accomplishment of the exempt purpose (other than the destination of income)?
- What is the size and extent of the activity in relation to the nature and extent of the exempt function that they purport to serve? Is it excessive?

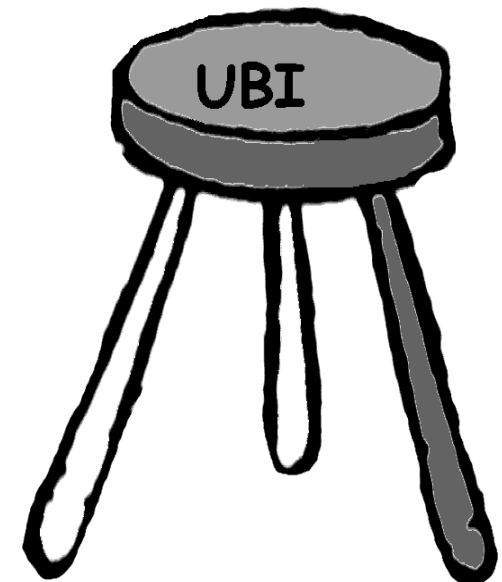


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

The local Space Museum has a large movie theatre. It charges admission to visitors to see educational films about the Apollo moon landing.

The local Space Museum has a large movie theatre. It charges admission to visitors to see classic science fiction movies.

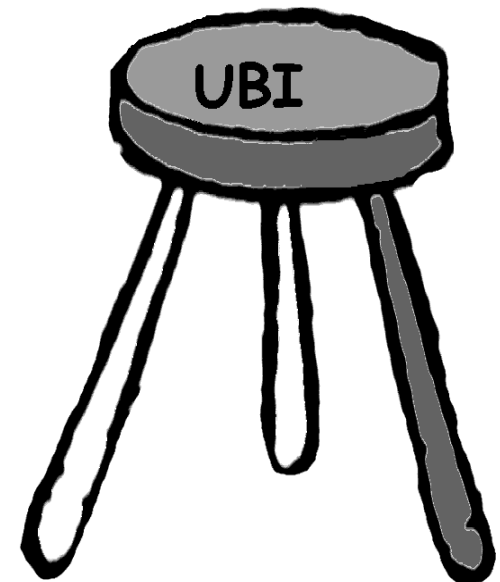


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

A well-respected exempt scientific organization sells endorsements of manufacturers' products.

A well-respected exempt scientific organization receives payments for the use of its logo.

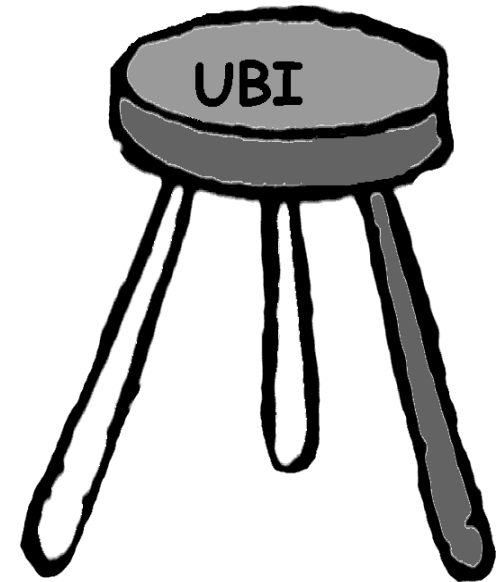


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Red State Zoo Gift Shop

1. T-shirts with animal pictures
2. T-shirts with animal pictures and a pamphlet describing the zoo's efforts to preserve that animal species and habitat
3. Postcards and calendars of zoo animals
4. Postcards of the Red State City skyline
5. Camera film and batteries
6. Newspapers
7. Snack bar
8. Sale of items on the website
9. Gift wrapping
10. Stuffed animals



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Advertising

- A public charity produces a magazine containing paid advertising.
- The paid advertising contains no commercial message, merely lists the name of the purchaser.
- The paid advertising contains no commercial message, merely the name of the purchaser in blocked-in space.
- Instead of a public charity, the magazine is produced by a trade association.

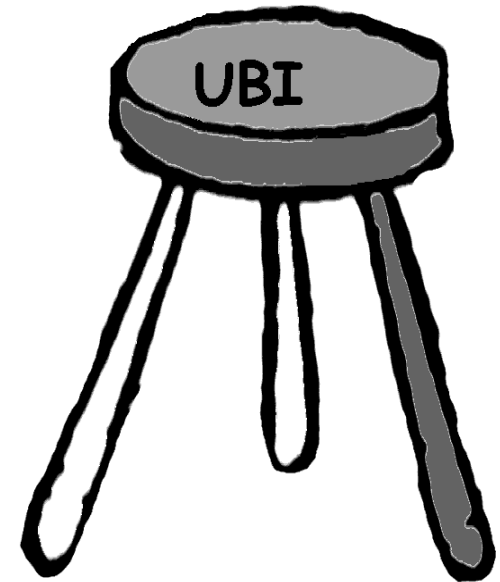
NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

“Qualified Sponsorship Payments”

Substantial return benefit

- Advertising
- Exclusive provider arrangement
- Facilities, services, or privileges
- Right to use exempt organization’s logo, trademark, patent, etc.
- Payments contingent on exposure



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

- **Qualified Sponsorship Payments**
 - **Charity M prints a monthly magazine. Corporation C purchases space for its name and logo, and simply states “Corporation C congratulates Charity M for the excellent work in this year’s Marathon”.**
 - **Blue State University receives a large donation from Sweetsie Cola, Inc. In return, BSU will name a writing competition after Sweetsie Cola, and will only sell Sweetsie Cola products on campus.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Advertising or QSP?

- **Charity M organizes a marathon, and serves refreshments donated by Corporation C. Corporation C also provides prizes with C's logo. Charity M prints flyers, banners, and posters for the event, prominently featuring C's logo. It renames the event "The Charity M ~ Corporation C Marathon".**
- **Same as above, except Corporation C stipulates that all items are a donation only if 1,000 or more people participate in the marathon.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Disposition - Reg. §1.513-1(d)(4)(ii)

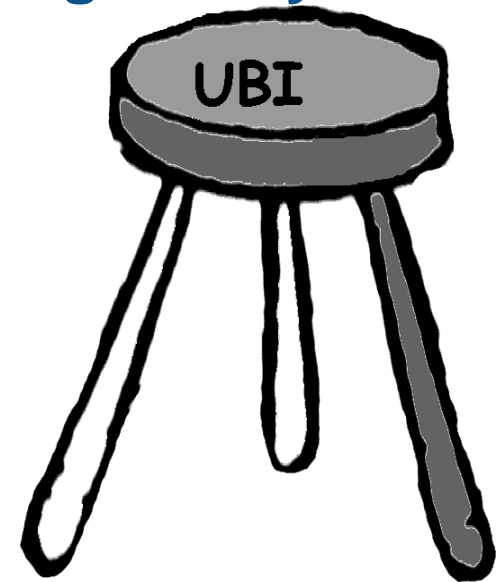
- **A blood bank collects and maintains inventories of human blood and blood products. Whole blood is separated into components, and much of the leftover plasma is sold to commercial laboratories.**
- **A college dairy farm processes milk into ice cream for sale.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Dual-use activities

- The exempt purpose of Charity X is to improve the quality of life for individuals suffering from Disease X.
 - Charity X maintains a vaccine manufacturing facility.
 - Facility manufactures vaccines to treat Disease X.
 - Facility also manufactures vaccines to treat Disease Y.

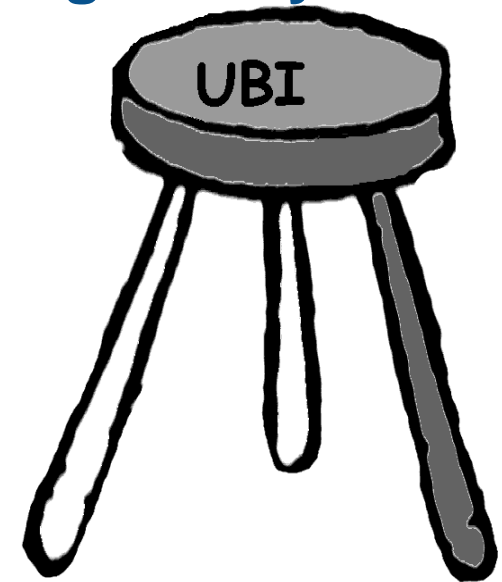


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Exploitation of an exempt activity

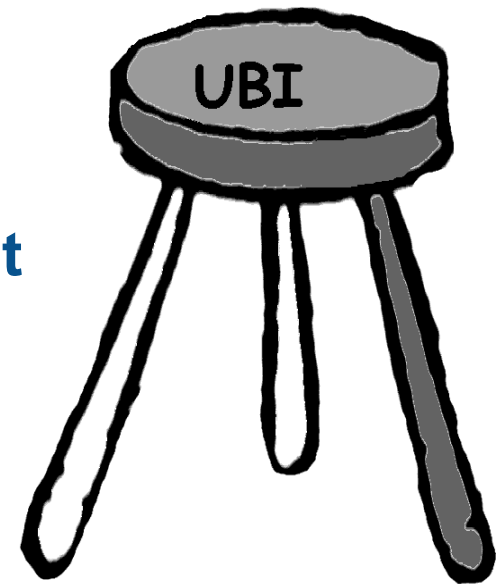
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NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

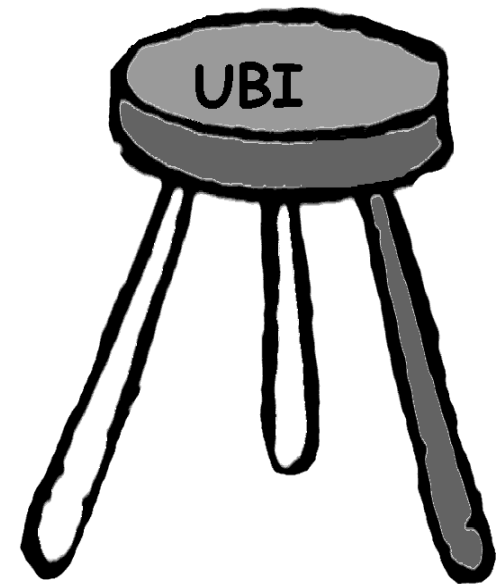
An Organization (whose purpose was to provide job training for unemployed residents) in a poor neighbourhood operated a food service business at prices substantially lower than those charged by competing grocery stores, provided free grocery delivery service to needy residents, and provided job training for unemployed residents. About four percent of the store's earnings is allocated for use in a continuous training program for the local chronically unemployed.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Organization formed to provide therapy for emotionally disturbed adolescents operates a grocery store which employs therapy patients. The grocery store is operated at a level to utilize only the number of adolescents residing at the facility. The development of job skills is secondary to the goal of emotional rehabilitation of the adolescents through job satisfaction and personal achievement.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Travel Tours

- Relationship to the organization's exempt activity
- Use of qualified study leaders
- Organization contacts at tour location
- Relationship to lectures, classes, prior tours
- Educational content

Wassamatta U. Alumni Association operates a travel tour program open to current members and guests to encourage 'lifelong learning.' Faculty members often participate, but there is no curriculum or specialized instruction.

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Travel Tours

Charity G's exempt purpose is to educate the public about geography and culture, offering courses and publishing books. Charity G conducts tours to national parks across the USA conducted by university professors. The tour includes lectures, instruction, study, and writing assignments. Participation qualifies for academic credit.

C4 Social Welfare is devoted to advocacy on a particular issue. Regularly scheduled travel tours to Washington, DC are designed to allow members to attend meetings with legislators and officials and receive policy briefings. Evenings are free for recreation and sight seeing.

Exceptions

An exempt orphanage operates a retail store selling items to the general public.

An exempt orphanage operates a retail store selling items to the general public. All of the individuals carrying on the work are uncompensated.

An exempt orphanage operates a retail store selling items to the general public. Persons desiring to benefit the organization contribute used clothes, books, and furniture to be sold to benefit the orphanage.



Exceptions

An exempt assisted-living facility operates a laundry for the benefit of the residents.

A public charity receives “passive” investment income, including , dividends, interest, and royalty income.

A public charity receives interest on a loan to a controlled taxable subsidiary.

- **An exempt organization sells its mailing/membership list to unrelated entities.**
- **An exempt organization sells its mailing/membership list to unrelated entities and provides support services.**

Exceptions

University's School of Engineering conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose of the University.

Charity R conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose Charity R. The results of the research are timely and adequately made available to the general public.

Charity R conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose Charity R. The research is performed for the State of Virginia.

Exceptions

An exempt organization rents out a large portion of its office building. It charges rent to tenants whose activities are unrelated the organization's exempt purpose.

There is a mortgage on the building.

The tenant occupies the first floor of a 12 story building.

Exceptions

Charity A is a 501(c)(6) trade association. A's mission includes supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

A conducts semi-annual trade shows to promote and stimulate demand for the products of A's industry. A plans and directs the show, secures the facility, charges admission, charges for rental of exhibitor space, and sells refreshments. There are educational seminars, and members and suppliers display products and services. Sales are permitted. Members, nonmembers, and potential customers attend the shows. Revenues from the shows are used to defray the shows' operating costs, and any net income is used in furtherance of A's exempt purposes.

Exceptions

Charity B is a 501(c)(6) trade association. B's mission includes supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

B has an Internet website available to the general public 24 hours a day, 7 days a week for two weeks, after which the website is removed. It does not overlap or coincide with any convention, annual meeting, or show conducted by B. The website permits members and the public to access information and visual displays, such as product directories and specific product listings, and contains links to the websites of B's members and suppliers. The website contains order forms, and allows on-line purchases from members and suppliers appearing. B charges a fee to those who wish to have information listed on the website.

UBIT Deductions

Allowable Deductions

- **Ordinary and necessary**
- **Proximate and primary relationship to the business activity**
- **Related Party Rules**
- **UNICAP**
- **Meals and Entertainment**
- **Fines and Penalties**
- **Excess readership costs**



UBIT Deductions

- **Charity X uses its auditorium for 160 days a year for exhibits and seminars related to its mission. 50 days a year, the auditorium is used for concerts, movies, and other activities unrelated to its mission.**

- **What portion of the indirect expenses of operating the auditorium are deductible?**
 - **50/210?**

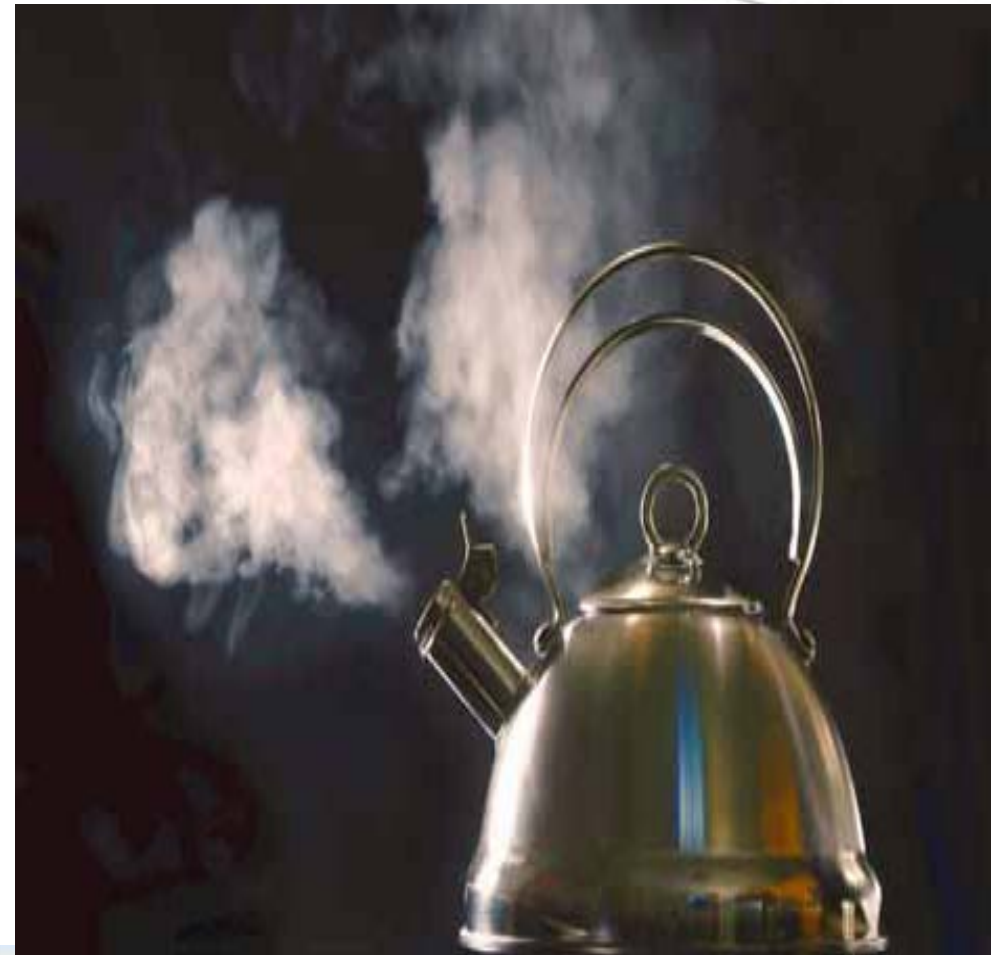
 - **50/365?**

 - **Some other allocation entirely?**

Unrelated Business Income

Other Potential Sources of UBI

- Investment in partnerships (LP, LLP, LLC, SMLLC)
- Alternative investments
- Corporate sponsorships
- Laboratory revenue
- Retail pharmacy
- Management services
- Gift shop
- Drug trials, clinical studies
- Fitness centers
- Parking Garage
- Cafeteria



Unrelated Business Income

SPECIAL RULES

- **Social Clubs - IRC §501(c)(7)**
- **Voluntary employee benefit associations - IRC § 501(c)(9)**
- **Unemployment compensation trusts - IRC §501(c)(17)**
- **Group legal service organizations - IRC §501(c)(20)**





Nonprofit Organizations

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