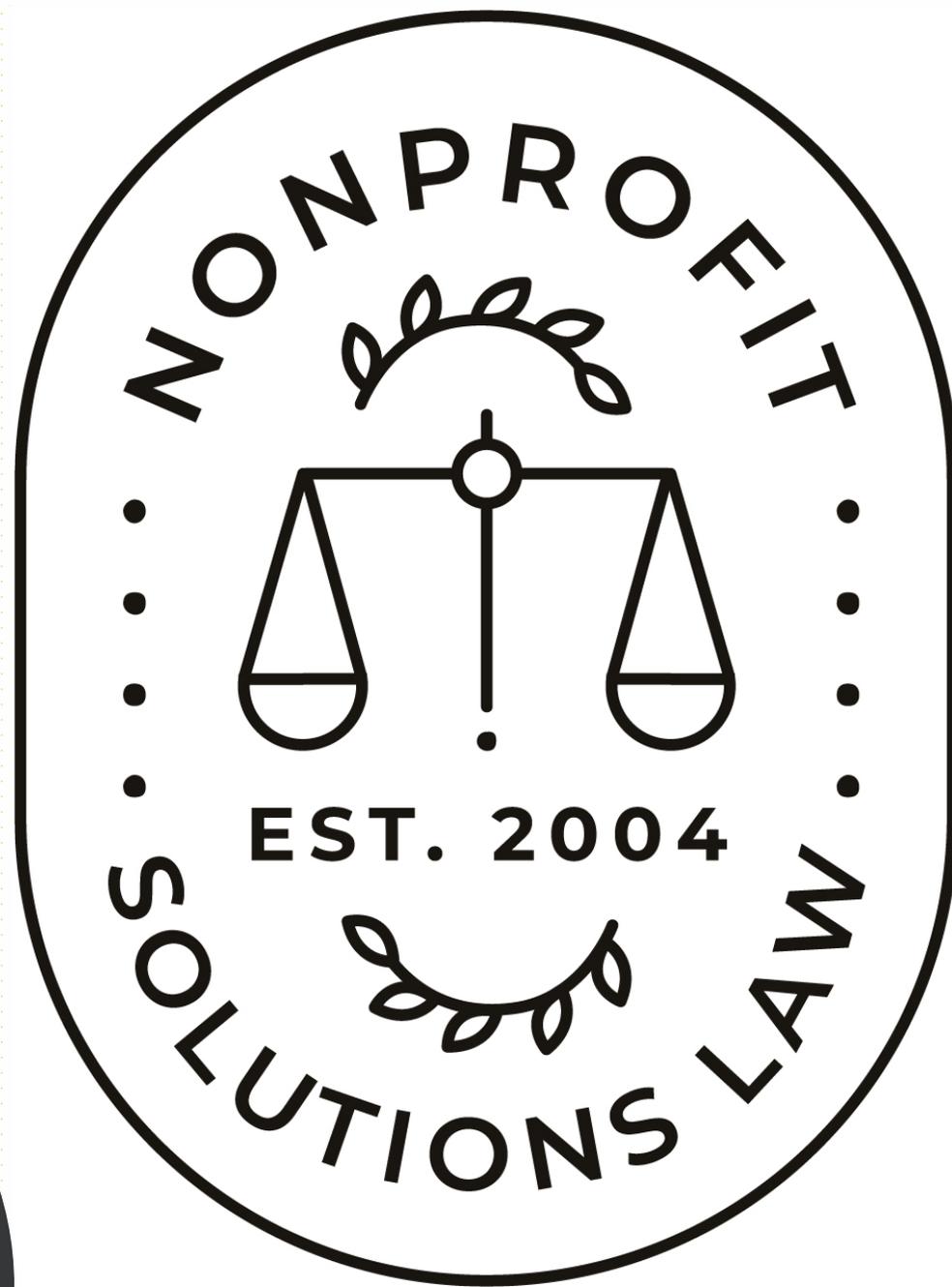




Unrelated Business Income

Jeri Holmes, ESQ, President & Founder
Nonprofit Solutions Law, P.C.
405-844-2222



Unrelated business income

Defined in IRC § 512

- 1) Income from a trade or business – *for production of income from selling goods or performing services. Pub 598, p 7 shows excluded exceptions.*
- 2) That is regularly conducted by the organization and – *frequency and continuity, and pursued in a manner similar to comparable commercial activities of nonexempt orgs.*
- 3) Is not substantially related to the performance of the organization's tax exempt functions – *case by case analysis of whether activity contributes importantly to exempt purpose. Compare size and extent of activities to nature and extent of the exempt function the activities are to serve. Is the activity conducted on an appropriate scale? The 'excess' could be considered unrelated.*

NOT taxable

Is it a trade or business (selling goods or performing services to produce income)?

no

yes

Is it excluded? (volunteer labor, service solely to convenience members/employees/students of the charity, selling mostly donated items, bingo)

yes

no

no

Is it regularly carried on (conducted in the same manner as a similar for-profit entity)?

yes

no

Is it substantially related to the exempt purpose (conducting the trade or business helps the organization accomplish its exempt purpose?)

yes

no

Is it done on a scale much larger than necessary to accomplish exempt purpose?

no

yes

Is it passive income – not furthering tax exempt purpose (rent, royalties, dividends, interest?)

yes

yes

Is the charity a “controlling entity” with respect to the organization producing the interest, dividend or capital gains? Pub 598, p. 15 – exceptions

no

YES taxable

Unrelated Business Income - examples

1. Artist's facilities –

- Purpose: to stimulate and foster public interest in fine arts by promoting art exhibits and sponsoring cultural events.
- Activity: 1) furnishing information about fine arts leases to artist tenants - unrelated; 2) operating a dining hall primarily for the artist tenants.

2. Opera parking –

- Purpose: to provide world class opera in Oklahoma City
- Activity: Parking lot used for fundraising purposes on weekdays where there are no performances.

3. Magazine publishing –

- Purpose: business league formed to promote the improvement of business conditions of one or more lines of business.
- Activity: publishes a consumer-oriented magazine 4x/year that is sold as a *promotional device* for the business league and is available to credit union members for purchase. -

Unrelated Business Income - examples

4. Membership list sales –

- Purpose: exempt educational organization (what is the purpose of education?)
- Activity: sells membership list to business firms

5. Museum eating facilities–

- Purpose: exempt art museum formed to enhance public understanding of the arts
- Activity: Dining room, cafeteria, snack bar for staff, employees, visitors. The facilities attract visitors and allows staff and employees to spend more time in the museum rather than seek food elsewhere.
- Activity: Dinner in dining room service while museum is closed with access outside of museum . (70's grandfather clause)

6. Museum shop–

- Purpose: Art museum maintained for exhibition of American folk art, enhance public understanding
- Activity: gift shop sells reproductions of works displayed in museum; metal, wood, and ceramic copies of collections on display; instructional literature regarding American folk art; *scientific books and souvenirs of the city where the museum is located*; rental of works of art that contain the artist name, title of work, and museum name.

Unrelated Business Income - examples

7. Membership directory–

- Purpose: business league – to promote business conditions
- Activity: publishes an annual directory with a list of all members, their addresses, and their areas of expertise. Each member has the same amount of space in the directory, and the format treats every entry the same. There are no commercial advertisements and is sold only to organization members. (key question: *does anyone derive private commercial benefit from directory circulation?*)

8. Sales of advertising space by a National Association of law enforcement officials

- Activity: Org publishes a monthly journal with articles and editorial material of professional interest. Distributed for free, mostly to members. The org sells advertising space for conventional advertising or to identify the purchaser without a commercial message. The organization solicits by personal contacts, large firms are solicited by contacting the CEO or Community Relations manager rather than the advertising manager. The organization also solicits by using form letters to appeal for corporate and personal contributions.
- The sale of advertising for the purchaser's commercial benefit is a commercial activity. Commercial benefit is assumed, even if no commercial message is conveyed. Other factors to consider as commercial benefit is not conclusive:
 - Normal manner the publication is circulated; territorial scope of the circulation; extent to which readers or promoters could reasonably be expected to further the commercial interest of the advertisers; the eligibility of the publishing organization to receive tax-deductible contributions; the commercial or non-commercial method used to solicit advertisers.
- There is a difference between the sale of advertising space and the sale of a listing where everyone is treated the same.

Activities excluded from definition of unrelated trade or business (exceptions and modifications)

1. Convenience of members – laundry on campus for student use
2. Convention or trade show activity – if purpose is promoting activities of the industry at convention and industry character is on display, is the convention a special event? Special time periods?
3. Distribution of low-cost articles incidental to soliciting contributions – incidental if: recipient didn't request; distribution made without express consent of recipient; article is accompanied by request for donation and recipient can keep article regardless of donation; value of article must be below \$11.20 (2020)
4. Employee association sales – excluded is sold for convenience of ass'n members at their regular place of employment. Only applies to work-related clothes and equipment and items in vending machines, food dispensing facilities, or snack bars.
5. Exchange/rental of member or donor lists – both orgs must be described in Section 501
6. Public entertainment activity – entertainment designed to attract the public to fairs. The entertainment must be paid for by an exempt org that regularly conducts agricultural and educational fair (4H presents Vanilla Ice!)
7. Gaming – in general games of chance do not further an exempt purpose. Reporting to the IRS is required in another manner and is complicated. Advised to seek legal advice before engaging in gaming activities.
8. Selling donated merchandise – thrift stores; proceeds must go to org
9. Volunteer workforce - in certain circumstances, even this may cross over into UBIT
10. Qualified sponsorship activity – payment made is for “use or acknowledgement”, not to cross the line into “advertising” (an advertisement has language containing qualitative or comparative language, price info, or indications of savings or value; endorsements; inducements to purchase, sell, or use the products or services) SEE NEXT SLIDE

Advertising versus Sponsorship

- **Advertising:** Call to Action by non-profit
 - A for-profit business is kind enough offer us 10% of the proceeds of all sales of their weekend event.
 - Our non-profit is so appreciative and wants to ensure the event is a success and therefore let everyone know through our social media that we will get 10% of the proceed of all sales at for-profit this weekend.
 - Our event is quite successful, and our non-profit receive \$1,000
- **Sponsorship:** No call to action by non-profit
 - Name, Logo, Tagline
 - Report as a donation

Reporting Requirements – Advertising Social Media Example:

- The for-profit business will report the \$1,000 as a business expense.
- Our non-profit business will report the \$1,000 as advertising revenue (UBI)
 - A charitable acknowledgement letter will not be issued.
- Our non-profit will file a 990T (tax return) to pay taxes on the revenue (UBIT)
 - Maintain records of all expenses to offset any tax.