



# Unrelated Business Income

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## **Mission of Pro Bono Partnership of Atlanta:**

To provide free legal assistance to community-based nonprofits that serve low-income or disadvantaged individuals. We match eligible organizations with volunteer lawyers from the leading corporations and law firms in Atlanta who can assist nonprofits with their business law matters.

## Pro Bono Partnership of Atlanta Eligibility & Other Information

- In order to be a client of Pro Bono Partnership of Atlanta, an organization must:
  - ✓ Be a 501(c)(3) nonprofit organization.
  - ✓ Be located in or serve the greater Atlanta area.
  - ✓ Serve low-income or disadvantaged individuals.
  - ✓ Be unable to afford legal services.
- *Visit us on the web at [www.pbpatl.org](http://www.pbpatl.org)*
- Host free monthly webinars on legal topics for nonprofits
  - ✓ To view upcoming webinars or workshops, visit the [Workshops Page](#) on our website

## Agenda

- Definition of Unrelated Business Income
- Exceptions/Exclusions to UBI
- Specific Revenue Generating Activities and Potential UBI Requirements

# Understanding UBI

## UBI - General Rule

Income derived from trade or business activities not substantially related to the tax-exempt organization's purposes is taxable as if earned by a comparable for-profit enterprise.

## Unrelated Business Income

- The Test:
  - ✓ Trade or business
    - Activity carried on for production of income from sale of goods or services
  - ✓ Regularly carried on
    - Regularity and continuity
    - Carried on in same way as a comparable commercial activity
  - ✓ Not substantially related to mission
    - No causal relationship to exempt purpose
- Note: The mere fact that the income produced will be used to carry out the mission is not a sufficient causal relationship. The activity must be related.

## “Trade or Business”

- Trade or business activities typically exhibit an intent to derive a profit from their conduct. In addition, the activities must be regularly carried on.
- ✓ Tip: When considering whether the activity is “regularly carried on” measure the frequency of the activity against the frequency with which a commercial enterprise would conduct it.



## “Regularly Carried On”

➤ If

- 1) the activity is infrequent;
- 2) the activity is conducted only for a short period during the year; or
- 3) the activity is not engaged in with a competitive or promotional intent,

➤ Then

It should not be considered as regularly carried on.

## “Unrelated”

- Is there a substantial causal relationship between the revenue-generating activity and the organization’s exempt purpose?

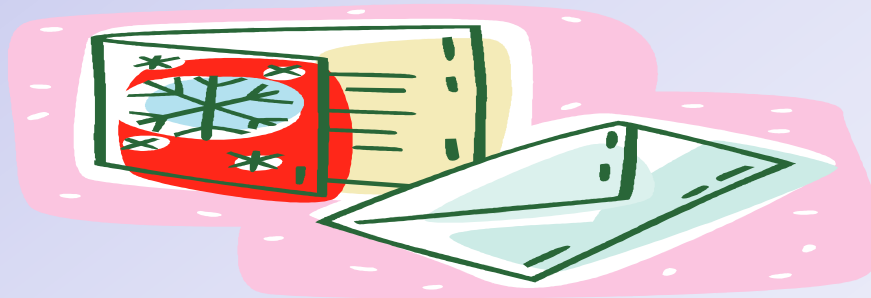
(the activity must contribute importantly to the accomplishment of the tax-exempt’s purposes)

- ✓ Note: The mere fact that the income produced will be used to carry out the mission is not a sufficient causal relationship. The activity must be related.

## Example 1

- Exempt organization derives revenue from distribution of holiday cards once a year.

Taxable?



**YES**

➤ But why?!

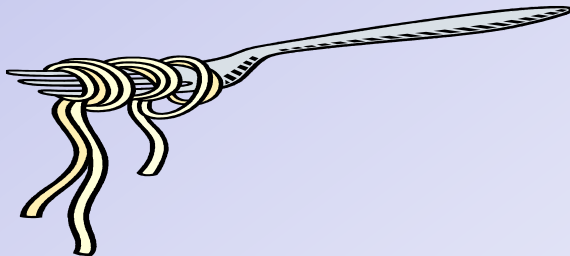
- ✓ Cards deemed to be sold at “retail” not distributed for “charitable contribution”
- ✓ Enterprise involved commercial co-venturer who was engaged in the “seasonal” activity for profit.

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## Example 2

- Nonprofit Law School purchases a spaghetti factory. The revenues from the spaghetti factory are used to support the Law School's exempt purposes.

Taxable?



## Yes – and Potential Loss of Exemption

- NYU School of Law purchased the factory prior to the enactment of UBI legislation.
- Congress and the public believed:
  - ✓ Such a tax-shelter was unfair to other taxable companies
  - ✓ The mission of a charitable organization must remain charitably-focused and not on running for-profit businesses
- If the taxable activity tail wags the charitable dog, loss of exemption can occur.

## Exceptions & Exclusions to UBI

- Exclusions to UBI
  - ✓ Volunteers
  - ✓ Benefit/Convenience of Members
  - ✓ Contributed Property
  - ✓ Rents from Real Property
  - ✓ Sale of Property
    - e.g. Capital gains
      - Note: Does not apply to inventory or property held in ordinary course of business

## Passive Income

Passive Income<sup>1</sup> excepted from UBI:

- ✓ Dividends
- ✓ Interest
- ✓ Annuities
- ✓ Royalties<sup>2</sup>

1. Not generated through activities of controlled organizations or through borrowed funds.

2. So long as there is no active business associated



## Revenue Generating Activities

### ➤ Selling Merchandise/Property

#### ✓ Key Questions:

- What is being sold?
- What services are provided?
- Who is providing the services?

#### ✓ Examples

- Name & Logo – marketing message/mission
- Donated merchandise
- Volunteer sales – Girl Scout Cookie Exception
- Low-cost article

### ➤ Rental Property

- ✓ Debt financed property?
- ✓ Services provided?



## Revenue Generating Activities (cont.)

- Qualified Sponsorship v. Advertising
  - ✓ 26 C.F.R. § 1.513-4
  - ✓ Advertising = unrelated business income
  - ✓ Corporate Sponsorship Rules
    - Acknowledgement of Sponsor: name & logo
      - No statements endorsing products
      - If website/email acknowledgement, no language endorsing or inducing site visitors to purchase or use sponsor's products
    - No other "substantial return benefit"
      - Substantial return benefit could = substantial private benefit = loss of exemption
      - Insubstantial value = all goods and services received from the charity by the sponsor must NOT exceed 2% of sponsorship payment for year
  - ✓ Sales Tax Ramifications

## Revenue Generating Activities (cont.)

- Cause Marketing/Commercial Co-Ventures
  - ✓ *As part of sales promotion, for-profit company uses charity's name to sell its products or services and makes a charitable donation based on sales*
    - A marketing approach to charitable giving
      - Company A does well by doing good for Charity B.
    - Payments structured as royalties for use of name and logo.

## Revenue Generating Activities (cont.)

- Large Tax-Exempt Organizations
  - ✓ Publication of periodicals/books
  - ✓ Membership list sales
  - ✓ Provision eating facilities
  - ✓ Travel Tour programs
  - ✓ Parking Decks

## **For More Information:**

If you would like more information about the services of Pro Bono Partnership of Atlanta, contact us at:

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