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RAC Leadership
Development
Workshop



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How UBIT Fits Into the 990 Puzzle

PowerPoints and handouts: www.regionalassociation.org

Presentation Objective

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- **Understand the basic elements of Unrelated Business Income (UBI)**
 - So that you can at least identify situations that may be problematic
- **Have a better understanding of the UBI implications of specific programs and activities**
 - Not offering tax opinions on your programs, but providing general information—tax issues are very fact specific and require research to come up with correct position
- **Have answers to some of your burning questions**

Taxable Activities

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- **An Association is not exempt from income tax imposed on activities which are substantially unrelated to those exempt purposes, even though these activities may bring in funds to support the organization's exempt operations.**

Unrelated Business Income - History

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- It all started with macaroni!!!
- Mueller Macaroni was owned and operated by New York University Law School. Profits went to the school.
- IRS challenged that producing macaroni was not related to educational purpose
 - Previously only looked at “destination of funds” rather than the source of the income
- Unrelated business income became taxable in 1950.
- Goal: Eliminate unfair competition by nonprofits against commercial enterprises

What is Unrelated Business Income?

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- **3-Prong Test**
 - Trade or business
 - Regularly carried on
 - Not substantially related to organization's exempt purpose

UBI – Trade or Business

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- **Broadly interpreted by IRS**
- **Any activity carried on for the production of income**
 - Sale of goods or services
 - Advertising

Regularly Carried On

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- A frequency or continuity of the activities similar to the activities of a comparable taxable enterprise
- An activity should not be considered as regularly carried on if it is:
 - On a very infrequent basis;
 - For a short period of time during the year; or
 - Without competitive and promotional efforts

Not Substantially Related

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- The activity does not contribute to the accomplishment of the organization's exempt purpose
- Simply supporting exempt activities does not make something related

Principal Exclusions from UBI

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- **GOOD NEWS:** There are certain exceptions in the Internal Revenue Code to exclude activities from UBI.

UBI Common Exceptions

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- **Volunteer Workforce**
 - If the activity is conducted by volunteers 85 percent or more of the time, the activity is not an unrelated business
- **Sales of Donated Merchandise**
 - If activity constitutes the sale of donated merchandise, it is not an unrelated business (i.e. thrift store)
- **Convenience of Members**
 - Certain activities carried on primarily for the convenience of members and employees are also exempt
- **Investment Income**
 - Rationale for exclusion: Income derived in a “passive” manner generally is income that is not acquired as the result of a competitive activity, and therefore, should not be taxed

UBI common Exceptions

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- **Royalty Exception**

- Royalty income is generally not UBI
- Royalty - payment for use of valuable intangible right.
- Third parties often make payments to associations for a number of different “intangible property rights”
 - ✦ **Examples: Right to use mailing list, right to use logo on products**
- Exception: If association has to perform services in exchange for payment

- **Rents from Real Property**

- Rents from personal property is UBI
- If rent is for both, allocations may be made, more complicated

Advertising vs. Corporate Sponsorship

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- Advertising is UBI
- Corporate sponsorship is not
- **GREAT OPPORTUNITY FOR REVENUE - IF PROPERLY STRUCTURED**

Advertising

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- **Definition:**
 - Messages containing qualitative or comparative language
 - Price information or other indications of savings or value
 - An endorsement
 - An inducement to purchase, sell, or use any company, service, facility or product

Qualified Sponsorship

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- No substantial benefits other than **use or acknowledgement** of its products or services:
 - Substantial benefits: risk is primarily advertising
 - Irrelevant whether sponsored activity is related or unrelated to recipient's exempt purpose
 - Biggest Issue: Distinguishing advertising from an **acknowledgment** (corporate sponsorship)
- **2% Rule: benefits are disregarded if aggregate FMV of ALL benefits provided to sponsor is not more than 2% of sponsorship payment**
 - Benefits may include advertising, exclusive provider arrangements, goods, facilities or services, or licensing (i.e. golf or other event passes)
- Cannot have advertising language or endorsement by the association on either the association's **or** sponsor's website

Acknowledgement

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- **The payor's brand or trade names**
- **Logos and slogans that do not contain qualitative or comparative descriptions of the payor's products or services**
- **Exclusive Sponsorship Agreements**

Allowable Deductions

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- **Unrelated business income tax (UBIT) is imposed on the net taxable income from the unrelated activities**
- **While determining the amount of UBI is important, of equal importance, is to what extent the association can deduct expenses to offset UBI**
- **In order for an expense to be deductible, it must meet two tests:**
 - Expense must be allowable as a deduction under one of the tax code provisions that allow business deductions for for-profit companies; and
 - Expenses must be “directly connected” with carrying on of the unrelated trade or business
 - ✦ May allocate dual-use (shared) expenses

Net Operating Losses

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- **Net operating loss rules are available to tax-exempt organizations**
- **Current law is first carryback 2 years, and then carryforward 20 years**
 - This is helpful to offset income from profitable activities
 - Certain exceptions to the carryover period exist or can be elected

Form 990-T

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- Required if gross income from UBI > \$1,000
- All UBI activities included on one 990-T
- Taxed at corporate rates
- If expect to pay UBIT, must make estimated tax payments
 - 4th, 6th, 9th and 12th months of tax year
- Due 15th day of 5th month after year-end
- Extensions: Automatic 3 month, Form 8868 (not 7004)
- Not subject to public inspection like Form 990, unless you are a public charity (new rule)

UBI – Internet Issues

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- **Potential Issues Raised by Internet**
 - Hosting advertising or sponsorship statements on your web site, including links to sponsors' and advertisers' web sites
 - ✦ Banners
 - ✦ Links
 - ✦ Sponsorships
 - Various merchandising transactions
 - Transactions involving mailing lists
 - Endorsement of companies' products or services
 - Virtual trade shows

UBI - Policies & Procedures

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- **Key components to minimizing risk:**
 - Written policies and procedures
 - Centralized control to ensure consistent application of the law
 - ✦ Familiarity with tax issues
 - ✦ Ensure potential contracts are reviewed for tax issues
 - Maintain adequate documentation
 - Education
 - Assessment of existing exposure

Conclusion

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- **UBI is NOT necessarily BAD!**
 - In fact, it may generate significant revenue for the association
- **Lots of organization pay UBIT**
- **The key is to analyze and report on 990-T**

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