



American Society of Interior Designers Tax Developments and Unrelated Business Income Tax For Chapters

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R. Michael Sorrells, CPA
National Director Nonprofit Tax Services
301-634-4942
rsorrells@bdo.com

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New Developments

Background

- Climate of suspicion around nonprofits
 - Well publicized cases of abuse
 - Senate Finance Committee hearings
- Pension Protection Act of 2006
 - Many provisions for nonprofits mostly related to areas of abuse and transparency

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New Small Organization Filing Important for Small Chapters!

- Previously, if under \$25,000 in gross receipts, no filing required of Form 990
- Beginning for 2007 tax year, such small organizations must file annual “electronic postcard” with IRS which basically lets IRS know the organization is still around
- Revocation of exemption if not done 3 years in a row
- May pose difficulties for volunteer organizations with treasurer turnover every year

Changes to 990

- 2006 and 2006
 - Disclosure, disclosure, disclosure— mostly about relationships
 - Must look at board relationships and any dealings with board members or their companies

Future Revamp of 990

- IRS released draft of new 990 in June of 2007
- Likely effective for 2008 tax year
 - Full redesign—many, many changes
 - Now a core document with a lot of attachments depending on the type and activities of the organization
 - Available on irs.gov

HISTORY

IRC Code Section 511 – 514, enacted in 1950

- Purpose
 - Eliminate unfair competition between tax exempt organizations and for profit entities
- 1969, expanded to include all exempt orgs.
- C.F. Mueller v. Commissioner (macaroni case)

3 Flavors of Income for Nonprofits:

- Related Income
- Excludable Income
- Unrelated Business Income

THREE CRITERIA For UBI

1. Trade or business,
2. Regularly carried on, and
3. Not substantially related to the organization's exempt purpose

Trade or Business

- Fragmentation rule – each activity is alone
- Exploitation
 - Selling products produced in an exempt function not subject to UBIT
 - Take one step further - UBIT
- Dual Use – facilities used for exempt and commercial purposes

Regularly Carried On

Frequent and continuous

- Comparable to commercial activities
- Infrequent or intermittent basis
- Once a year for short duration is *not* regularly carried on
- Preparatory Time – key factor (e.g. advertising income for an annual yearbook)

Substantially Related

Factual Question

- Relationship between activity and accomplishment of organization's exempt purpose
- IRS compares incorporation documents and operations
- New activities should be reviewed to make sure for consistency with exempt purpose
- Simply raising money to be used for exempt purpose is not related to exempt purpose!

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Income Categories:

- Related Income
- **Excludable Income**
- Unrelated Business Income

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UNRELATED BUSINESS INCOME TAX

Excludable Income (common exclusions—items that would be taxable except they are excluded by statute):

- Dividends – except S Corp Income
- Interest
- Royalties – payment for use of a valuable right but no personal services, Sierra Club case (mailing lists and affinity arrangements)
- Rents – unless personal services are rendered; debt-financed property; based on % of sales

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UNRELATED BUSINESS INCOME TAX

Excludable Income (continued):

- Capital Gains – dealer rules apply
- Research Income – not ordinary testing of products
- See 990 instructions for many more

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UNRELATED BUSINESS INCOME TAX

The Controlled Corporation Sec. 512(b)(13) Trap For Passive Income:

- The exclusion from UBIT from interest, rents, royalties or annuities from a controlled sub *is not allowed* if those amounts reduce the net taxable income of a controlled subsidiary (or increase its NOL)
- Controlled organization = more than 50% vote or value, constructive ownership applies
- This is often overlooked, so check if there is a for-profit subsidiary

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UNRELATED BUSINESS INCOME TAX***Specific Exclusions under Section 513***

- Volunteer Labor—85% rule
- Convenience of members or constituents
- Donated Merchandise
- Qualified Convention and Trade Show Activities
- Bingo Games
- Low Cost Articles Distributed with Solicitation
- Rental or Exchange of Mailing Lists between charities
- Qualified Sponsorship Payments

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Finalized Treasury Regulations, April 2002

- Advertising
 - Unrelated business income
 - Subject to federal and state income tax
- Corporate Sponsorship
 - Contributions
 - Related income
 - Exempt from federal and state income tax

Advertising

- Promotes or markets a product or service
- Qualitative or comparative language
- Endorsement
- Inducement to buy (coupon)

Corporate Sponsorship

- No Substantial Return Benefit—only return benefit must be for acknowledgement of support
 - May be combined with advertising or other benefits but must allocate portion to payment to advertising or other benefits

Specific Rules in the Regulations:

- Can have sponsor's logo and a link to sponsor's Website along with acknowledgement message
- Cannot have advertising language or endorsement by the nonprofit on either the np or sponsor's website
- Great opportunity for revenue if properly structured

Allocation of Expenses:

- Directly Connected Expenses
- Dual Use Expenses
- Exploitation of Exempt Activities

Directly Connected Expenses:

- Expenses directly related to performing unrelated business
 - Salaries
 - Office space
 - Other

Dual Use Expenses:

- “Reasonable Allocation” of expenses between exempt and unrelated functions
- Rensselaer Polytechnic Institute v. Comm.
 - Student use and commercial use
 - Fixed expenses based on actual use rather than available for use (200 days v. 300 days)
 - Reduction from 25% of expenses to 16.5%

Exploitation of Exempt Activities:

- Unrelated activity exploits exempt function
- Unrelated activity performed by taxable orgs.
- Exempt function carried on by taxable orgs.

- Example: advertising Reg. 1.512

Regulation 1.512 Example:

(A) Unrelated trade or business (sale of advertising):

Advertising Income	\$100,000	
Direct Advert. expenses	(25,000)	
Subtotal		\$75,000

(B) Exempt function (publication of periodical):

Income (from subscriptions)	60,000	
Non-advertising Publication expenses	(110,000)	
Net exempt function income (loss)		(50,000)

Unrelated business taxable income		25,000
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- Rev Ruling 2004-112
 - ✓ Significant for Two Reasons:
 - An actual ruling on Internet Activity
 - Virtual trade shows created a real bone of contention—were they really exempt as qualified trade show activity or were they simply a form of advertising UBI?

- Creates two fact situations—good and bad
 - ✓ Good Facts:
 - Trade assoc has semi annual trade shows at exhibition facility that last about 10 days
 - Adds special section on Website beginning 3 days before actual show and ending 3 days after

- Bad Facts:
 - ✓ Assoc has temp website with similar function as in good facts for a 2-week period a couple of times a year
 - ✓ 2-week period does not overlap any convention or actual trade show that the assoc conducts
 - ✓ Since not conducted in conjunction with actual show, the activity is considered UBIT

Form 990-T

- Required if gross income from UBI > \$1,000
- Where: IRS, Ogden, Utah 84201
- When: 15th day of 5th month (IRA – 4th month)
- Extensions: Form 8868 (not 7004)
- Not subject to public inspection like form 990 unless you are a public charity (new rule)

QUESTIONS?

Mike Sorrells
BDO Seidman, LLP
Bethesda, MD
301-654-4900
rsorrells@bdo.com