Commercial activities and the unrelated business income tax

January 19, 2023

40th Annual Nonprofit Organizations Institute

1

Disclaimer

- EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.
- The views expressed by the presenters are their own and do not necessarily represent the views of Schell Bray PLLC, Ernst & Young LLP or other members of the global EY organization. Ernst & Young LLP expressly disclaims any liability in connection with the use of this presentation or its contents by any third party.
- This presentation is provided solely for educational purposes and enhancing knowledge of tax matters. It does not provide accounting, tax or other professional advice because it does not take into account any specific taxpayer's facts and circumstances. Please refer to your advisors for specific advice.

2

2

Presenters

Justin J. Lowe
Ernst & Young LLP
Washington, DC
+1 202 327 7392
justin.lowe@ey.com

Ed Chaney
Schell Bray PLLC
Chapel Hill, NC
+1 919 869 3080
echaney@schellbray.com

Today's agenda

- **Unrelated business income tax (UBIT) refresher**
- Royalties vs. commissions
- Spin-off (if, when and how?)
- Joint ventures
- Key takeaways – why it's important to include tax early in commercial activity development

UBIT overview

- Under Internal Revenue Code (IRC) Section 511, UBIT applies to otherwise tax-exempt organizations (EOs) described in IRC Section 401(a) (qualified benefit plan trusts) and Section 501(c), as well as most state colleges and universities.
- It is a tax on the gross income (less directly connected expenses) derived from (1) a trade or business, (2) regularly carried on and (3) not substantially related to the organization's exempt purpose.
- An activity is "substantially related" if it "contribute[s] importantly" to an organization's exempt purposes.
- Too much unrelated business activity may indicate a substantial nonexempt purpose and jeopardize exemption.

UBIT overview

- Under IRC Section 512(b), passive income, such as dividends, rents from real property, interest and royalties, is generally not subject to UBIT unless:
  - Such income (other than dividends) is paid to a charity by a more than 50% controlled entity and the payment reduces the controlled entity's net unrelated income (and tax liability) or increases its net unrelated loss.

    Or
  - Income is generated by debt-financed property that is not used in furtherance of exempt purposes.
- Whether a commercial activity is taxable often requires determining the character of the income (e.g., royalty vs. sales commissions).

Title search: Commercial Activities and UBIT

Also available as part of the eCourse
2023 Nonprofit Organizations eConference

First appeared as part of the conference materials for the
40th Annual Nonprofit Organizations Institute session
"Commercial Activities and UBIT"