Commercial activities and the unrelated business income tax

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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).

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Commercial Activities and UBIT for Nonprofits

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