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## **Unrelated Business Taxable Income: A Focus on Sponsorships & Advertising Income**

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# Agenda

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1. What is Unrelated Business Income?
2. Potential UBI Revenue Stream: Sponsorship Income
3. Potential UBI Revenue Stream: Advertising Income
4. How to Manage Your Organization's UBI Exposure

# What is Unrelated Business Income?

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- According to IRC Section 513:
  - *“The term “unrelated trade or business” means...any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section [501](#)...”*
  
- 3 Part Test:
  1. Is the activity a trade or business?
  2. Is the activity regularly carried on?
  3. Is the activity not substantially related?

## Part I: Is the Activity a Trade or Business?

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- Profit Motive: Selling goods or services to generate income
  - Activities that are related to the organization's exempt function (not taxable)
  - Activities not related to the organization's exempt function (taxable)
  
- Commercial nature: For profits selling similar goods or services
  
- Example: A tax-exempt organization solicits, sells, and publishes advertisements for commercial businesses in its monthly magazine. Even though the magazine contains content related to the organization's exempt purpose, the publishing of advertising is still an unrelated trade or business.

## Part 2: Is the Activity Regularly Carried On?

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- Compared to frequency with which the commercial activity is carried on by non-exempt entities.
  
- Examples:
  - Not UBI: Advertising in program booklets over two weekends not frequent enough, although advertising sales took place over several months
  - Not UBI: Special fundraising events (galas, golf tournaments, etc.) that occur annually but only one-time a year are not regularly carried on.
  - UBI: Selling Christmas cards, even though for a short period of time, is a seasonal business and seasonal participation is considered regularly carried on.

## Part 3: Is the Activity Not Substantially Related?

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- Organization's need for additional revenue does not make income related to exempt purpose
- Subject to two requirements according to Reg. 1.501(c)(3)-1(e)(1)
  - Activities be "in furtherance of" an exempt purpose; and
  - Not being operated for the "primary purpose" of carrying on an unrelated trade or business as defined in IRC 513
- Facts and circumstances analysis on primary purpose

## Qualified Sponsorship Income

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- Definition - A payment by any person engaged in a trade or business to an exempt organization without an arrangement or expectation that the payor (sponsor) will receive a substantial return benefit (valued at 2% or less of sponsorship payment)
- Statutorily excluded from unrelated business income under Internal Revenue Code 513(i)(1)

## What is not Qualified Sponsorship Income?

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- Payment based on the level of attendance, broadcast ratings, or other factors indicating the level of public exposure under IRC 513(i)(2)(B)(i)
- Payment which allows the company to the use or acknowledgement of the name or logo (or product lines) of the company's trade or business in regularly scheduled and printed material published by or on behalf of the organization that is not related to and primarily distributed in connection with a specific event conducted by the organization under IRC 513(i)(2)(B)(ii)



# Substantial Return Benefits

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- Advertising
- Exclusive provider arrangements
- Goods, facilities, services or other privileges
- Exclusive or nonexclusive rights to use an intangible asset such as a trademark, logo...

## De Minimis Benefits to Sponsor

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- Charity may provide sponsor with benefits that have an aggregate fair market value of not more than 2% of the sponsor's payment. (Treasury Regulation 1.513-4(c)(2)(ii))
- If benefits exceed the de minimis exception, the fair market value of all goods and services provided to the sponsor is potentially unrelated business income

## 2% Safe Harbor Example

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- ABC Company makes a \$10,000 donation to the XYZ Foundation.
- 2% Safe Harbor = \$200
- ABC Company receives: \$180 value
  - \$80: 2 Tickets to the gala dinner
  - \$100: Advertising in the gala dinner program
- ABC Company receives: \$250 value
  - \$80: 2 Tickets to the gala dinner
  - \$100: Advertising in the gala dinner program
  - \$70: Licensing rights

# How to Manage Sponsorship Payments

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- Company could have a separate agreement for advertising and an additional agreement for sponsorship payment.
- Be careful with discounted advertising with sponsorship payments.
- Website Links – include rules in agreement
- Potential excess benefit transactions
  - For example, a company sponsor is 75% owned by a board member of the charity

## Exclusive Sponsor

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- Generally NOT considered unrelated business income
- Acknowledgement that an event is sponsored by the payor
- Payor/sponsor receives no or de minimis substantial return benefit

## Exclusive Provider

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- Generally IS considered unrelated business income
- Definition – an arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities in exchange for consideration
- Example – Co. A agrees to provide charity \$XXX for the next five years if charity will only allow the sale of Co. A's products in its vending machines, snack bars and sporting events. Charity agrees to keep competitors' products off of its campus.
- Such arrangements are not qualified sponsorship payments and whether or not the payments are unrelated business income must be analyzed based on the other rules for unrelated business income

## Use or Acknowledgement – Not Advertising

- Use or acknowledgement of the name, logo, or product lines
- Exclusive **sponsorship** arrangements
- Logos/slogans that do not contain qualitative or comparative descriptions of payor's products, services, facilities or company
- A list of the payor's locations, telephone numbers, or website
- Value-neutral descriptions – including displays or pictures of the payor's product-line or services (picture of a diet coke bottle)
- Display or distribution of a payor's product at a sponsored event (water bottles with the payor's/sponsor's logo)  
(Treasury Regulation 1.513-4(c)(2)(iv))

# Advertising

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- Any message that contains qualitative or comparative language
- A message that has price information or indications of value or savings
- An endorsement
- A message that contains an inducement to sell, or use the sponsor's product or service



## Other Examples of Advertising Income

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- Website advertising
- Periodical advertising
- Name and logo on unrelated items
- Endorsement
- Sports programs
- Call to action

# How to Manage Your UBI Exposure

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- Review all revenue streams and any new streams each year.
  - Complete the UBI 3 part test and document the results.
- Review expenses attributable to UBI
  - Be sure expenses are directly connected with the unrelated business and any allocations are reasonable.
  - According to Reg. 1.512(a)-1(a), “an item of deduction must have proximate and primary relationship to the carrying on of that business”

# How to Manage Your UBI Exposure

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- Documentation and recordkeeping are key!
- Evaluate UBI activities particularly ones with consistent losses.
  - IRS has been disallowing NOLs during examinations.
- UBI and Governance Policies
  - Consider seeking outside advice for UBI issues
  - Include Form 990T and UBI issues with board review of Form 990
  - Follow the organization's conflict of interest policy for sponsorship payments

# Contact Information



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