

Innovative Programs

Presented by
Nicola Fuentes Toubia

2450 Louisiana, Suite 400
Box 936
Houston, TX 77006
Phone: (713) 589-2138
Cell: (202) 288-8268
nicola@toubialaw.com



Innovative Programs

1. Joint Ventures
 - A. What are they?
 - B. What are current IRS rules?
 - C. Can they help you?
2. New Programs
 - A. Unrelated Business Income Tax
 - B. Implementation



Introduction:

- Is social entrepreneurship still alive?
- What is the right language for effective philanthropy?
- Is your board able to embrace innovation in a troubled economy?
- What are the public relations risk with starting a new endeavor now that the Form 990-T is subject to public disclosure?
- How will the IRS Colleges and Universities Compliance Project impact the UBIT rules?

Joint Ventures:

- What are they?
 - Partnership with another nonprofit
 - Partnership with a for-profit
 - Limited liability company
 - Corporation
 - Contractual agreement

Joint Ventures:

- Case Study

- Miss Marple's School of Mystery & Manners, a Texas nonprofit and section 501(c)(3) organization, has loads of charm, manners, and wannabe gumshoes, but no money
- Miss Marple's School needs student housing
- Dastardly Dan Developers, a Texas corporation, owns and operates housing facilities and has lots of capital



Joint Ventures:

- To provide student housing for Miss Marple's School of Mystery & Manners, Dastardly Dan Developers and the School will form a joint venture
 - Dastardly Dan Developers will contribute cash to finance the housing construction
 - The School will contribute land and ground lease
 - Joint venture will own housing until expiration of ground lease
 - Parties each receive 50% capital and profits interest in joint venture



Joint Ventures:

- What should be the joint venture's form?
 - Pass-through entity, like partnership or limited liability company, or corporation?
 - Does one form provide greater liability protection than another?
 - Would one form minimize tax liability?
 - Is the form an ancillary or a whole joint venture?

Joint Ventures:

- Critical issues for Miss Marple's School of Mystery & Manners
 - Can a section 501(c)(3) organization enter into a joint venture with a commercial interest?
 - Will the joint venture jeopardize the School's tax-exempt status?
 - Will the joint venture trigger unrelated business income tax (UBIT)?



Joint Ventures:

- What are the current IRS rules?
 - Section 501(c)(3) organizations must be organized and operated exclusively for charitable purposes
 - No private inurement (insiders)
 - No private benefit (outsiders)
 - No excess benefit
 - Activity must be related to the School's exempt purpose or be insubstantial
 - The School must include its proportionate share of income if it owns > 50%



Joint Ventures:

- Factors to consider
 - Who controls joint venture?
 - Does Dastardly Dan bring expertise needed by the School?
 - Was there an independent valuation for assets contributed by the School?
 - Who manages and controls day-to-day operations?
 - Is there an unwind trigger?
 - Were bids solicited?
 - How was board selected?
 - Did the School receive ownership interests in proportion to its contributed assets?

Joint Ventures:

- Can they help you?
 - Look for partners with expertise or assets that you do not have
 - Retain control of joint venture
 - Ensure that joint venture furthers your charitable purposes
 - Leverage your and for-profit's talents

New Programs:

- Unrelated Business Income Tax
 - Trade or business
 - Regularly carried on
 - Not substantially related to exempt purpose
- Policy: Eliminate unfair competition by nonprofits against commercial enterprises

New Programs: UBIT

- *Trade or business requirement:*
 - Any activity carried on for the production of income from sale of goods or performance of services
 - Same meaning as in section 162
 - IRS takes broad view and courts typically agree
- **Fragmentation Rule:** Allows IRS to divide organization's activities between related and unrelated ones even though activities may be intertwined with one another

New Programs: UBIT

- *Regularly Carried On*
 - Examines frequency and continuity of activities
 - Compares to commercial frequency
 - Ignores occasional, intermittent or sporadic fundraising activities
 - Similarly, excludes business activities that are carried on discontinuously or periodically without typical commercial promotional efforts

New Programs: UBIT

- *Not Substantially Related to Exempt Purpose*
 - Examines relationship between business activity and exempt purpose
 - Determines “related” ONLY where conduct of business has CAUSAL relationship to achievement of exempt purpose
 - Requires CAUSAL relationship to be a SUBSTANTIAL one that CONTRIBUTES IMPORTANTLY to exempt purpose
 - Applies facts and circumstances test



New Programs: UBIT

- *Not Substantially Related to Exempt Purpose*
- **Size & Scope:** Are size and scope of activities conducted on a scale that is larger than necessary to meet charity's needs?
- **Same State:** Has the state of the goods been altered after completion of exempt function?
- **Dual Use:** Is an asset used for both exempt and non-exempt purposes?
- **Exploitation:** Is intellectual property created via exempt activities being exploited in a commercial manner?



New Programs: UBIT

- To much UBTI can kill you, but there is NO bright line rule as to what is too much UBTI
- Factual question as to whether an organization has too much UBTI
- Commensurate in Scope: EO may generate a significant amount of UBTI so long as it performs charitable programs commensurate in scope with its financial resources
- Primary purpose test: Is EO operating *primarily* for exempt purpose?

New Programs: UBIT

Statutory Exceptions to UBTI

- Volunteer exception: substantially all of the work is performed without compensation
- Convenience exception: activity is carried on primarily for convenience of members, students, patients, officers, etc.
- Thrift shop exception: substantially all merchandise sold by EO was donated

New Programs: UBIT

- *Statutory Exceptions:*

 - *Qualified Sponsorship Payments*

 - Any payment where no expectation of a substantial return benefit other than acknowledgement
 - Irrelevant whether sponsored activity is related or unrelated to recipient's exempt purpose
 - 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



New Programs: UBIT

- *Modifications to UBTI*
 - Dividends, interest, annuities
 - Royalties
 - Rent UNLESS
 - For services
 - >50% personal property
 - Based on income of lessee
 - From debt-financed property
 - Capital gains
 - Research income
 - Performed for federal, state or local governments
 - Performed by college, university, or hospital
 - Performed by research organization and freely available to the general public



New Programs: UBIT

TAXABLE SUBSIDIARIES

- Pros:

- Parent will NOT have UBTI
- No Form 990-T disclosure requirement for Form 1120
- Protect EO parent's assets from liabilities
- Easier to claim deductions
- Stock incentives
- Greater flexibility

- Cons:

- Additional expenses
- Income allocation issues
- Limitation on capitalizing sub with debt-financed property
- Section 512(b)(13) problems

New Programs: UBIT

- IRS STILL has NOT published general guidance on *Internet* activities and UBTI
- Currently, 2 CPE texts from 1999/2000 are only insight into IRS analysis
- Basic UBTI rules still apply
- Sponsor links: a hyperlink to sponsor's website is analyzed similarly to qualified sponsorship payment. Does EO endorse the sponsor?
- Banners: OK so long as no qualitative or comparative language
- Fundraising: electronic confirmations are OK



New Programs: Case Study

- **Facts:** President of a community foundation, a public charity, consults with other charities on effective grant-making techniques. The foundation charges a fee for president's services, which equals the market rate for commercial fundraisers. This program covers 15% of the foundation's budget. The foundation also offers administrative back-office services to maintain grant records and computer support for other charities' web pages. The fee for these services is just below market rates.
- Providing grant-making advice and administrative and computer services are trade or businesses like providing consulting services
- Consulting is regularly carried on because not one-time event
- Good argument that grant-making advice is substantially related to the foundation's exempt purpose to support the local area
- Difficult to argue that administrative and computer services are related due to their commercial nature and fee being just below market. If fee were substantially below market, there is a better argument that these services are related because greater assistance to charitable class.

New Programs: Case Study

- Facts:

Hockey Team's Foundation's purpose is to teach children value of sportsmanship and athletics. Local energy company will sponsor annual golf tournament with \$75,000 contribution. In return, it receives: 12 tickets to pre-game tournament; recognition in program; mid-court drop-the-puck appearance at team's first game; 12 tickets to a game; sponsorship sign at one hole; 4 places in tournament; announcement as sponsor; "ad" in game rosters.

- Qualified sponsorship portion: signage at hole, mid-court appearance, recognition in program and "ad" if it is not an endorsement
- Non-qualified portion: provision of tickets, games and golf-tournament places. Apply 2% rule.
- Argument that non-qualified portion is not UBTI because not regularly carried on



New Programs: Implementation

- Think “*Outside the Pledge Card*”
- Tap into current philanthropreneurism
- Brainstorm
- Identify new resources and/or collaborate with existing ones
- “*If you worry about money first, you do cheap ideas. ... You should do the best ideas and raise money once you have the good idea.*”
Paul Greenhalgh, Corcoran Gallery of Art

New Programs: Implementation

- Start small
- Set clear goals
- Evaluate demand
- Do your homework
- Develop business plan
- Raise necessary capital
- Identify key leaders

Conclusion:

QUESTIONS?