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UBIT: Case Studies

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New legislation pertaining to UBIT

- (1) Form 990-T public disclosure—6104(d)(1)(A)(ii)
- (2) 512(b)(13)
- (3) 664(c)
- (4) Credit Counseling Organizations—501(q)
- (5) 514(c)(9)(C)(iv)

Case Study 1—501(c)(14) credit union

C is a state-chartered credit union which is recognized as exempt from federal income taxation under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(14)(A). C's purposes as stated in its articles of incorporation are to promote thrift and provide low cost credit for its members. C accepts deposits from members in either share accounts or share draft accounts. C also makes loans to members.

A. Sale of accidental death and dismemberment insurance

C offers accidental death and dismemberment insurance to its members under a policy offered by an insurance company. C receives a fee for administrative services that it provides such as making members aware of the policy; answering basic questions and obtaining and submitting applications, premiums and claims.

Is this fee subject to UBIT?

B. Sale of group health, life and cancer insurance

C markets and sells group life, health and cancer insurance to its members. C receives a fee for collecting and remitting the premiums to the insurance company that offers the policy.

Is this fee subject to UBIT?

C. Sale of credit life and credit disability insurance

C offers its members the opportunity to purchase credit life and credit disability insurance on certain loans. Credit disability insurance pays installment loan payments for up to 120 months up to a certain dollar limit if a borrower becomes physically disabled in a way that affects employment. C adds the insurance premiums to the member's loan balance. C receives a commission that is a percentage of the premiums written and pays its employees bonuses based on the number of policies the employee sells.

Is the commission subject to UBIT?

D. Sale of guaranteed auto protection (GAP) insurance

C offers its members who take out auto loans from C the opportunity to purchase GAP insurance that covers any difference between what the member's auto insurance coverage and the balance on the loan for their automobile if the car is destroyed. The insurance is not required in order to obtain a car loan from C, though regular car insurance is. C receives payments from the insurance company that provides the GAP insurance policies.

Are these payments subject to UBIT?

E. Sale of car warranties

C allows W, a company that has a car warranty program, to offer this program to its members. C provides office space to employees of W and C's employees offer and explain the program to members who are obtaining car loans. W pays C for each warranty sold.

Is this payment subject to UBIT?

F. Sale of MEMBERS financial management services

C has entered into an exclusive agreement with V to provide financial services to C's members that C does not offer. The services include mutual funds, annuities, and insurance products. V pays C a percentage of the new business expense allowance dollars on all products offered by the MFS program.

Is this fee subject to UBIT?

G. Car buying service

C offers members the opportunity to use X, a company that locates and purchases cars for a fee. C refers members to X. X pays a fee to C for each car it sells to a member.

Is this fee subject to UBIT?

H. Sale of collateral protection insurance (CPI)

If a member of C who has a car loan from C, loses his or her car insurance or cannot obtain car insurance, C will purchase CPI and the cost of the insurance is added to the member's loan. Under CPI, C is the insured party. The insurance is "force-placed" on the borrower because of a lack of regular insurance. C is reimbursed for its administrative expenses related to operating the CPI program.

Is this reimbursement subject to UBIT?

I. Sale of checks

C has an agreement with Y in which C markets and sells Y's checks to its members. C receives a commission from Y for the sales.

Is this commission subject to UBIT?

(Patterned on recent TAMs)

Case Study 2—convention/conference center

Organization X is organized to promote education by operating a conference center. A mix of government, nonprofit, and for-profit organizations and individuals use the facilities for conferences, cultural events, and private events such as weddings. Organization X sets its fees slightly lower than the going rate at for-profit conference centers in the area. Organization X operates the facility on a break-even basis and earns net income from investments. Organization X has a budget for advertising and promotion, though somewhat less than neighboring facilities.

Organization Y is organized to lessen the burdens of government by building and operating a convention center and arena for the City for sporting events, concerts, conferences, conventions, etc. The City Council and Mayor assisted in Organization Y's creation and appoint the board. The City finances the construction with general obligation bonds and has title to the facility. Organization Y provides labor to operate the facility. Organization Y receives the following income from the facility: rents from users; a portion of ticket sales; rental of skyboxes; reimbursement from promoters for advertising expenses incurred by Organization Y; a portion of all food sales by a contractor caterer; a portion of all sales of merchandise by promoters; exclusive sponsor payments; exclusive provider payments; a portion of parking fees; fees for broadcasting rights; license of naming rights treated as royalty payment by parties; and percentage of fees from public use of pay phones and ATMs.

Is either organization exempt under IRC 501(c)(3)? If so, does the operation of the facility generate UBTI?

Patterned on Airlie Foundation v. IRS, 283 F.Supp.2d 58 (D.D.C. 2003) and PLR 200634036 (April 10, 2006)

Case Study 3—CRSO v. Comm’r, 128 T.C. No. 12 (2007)

P is a nonprofit corporation that has applied for tax exempt status under IRC section 501(c)(3). P’s sole activity is receiving rental income from commercial real estate that it owns and distributing it to a publicly supported section 501(c)(3) organization. The commercial real estate consisted of two buildings subject to acquisition indebtedness. A management company leased and operated the buildings.

Are P’s activities a trade or business under IRC 502, making P a feeder corporation and not eligible for exemption under IRC 501?

Case Study 4—Hospital subsidiary

501(c)(3) hospital system is affiliated with taxable professional corporation (PC) engaged in the practice of medicine; the affiliation is through a combination of employment, affiliation, and shareholder agreements. State law requires a physician to hold PC stock. PC is funded by Hospital and 509(a)(3) Parent through formal and informal loans and advances. Parent came up with the funding partly by incurring debt. PC makes repayments of principal and interest to Hospital and Parent. Physician is employed by Hospital through the PC as head of a department. PC provides medical care to patients; the patients are not patients of Hospital. PC must give Hospital any net income. Physician is barred from transferring or encumbering PC stock. Either Hospital or Physician can terminate Physician’s employment agreement at any time; if Physician’s employment is terminated, Physician must transfer PC stock to another individual selected by Hospital for the same nominal value Physician paid. Hospital provides management, professional, and administrative services to PC.

Is any part of the payments from PC to Hospital UBTI under 512(b)(13)?

Patterned on PLR 200716034

Is any part of the payments from PC to Hospital unrelated debt-financed income under 512(b)(4) and 514?