



Navigating Advertising Rules for Nonprofit Organizations

Balancing Revenue Generation with Tax Compliance



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1. Introduction

Nonprofit organizations operate within a framework of mission-driven objectives, leveraging various fundraising strategies to sustain and expand their impact. Among these strategies, advertising and sponsorships offer significant opportunities for growth, enabling nonprofits to connect with broader audiences and secure essential funding. However, these activities introduce complex legal and tax implications that must be navigated with precision and care. Understanding nonprofit advertising rules is crucial for these entities to harness the full potential of their fundraising efforts without inadvertently incurring unnecessary taxes.

The challenges and opportunities presented by nonprofit advertising are deeply intertwined with the broader regulatory environment. As organizations seek to innovate in their fundraising approaches, they encounter the nuanced distinctions between activities that generate **related versus unrelated** business income—a categorization that directly influences their tax obligations under the Unrelated Business Income Tax (UBIT) guidelines. These distinctions have real-world consequences for a nonprofit's financial health and operational efficiency.

The significance of mastering nonprofit advertising rules lies in the dual objectives of maximizing fundraising capabilities while maintaining compliance with tax regulations. By adeptly navigating legal requirements, nonprofits can unlock new revenue streams that support their missions, all while avoiding the pitfalls of tax liabilities that could divert resources away from their core objectives. This exploration is not just about adherence to regulations; it's about empowering nonprofits to thrive within a framework that respects their unique status while acknowledging their need for innovative fundraising solutions.

This guide includes discussion on the following topics that a not-for-profit organization may encounter in its review and application of nonprofit advertising rules:

- Overview of Nonprofit Status and Taxation
- Understanding UBI and UBIT
- Advertising and Sponsorships in Nonprofits
- Special Considerations: Periodicals, Membership Receipts, and Trade Shows
- Advertising and Sales Tax Considerations
- Trends in Nonprofit Advertising and Their Impact on UBI



2. Overview of Nonprofit Status and Taxation

Nonprofit organizations, recognized under the Internal Revenue Code (IRC), such as section 501(c)(3), enjoy tax-exempt status due to their dedication to charitable, educational, or similar purposes beneficial to public interest. This status allows them to focus more resources on their mission by exempting them from federal income tax on related income.

The Relationship Between Nonprofit Status and Tax Exemption

Nonprofit status provides organizations a reprieve from federal income taxes, underpinning the societal contract that these entities provide a public benefit that outweighs the need for tax contributions. The rationale for tax exemption is deeply rooted in the idea that nonprofits alleviate the government's burden by providing valuable services and support to the community, thereby justifying their exemption from income taxes.

This tax-exempt status, however, is contingent on the nonprofit's adherence to operational conduct that aligns with its exempt purposes. Engaging in commercial activities outside these purposes can jeopardize this status, particularly if such activities generate unrelated business income (UBI) above stated thresholds.

Distinction Between Tax-Exempt Income and Taxable Income

Income earned by nonprofit organizations falls into two primary categories: tax-exempt income and taxable income, the latter stemming from unrelated business activities. Tax-exempt income encompasses donations, grants, membership fees, and proceeds from activities intimately tied to the organization's exempt mission. For instance, the revenue a museum garners from ticket sales for educational tours aligns with its educational objectives, rendering it exempt.

In contrast, taxable income arises from activities that stray from the nonprofit's core purpose and are conducted in a commercial manner. This delineation becomes particularly significant in discussions about nonprofit advertising and sponsorships. As an example, advertising revenue from a newsletter might qualify as unrelated business income (UBI) and become taxable if the advertising is frequent and mirrors commercial business practices, straying from the nonprofit's exempt activities.

Engaging extensively in unrelated business activities risks jeopardizing the organization's tax-exempt status. The IRS could perceive such an organization as veering towards commercial pursuits at the expense of its exempt purposes. Consequently, while nonprofits are allowed to generate unrelated business income, it is crucial for them to navigate this territory with caution. Ensuring that these activities remain peripheral and do not eclipse their mission-centric goals is vital for maintaining their tax-exempt status.

Key Definitions:

Nonprofit Organization: An entity organized and operated for collective, public or social benefit, without the aim of generating profits for private owners or shareholders.

Tax-Exempt Status: A designation that exempts an organization from paying federal income tax on income related to its exempt purpose.

The Impact of Advertising Activities on Tax Status

Advertising activities represent a complex area for nonprofits, given their potential to affect tax-exempt status. The IRS distinguishes between income generated from activities related to the nonprofit's mission (related business income) and those that are not (unrelated business income or UBI). While related business income supports the organization's tax-exempt purposes and is therefore not taxable, UBI is subject to Unrelated Business Income Tax (UBIT) if it meets certain criteria: it is a trade or business, it is regularly carried on, and it is not substantially related to the organization's exempt purpose.

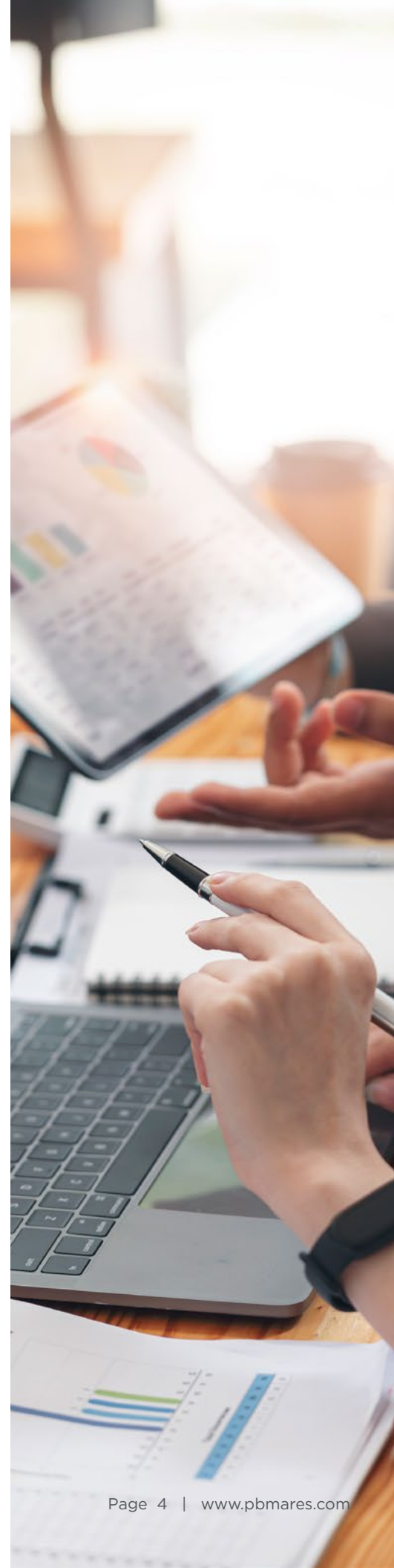
The differentiation between sponsorships (which are generally not taxed) and advertising (which might be considered UBI and therefore taxable) is crucial. Sponsorships typically involve payments to the nonprofit that do not expect substantial return benefits, falling into the category of qualified sponsorship payments. These are exemplified by acknowledgments such as listing the sponsor's name, logo, and providing a generic thank-you, without endorsing or promoting the sponsor's products or services.

Conversely, advertising activities that promote a sponsor's products or services, offer qualitative assessments, or suggest endorsements, can transform sponsorship income into taxable UBI. This nuanced distinction underscores the importance for nonprofits to carefully structure their advertising and sponsorship agreements to preserve their tax-exempt status while engaging in these potentially beneficial activities.

By maintaining a keen awareness of the implications of advertising activities and their potential to generate UBI, nonprofits can navigate the delicate balance between generating necessary revenue and preserving their tax-exempt status. This balance is pivotal to sustaining their operations and continuing to serve the public good effectively.

3. Understanding UBI and UBIT

Not-for-profit entities engage in a variety of revenue-generating activities, some of which are subject to taxation. Notable examples include profits generated from advertisements, museums operating gift shops, educational institutions leasing their facilities, and social service entities providing conference rooms for rent. These ventures often result in the accrual of [unrelated business income \(UBI\)](#), a form of taxable income that remains broadly misunderstood. A lack of familiarity with the regulatory and reporting obligations associated with UBI can pose significant challenges for organizations.



Definition of Unrelated Business Income (UBI)

Unrelated Business Income (UBI) is income from an activity that is regularly conducted and not substantially related to the charitable, educational, or other tax-exempt purpose of the organization. The IRS scrutinizes three main criteria to classify income as UBI:

- **Trade or Business:** The activity producing income must be trade or business, defined as any activity conducted for the production of income from selling goods or performing services.
- **Regularly Conducted:** The activity must be carried out with a frequency and continuity similar to comparable commercial activities.
- **Not Substantially Related:** The activity does not significantly contribute to furthering the nonprofit's mission, beyond the need for income generation.

“Unrelated business income is the income from a trade or business regularly conducted by an exempt organization and not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity. Certain trade or business activities aren't treated as an unrelated trade or business.”

Introduction to Unrelated Business Income Tax (UBIT)

The concept of Unrelated Business Income Tax (UBIT) was introduced in 1950, aiming to ensure that nonprofit organizations contribute their fair share of taxes on income generated from specific business activities, while still maintaining their tax-exempt status for their core functions.

UBIT applies to income from a trade or business that is regularly conducted by an exempt organization and is not substantially related to the organization's exempt purpose, except when the profits are used to further the exempt purpose. This framework ensures that nonprofits contribute their fair share for activities that diverge from their primary, tax-exempt functions.

A critical aspect of UBIT is the potential scrutiny organizations may face if their unrelated business income exceeds 15 to 20 percent of their total gross revenue. This threshold often necessitates a comprehensive UBIT analysis to ensure all activities are accurately recorded. Depending on the outcome, it may be strategically beneficial to establish a separate taxable entity for these business operations.

Nonprofit organizations are subject to a standard tax rate of 21 percent on unrelated business income exceeding \$1,000 annually. If an organization anticipates a UBIT liability of over \$500 for the fiscal year, it must make quarterly estimated tax payments.

To meet IRS requirements, these organizations must file IRS Form 990-T, reporting UBI and calculating UBIT, even if no tax is due. The filing deadline for Form 990-T depends on the organization's fiscal calendar: April 15 for those on a calendar year and November 15 for those with a fiscal year ending on June 30.

In 2021, the IRS Inspector General recommended increasing enforcement of unrelated business income for exempt organizations. With increased funding for enforcement, it's essential for nonprofits to carefully identify and accurately report activities generating income.

It's important to note that UBIT liabilities can be mitigated through the application of relevant business tax credits, offering a pathway to manage tax obligations effectively.



Common Advertising Activities that Generate UBIT

The determination of what constitutes unrelated business income (UBI) varies based on the specific nature and context of each nonprofit organization. Revenue from advertising often qualifies as UBI, particularly when it implies endorsements or promotes sales. This differs from sponsorship income, where the financial contribution does not afford substantial returns or benefits to the sponsor.

The list below outlines advertising activities commonly recognized as generating UBI, thus subjecting them to taxation:

- **Periodicals:** Advertising in newsletters, magazines, and member directories often generates UBI because it involves the sale of advertising space to unrelated third parties.
- **Membership Receipts:** Subscription-based services that provide benefits in return for membership fees can generate UBI if those benefits include advertising or access to advertising.
- **Broadcasting Rights:** Income derived from commercials and product placement during broadcasts by the nonprofit can constitute UBI, as it is income from regularly conducted business activities not related to the exempt purpose.

Notably, trade shows and conventions are generally not considered advertising for tax purposes due to their educational or promotional nature, which can align more closely with a nonprofit's exempt purpose.

Strategies for Minimizing UBIT Liability

To minimize Unrelated Business Income Tax liability, nonprofits can adopt several strategic practices. These include:

Directly Connected Expenses: Deduct all expenses directly connected to the conduct of the unrelated business activity, including salaries, utilities, and depreciation. Meticulous record-keeping is essential to substantiate these deductions.

Passive Income Exclusions: Understand what income is excluded from UBI, such as dividends, interest, certain rents from real property, and royalties. Structuring income sources to fall within these exclusions can significantly reduce UBIT liability.

Dual Use Expenses: Allocate expenses between related and unrelated activities when facilities or personnel are used for both purposes. Accurate allocation can lower the net income subject to UBIT.

Alternative Corporate Structures: Consider using a subsidiary entity to conduct unrelated business activities. This can protect the nonprofit's tax-exempt status and potentially offer more favorable tax treatment for certain income.

Navigating UBIT Compliance

Nonprofits are encouraged to adopt a proactive approach in managing their unrelated business activities to ensure compliance with tax regulations. This involves conducting regular reviews of income-generating activities, consulting with tax professionals to understand the nuances of UBIT, and exploring strategies for minimizing tax liabilities while maintaining alignment with the organization's mission and values.

Understanding and effectively managing UBIT is essential for nonprofits to navigate the complexities of tax compliance while leveraging opportunities to generate revenue through business activities unrelated to their primary exempt purposes. By staying informed and prepared, nonprofits can successfully navigate the challenges of UBIT and ensure their long-term sustainability and impact.

4. Advertising and Sponsorships in Nonprofits

Nonprofits leverage [advertising and sponsorships](#) as vital strategies for fundraising and visibility. However, navigating the tax implications requires a careful understanding of IRS regulations regarding Unrelated Business Income (UBI) and Unrelated Business Income Tax (UBIT). This section delves into the definitions, tax implications, and best practices related to advertising and sponsorships, with a focus on qualified sponsorship payments and the concept of substantial return benefits.

Understanding Advertising vs. Sponsorships

Advertising refers to the sale of advertising space, whether in newsletters, on websites, or at events. Income generated from advertising is typically considered unrelated business income (UBI) because it derives from activities not directly related to the organization's exempt purpose. Advertising often involves messages that endorse or encourage the purchase of products and services, making it subject to unrelated business income tax (UBIT).

Sponsorships differ from advertising in that they involve payments from businesses in exchange for recognition at events, on websites, or through other nonprofit channels. If structured properly, sponsorships do not constitute UBI because they are considered donations. A key factor distinguishing sponsorships from advertising is the absence of any qualitative or comparative language, pricing information, calls to action, or endorsements.

Qualified Sponsorship Payments

Qualified sponsorship payments are contributions from a business to a nonprofit without the expectation of any substantial return benefit. These payments are made to support the nonprofit's activities, and in return, the sponsoring business is acknowledged in a manner that does not constitute advertising. Such acknowledgments can include the sponsor's name, logos, and general product line descriptions without qualitative or comparative language, pricing information, or calls to action.

Key characteristics of qualified sponsorship payments include:

- **No Advertising:** Acknowledgment of the sponsorship should not promote the sponsor's products or services. Mention of the sponsor's name, logo, and contact information is permissible, but it should not include endorsements or qualitative assessments.
- **No Calls to Action:** The acknowledgment should not contain any call to action, such as urging the public to buy the sponsor's products or services.
- **No Pricing Information:** Mentioning the price of products or services offered by the sponsor disqualifies the payment from being a qualified sponsorship.
- **Limited Product Display:** Displaying the sponsor's product at an event is allowed as long as it's for identification and acknowledgment purposes only, without any promotional messaging.

Substantial Return Benefits

A substantial return benefit refers to any benefit returned to the sponsor that has a monetary value and goes beyond mere acknowledgment. This could include advertising services, exclusive provider arrangements, or any other privileges that confer a significant benefit to the sponsor. If the value of the return benefits exceeds two percent of the sponsorship payment, the payment, or a portion thereof, may be subject to UBIT as it no longer qualifies as a sponsorship payment but rather as a commercial transaction.

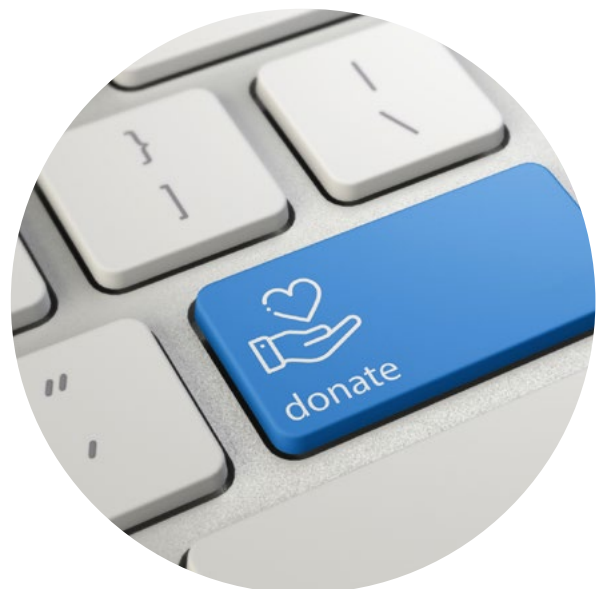
Managing substantial return benefits effectively may include:

- **Value Assessment:** Evaluate all benefits provided to the sponsor to determine if they could be considered substantial. This includes advertising, exclusive sales rights, or other privileges.
- **Two Percent Rule:** Calculate the fair market value of all return benefits provided to the sponsor. If the value is more than two percent of the total sponsorship payment, the excess payment is considered UBIT.
- **Documentation:** Keep detailed records of the value of all benefits provided to sponsors to substantiate the classification of payments as qualified sponsorships.

Illustrative Case Studies

Case Study 1: Taxable Advertising Scenario

- **Situation:** A nonprofit organization sells advertising space in its monthly newsletter to a local car dealership. The ads feature specific promotions, pricing details, and calls to action.
- **Analysis:** This is considered unrelated business income (UBI) because it includes promotional content similar to that found in commercial advertising, making it subject to unrelated business income tax (UBIT).



Case Study 2: Non-Taxable Sponsorship Scenario

- **Situation:** A nonprofit hosts its annual 5K run and secures a sponsorship from a local business. In exchange for the contribution, the business is acknowledged in event materials and banners without any promotional content, merely stating the business's name and logo.
- **Analysis:** This arrangement is not subject to UBIT, as the sponsorship does not provide substantial return benefits beyond simple recognition, thus qualifying as a tax-exempt qualified sponsorship payment.

Case Study 3: Scenario with Both Elements

- **Situation:** A corporation sponsors a nonprofit's annual gala with a \$50,000 payment. In return, the nonprofit agrees to prominently display the sponsor's logos, mention the sponsor in all event-related press releases, and provide the sponsor with a booth at the event to showcase its products.
- **Analysis:** The acknowledgment in press releases and logo displays falls within the realm of qualified sponsorship payments, assuming no qualitative or comparative language is used. However, the provision of a booth could be viewed as a substantial return benefit if its fair market value exceeds two percent of the sponsorship amount (\$1,000 in this case). If the fair market value of the booth space is assessed at \$2,000, then \$1,000 of the sponsorship payment could be subject to UBIT.

Through these case studies, nonprofit organizations can see the nuanced distinction between taxable advertising and non-taxable sponsorships within nonprofit operations. The third case study, in particular, highlights the complexity of scenarios where arrangements can include both taxable and non-taxable elements, emphasizing the importance of careful analysis and compliance to avoid unintended tax liabilities.

Best Practices for Advertising and Sponsorships

Navigating the nuanced terrain of nonprofit advertising and sponsorships requires a strategic approach to maximize benefits while ensuring compliance with tax regulations. Key guidelines include:

Understanding IRS Regulations: Nonprofits should familiarize themselves with IRS guidelines, particularly those related to UBI and UBIT. IRS Publication 598 is a critical resource for this purpose. A thorough understanding of these rules helps ensure compliance and avoid potential penalties.

Distinguishing Between Sponsorships and Advertising: The IRS differentiates between qualified sponsorship payments, which are not considered UBI and therefore not taxable, and advertising, which might generate UBI and be taxable. A sponsorship where the sponsor receives substantial return benefits beyond mere acknowledgment (e.g., product endorsements or service recommendations) can be deemed as advertising.

Maintaining Meticulous Records: Nonprofits must keep detailed records of all transactions related to advertising and sponsorships, including contracts, communications, and financial transactions. This documentation is vital for IRS compliance and for internal tracking of these activities.

Using IRS Form 990-T for Reporting: If a nonprofit generates income from unrelated business activities, including certain types of advertising and sponsorships, it must report this income accurately using IRS Form 990-T, along with any associated expenses, as they can be deducted from the UBI.

Establishing Clear Policies: Nonprofits benefit from developing and implementing clear policies regarding advertising and sponsorships. These policies outline what types of activities are acceptable, how they align with the nonprofit's mission, and the process for approving these arrangements.

Educating Boards and Staff: Nonprofits can help their board members and staff understand the difference between advertising and sponsorship activities, including potential tax implications. Regular training and updates can help keep everyone informed.

Reviewing Language in Agreements: The language used in sponsorship acknowledgments encompasses simple acknowledgments, such as listing the sponsor's name, logo, and a generic thank-you message. The deliverables for sponsorships may not include any benefits that could be construed as advertising services, such as exclusive promotional opportunities or endorsements.

Considering Mission Alignment: Nonprofits benefit from choosing sponsors and advertising partners that align with their mission and values. Partnerships closely aligned with the mission are less likely to be viewed as unrelated business activities and can enhance the organization's reputation.

Monitoring and Evaluating Activities: Nonprofits can regularly monitor and evaluate their advertising and sponsorship activities to ensure they remain compliant with IRS rules and are financially beneficial. This includes assessing the return on investment and the impact on the nonprofit's tax-exempt status.

Seeking Professional Advice: Given the complexities of tax law and the potential consequences of non-compliance, nonprofits often seek out professionals specializing in nonprofit law and taxation. This can help ensure that the organization navigates these activities safely and effectively.

Adopting these best practices will help nonprofit organizations navigate the complex regulations for advertising and sponsorships. By distinguishing between sponsorships and advertising, minimizing tax liability, and ensuring compliance with IRS regulations, nonprofits can effectively leverage these activities to support their missions while maintaining their tax-exempt status.

UBIT Red Flags

Distinguishing between corporate sponsorship and advertising in the nonprofit sector can be challenging, as seemingly similar situations may result in differing tax implications due to the presence of substantial return benefits. To avoid possible UBIT, nonprofit leaders will want to meticulously examine sponsorship agreements for signs of:

- Substantial return benefits or payments that depend on event attendance
- Payments tied to acknowledgments
- Exclusive provider agreements

Should a contract include acknowledgment, it's crucial for nonprofits to recognize that any qualitative or comparative language, references to prices, savings, value, or endorsements may convert the sponsorship into a transaction subject to unrelated business income tax.

5. Special Considerations

This section elaborates on specific areas that nonprofit organizations must navigate with care to remain compliant with UBIT regulations while optimizing their revenue generation strategies. These considerations include the management of periodicals, membership receipts, trade shows, and conventions.

Treatment of Periodicals

The sale of advertisements in [periodicals](#), such as newsletters and magazines, is generally taxable, except where such publications are closely related to the organization's exempt purpose. The content, distribution frequency, and relationship between the advertisements and the organization's mission are evaluated to determine taxability. Publications serving an educational, informational, or other purpose aligned with the organization's exempt status, where advertising is incidental and not a primary source of income, may not trigger UBIT.

[IRS Regulation 1.512\(f\)](#) offers clarity on the treatment of income derived from advertising and acknowledgments in printed materials and periodicals published by exempt organizations. The regulation specifies that income from advertising in periodicals does not apply to the taxability rules if the periodical is related to the organization's exempt purpose, regularly published, and primarily distributed to members or in connection with specific events.

However, when a periodical's advertising content becomes a significant source of income, and the activities are regularly carried on in a manner comparable to commercial publishing practices, the revenue may be subject to unrelated business income tax (UBIT). The key factors considered include the frequency of publication, the ratio of advertising content to other content, and whether the advertising activities are conducted in a commercial manner.



Key Definitions

Understanding key terms and definitions related to nonprofit periodical advertising is crucial for nonprofit financial leaders. While selling ads in periodicals typically qualifies as an unrelated business activity, certain rules allowing deductions can significantly impact the taxable income generated from such sources. Key definitions include:

- **Gross Advertising Income:** This encompasses all revenue derived from the unrelated advertising activities of an exempt organization periodical.
- **Excess Advertising Costs:** When the direct advertising costs of a periodical by an exempt organization exceed its gross advertising income, the surplus costs can be deducted to determine UBTI from any unrelated trade or business activity.
- **Excess Advertising Income:** If the gross advertising income exceeds the direct advertising costs, deductions related to creating and distributing periodical content can be considered as deductions directly associated with unrelated advertising activity. However, these deductions can only be used to calculate UBTI if they exceed the income derived from or related to the production and distribution of such content. It's important to note that these deductions cannot result in a net loss from advertising activity.
- **Circulation Income:** This includes income obtained from producing, distributing, or circulating a periodical, encompassing proceeds from selling or distributing its content. Additionally, if membership or a similar status in an exempt organization is required to receive the periodical, circulation income also includes the portion of membership fees attributable to the periodical.

Determining UBTI for Periodicals

The method for calculating UBTI from periodicals depends on the relationship between circulation income and readership costs:

- If the circulation income exceeds the readership costs, the UBTI attributable to the periodical is the excess of its gross advertising income over direct advertising costs.
- Conversely, if the readership costs exceed the circulation income, the UBTI is the excess, if any, of the total income attributable to the periodical over the total periodical costs.

Example 1: An exempt trade association publishes a periodical with advertising. During the year, the organization realizes a total of \$40,000 from the sale of advertising and \$60,000 from the periodical sales to members and nonmembers (circulation income). The total periodical costs are \$90,000 of which \$50,000 is directly connected with the sale and publication of advertising (direct advertising costs) and \$40,000 is attributable to the production and distribution of the readership content (readership costs).

Since the direct advertising costs of the periodical (\$50,000) exceed gross advertising income (\$40,000), the UBTI attributable to advertising is determined solely on the basis of the income and deduction directly connected to the production and sale of the advertising:

- Gross advertising revenue \$40,000
- Direct advertising costs \$50,000
- Loss attributable to advertising \$10,000

Thus, the unrelated taxable income from the advertising in the exempt organization's periodical is non-taxable.

Example 2: Assume the same facts as above, except that the circulation income of the periodical is \$100,000 instead of \$60,000, and of the total periodical costs, \$25,000 are direct advertising costs, and \$65,000 are readership costs. Since the circulation income (\$100,000) exceeds the total readership costs (\$65,000), the UBTI attributable to the advertising activity is \$15,000, the excess of gross advertising income (\$40,000) or direct advertising costs (\$25,000).

Example 3: Assume the same facts from Example 1, except that the total periodical costs (\$20,000) are direct advertising costs, and \$70,000 are readership costs. Since the readership costs of the periodical (\$70,000) exceed the circulation income of \$60,000, the excess of the total income attributable to the periodical over the total periodical costs is taxable. The UBTI attributable to the advertising activity is \$10,000: \$100,000 (total income) less the periodical costs of \$90,000.

Example 4: Assume the same facts from Example 1, except that the total periodical costs are \$120,000 of which \$30,000 are direct advertising costs and \$90,000 are readership costs. Since the readership costs of the periodical (\$90,000) exceed the circulation income of \$60,000, the UBTI attributable to advertising is the excess of the total income attributable to the periodical over the total periodical costs.

Since the total income of the periodical (\$100,000) does not exceed the total periodical costs (\$120,000), the organization has not derived any UBTI from the advertising activity.

Allocable Membership Receipts

For exempt organizations, particularly trade associations or professional groups, accurately [allocating membership receipts](#) is crucial for managing the taxable implications associated with periodicals. This becomes significant when such organizations generate income through subscriptions or member dues, offering exclusive access to content.

What are Allocable Membership Receipts?

Nonprofits might generate taxable income through subscription fees or member dues, similar to how advertising or sponsorship income is treated. The process for determining allocable membership receipts for an organization's periodical follows specific guidelines:

- **Subscription Price for Non-Members:** When 20 percent or more of a periodical's total circulation is from sales to nonmembers, the nonmember subscription price sets the periodical's price for membership receipt allocation.
- **Reduced Dues for Members Opting Out:** If 20 percent or more of an organization's members pay reduced dues because they opt out of receiving the periodical, this reduced dues amount dictates the periodical's price for allocating membership receipts.

Pro Rata Allocation Method

Membership receipts and gross advertising income, being generally considered available for all exempt activities equally, lead to a pro rata allocation where the periodical's share of membership receipts equals the organization's total membership receipts. This is then multiplied by a ratio of total periodical costs to the sum of these costs and the costs of other exempt activities.

For example, if an organization has total periodical costs of \$30,000 and other exempt activity costs of \$70,000, with membership receipts totaling \$60,000, then \$18,000 (calculated as \$60,000 multiplied by the fraction $\$30,000/\$100,000$) is allocated to the periodical's circulation income.

The Broader Implications

Professional associations and similar organizations often face challenges in accurately accounting for membership receipts and periodical sales. Beyond offering valuable content, periodicals serve as vital tools for engaging an organization's audience and furthering its mission. Understanding and applying the correct strategies for tax implications is essential, highlighting the need for careful consideration of allocable membership receipts in maintaining compliance and optimizing tax obligations.

Trade Shows and Conventions

[IRS Regulation 1.513-3](#) recognizes that trade shows and conventions can qualify for tax exemption if they are conducted with the intent to promote and stimulate interest in, or educate attendees about, products or matters significant to the industry or to the exempt organization's mission. The exemption applies as long as these activities do not veer into commercial territory, such as facilitating the sale of products in a manner similar to a retail or trade business.



These regulations underscore the importance of maintaining a clear connection between income-generating activities and the nonprofit's exempt purposes. Organizations must carefully navigate these rules to ensure compliance while leveraging advertising and sponsorships as effective tools for supporting their mission. The legal framework established by the IRS serves both to protect the integrity of the tax-exempt sector and to provide a pathway for nonprofits to engage in essential fundraising activities.

6. Advertising and Sales Tax Considerations

Exempt organizations often focus intently on federal tax compliance, yet the complexities of state and local [sales taxes](#) can present unexpected challenges. Unlike the more uniform federal tax exemptions, state and local jurisdictions do not provide blanket sales tax exemptions for exempt organizations, regardless of their charitable, educational, religious, or state-related purposes.

Nexus and Its Impact on Sales and Use Tax Obligations

The concept of “nexus” is central to understanding a nonprofit's sales and use tax obligations. Nexus, or a sufficient physical or economic presence within a state, triggers the requirement to collect and remit sales tax or to pay use tax. Traditional indicators of nexus include having inventory, offices, or employees within a state. However, modern trends like remote work can extend nexus to new jurisdictions, as employees working from home may create tax obligations in locations separate from the organization's primary base of operations. Economic activities, such as reaching a sales revenue threshold or conducting a certain number of transactions within a state, can also establish nexus, compelling nonprofits to register for sales and use tax purposes.

Taxability, Exemptions, and Compliance

Once nexus is established, exempt organizations must navigate the taxability of their sales and purchases, as well as any potential exemptions. States generally tax the sale or purchase of tangible personal property and certain services. For nonprofits, this encompasses a wide array of transactions, from membership dues and event tickets to purchases of office supplies and promotional materials. Each state has its own criteria for what transactions are taxable and what exemptions may apply, often based on the nature of the transaction or the status of the organization involved.

While many states offer exemptions for transactions directly related to an organization's exempt purpose, the scope and applicability of these exemptions can vary significantly. For example, Virginia requires nonprofit organizations to apply to the Virginia Department of Taxation and meet specific criteria to qualify for a sales tax exemption. This includes being exempt from federal income taxation under sections such as 501(c)(3), 501(c)(4), or 501(c)(19), providing proof of compliance with Virginia's laws related to solicitation of contributions, and ensuring that annual administrative costs do not exceed 40% of the organization's annual gross revenue. In North Carolina, a Section 501(c)(3) organization is required to initially pay sales tax on purchases of goods and services. Then, if eligible, the organization may then apply to the North Carolina Department of Revenue for a semiannual refund of the sales and use taxes paid.

Strategic Considerations for Compliance

Organizations must meticulously document their eligibility for any exemptions and may be required to provide exemption certificates or even apply for state-specific exemptions to avoid taxation. To effectively manage sales and use tax obligations, consider the following:

- Thoroughly understand the nexus criteria in each state where they operate, recognizing that economic activity may create tax obligations independent of physical presence.
- Carefully assess the taxability of their transactions, seeking out applicable exemptions that may reduce or eliminate tax liabilities.
- Ensure compliance with state requirements for claiming exemptions, which may include providing exemption certificates or applying for state-specific exempt statuses.

Proactive compliance strategies are essential, particularly in a landscape where exemptions are not guaranteed and where each state's rules can significantly differ. By diligently reviewing the sales and use tax requirements in each jurisdiction, exempt organizations can navigate these complex obligations successfully, ensuring that their resources are directed towards their mission rather than unforeseen tax liabilities.

7. Trends in Nonprofit Advertising and Their Impact on UBI

Nonprofit advertising and sponsorship activities are continually evolving, influenced by technological advancements, shifts in consumer behavior, and regulatory changes. These developments not only offer new opportunities for nonprofit organizations to amplify their message and engage with supporters but also introduce complexities in managing unrelated business income (UBI) and navigating tax implications.

Emerging Trends in Nonprofit Advertising and Sponsorships

Digital Transformation: The movement towards digital advertising platforms—encompassing social media, content marketing, and targeted online campaigns—presents nonprofits with unprecedented opportunities to connect with a global audience. However, as these activities become more integral to fundraising strategies, they also attract scrutiny regarding their potential to generate UBI. Nonprofits must carefully monitor the revenue from digital ad spaces to ensure compliance with UBIT regulations.

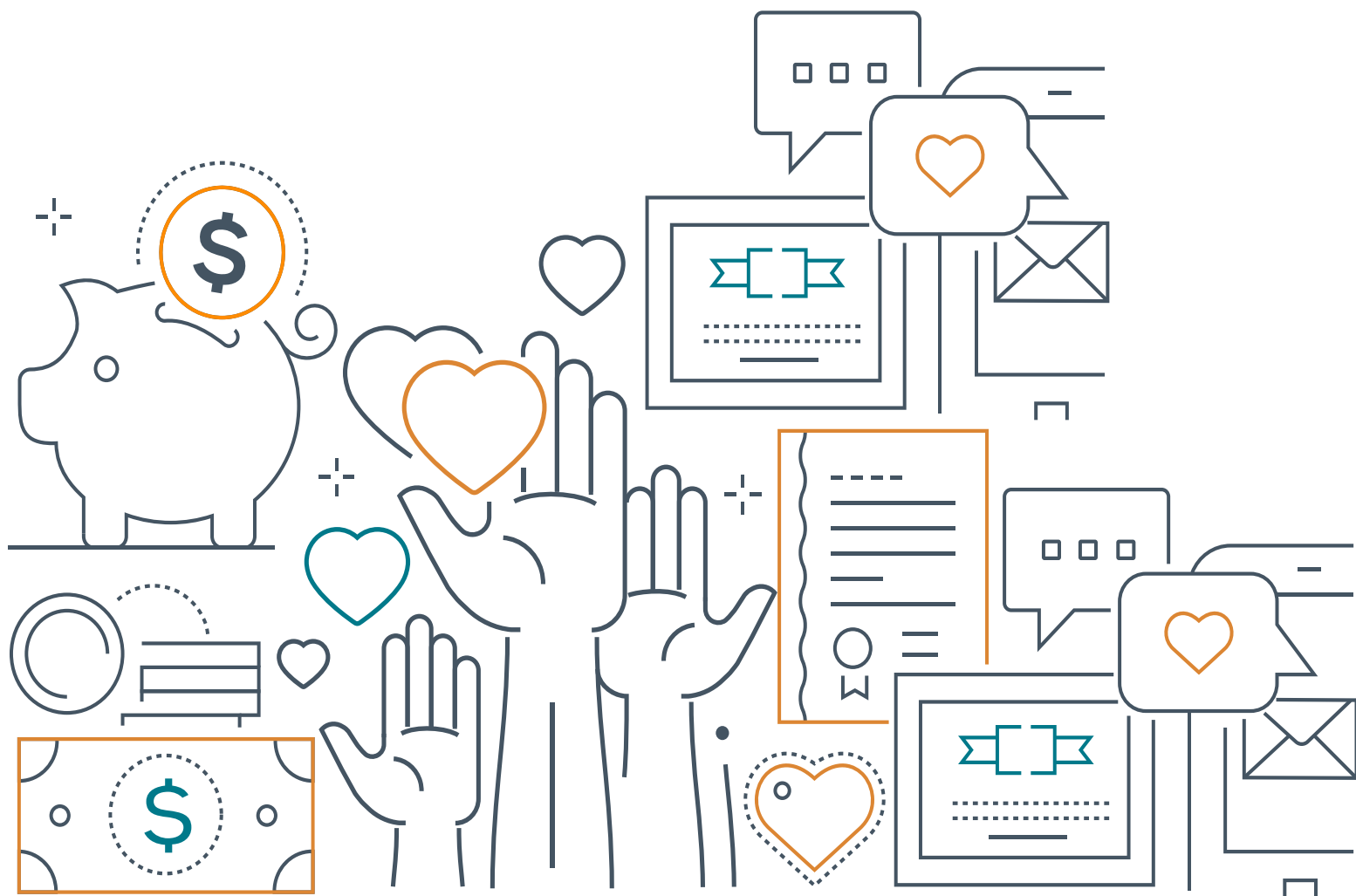


Data-Driven Strategies: Nonprofits are leveraging data analytics to optimize their advertising and sponsorship efforts. By analyzing donor behavior and preferences, organizations can tailor their campaigns to increase engagement and maximize impact. This trend towards data-driven decision-making helps nonprofits allocate their resources more efficiently and achieve better outcomes.

Collaborative Partnerships: The trend towards forming partnerships with for-profit entities, through co-branded campaigns or sponsorships, offers mutual benefits in terms of increased visibility and resource sharing. These arrangements, however, necessitate careful consideration of UBI implications. Collaborations that primarily serve a commercial purpose or confer substantial benefits to the for-profit partner may result in income that is subject to UBIT, emphasizing the importance of structuring these agreements to align with the nonprofit's exempt objectives.

Ethical and Value-Based Advertising: As nonprofits increasingly prioritize alignment with their mission and values, they forge deeper connections with supporters who value authenticity and social responsibility. This trend can positively influence the organization's tax situation by ensuring that advertising partnerships and sponsorship activities are closely tied to, and in support of, their exempt purposes, potentially mitigating UBI concerns.

As nonprofit organizations navigate these emerging trends, understanding the implications for UBI and tax compliance is crucial. It requires a balanced approach—embracing innovation to enhance engagement and support, while diligently managing the potential impact on unrelated business income and tax obligations.



Conclusion: Strategic Growth and Compliance

In navigating the complex landscape of tax regulations and fundraising strategies, nonprofit leaders find themselves at a crucial intersection. The primary challenge lies in leveraging advertising and sponsorship opportunities to further their mission, while also ensuring strict compliance with tax laws. This balance is essential not only for maintaining the organization's tax-exempt status but also for maximizing its financial resources. Through a clear understanding of unrelated business income (UBI) and unrelated business income tax (UBIT), nonprofits can strategically approach advertising and sponsorships, turning potential liabilities into assets that support their core objectives.

The distinction between tax-exempt income and taxable income underlines the importance of accurately categorizing revenue-generating activities. Nonprofits must tread carefully, particularly with advertising and sponsorships, to avoid activities that could inadvertently lead to taxable income. Recognizing which activities align with their mission and which pose risks of UBIT is crucial. This awareness enables nonprofits to navigate the regulatory environment successfully, ensuring that their fundraising efforts enhance rather than detract from their mission.

Looking ahead, the key for nonprofit organizations is to remain vigilant and informed. Staying up-to-date on tax regulations, adopting best practices for compliance, and aligning advertising and sponsorship activities with their mission will be essential for thriving in a changing landscape. This pragmatic approach empowers nonprofits to not only avoid tax pitfalls but also to harness the full potential of their fundraising activities. By committing to this balance between growth and compliance, nonprofits can continue to make a significant impact in their communities, leveraging every opportunity to support their vital work.

Moving You Forward

Want to learn more about navigating nonprofit advertising rules and their tax implications? Get in touch with our Not-For-Profit team today.

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