Too Small to Succeed: How Small Nonprofits are Disadvantaged by the Unrelated Business Income Tax

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“The hardest thing in the world to understand is the income tax.”
—Albert Einstein

INTRODUCTION

At the exit of many museums, and sometimes sprinkled throughout the experience, there is a museum gift shop. Oftentimes, for children, this is the most magical part of the museum experience because it allows them the opportunity for a new fun game or toy. In fact, the Metropolitan Museum of Art, the fourth largest art museum in the world, explicitly has a section of the gift shop targeting children, even using it as an online advertising category. Museum gift shops contribute anywhere from 5 to as much as 25 percent of a museum’s annual revenue and serve as multifaceted outreach opportunities for the museum to educate visitors, expand branding, and highlight the importance of the museum’s existence and collection.

Museum gift shops also hold a unique and special place in tax law. In many cases, although not all, museum gift shops can fall under a specific type of taxation called the unrelated business income tax (UBIT), which can lead to complications

when determining taxes owed from gift shop revenue.\textsuperscript{5} Charitable and educational organizations, such as museums, are typically exempt from paying income taxes.\textsuperscript{6} However, when these organizations generate income from unrelated business income, that income is subject to taxation.\textsuperscript{7}

Practically speaking, for an organization to determine if some part of its income falls under UBIT, it must analyze if the income is (1) from a “trade or business;” (2) “regularly carried on;” and (3) “not . . . substantially related . . . to the exercise or performance by such organization of its charitable, educational, or other purpose . . . constituting the basis for its exemption.”\textsuperscript{8} The “production of income” is not substantially related to the mission of the organization’s tax-exempt purposes.\textsuperscript{9} In other words, simply raising money for the goal of carrying on a nonprofit’s charitable purpose is not considered tax exempt. For example, museum gift shops can fall under unrelated business income and therefore be taxable because (1) the “sale of goods is a trade or business,” (2) the services are “regularly carried on,” and (3) the items sold can be determined not to be substantially related to the exempt purposes set forth by a museum (such as promoting culture, education, or research).\textsuperscript{10} Specifically, a gift shop may not be substantially related to a museum’s tax-exempt purposes because, if it sells items not related to the museum’s exempt purpose, it simply intends to “capitalize on patrons’ charitable and souvenir-hunting impulses . . . to cover their operating costs.”\textsuperscript{11}

Museum gift shops are not the only recognizable form of income subject UBIT. The endowments of large universities, when partnering with private equity firms, are also subject to UBIT.\textsuperscript{12} Insurance and other benefits provided by churches as

\textsuperscript{5} Susan R. Bills, Keeping Ahead of the UBIT Consequences of a Gift Shop, 13 J. TAX’N EXEMPT ORGS. 35, Westlaw at *1 (2001); see also I.R.S. Priv. Ltr. Rul. 201429029, at 5 (Apr. 24, 2014) (showing that a museum gift shop’s revenue could be found to be tax-exempt income for certain items).

\textsuperscript{6} I.R.C. § 501(a), (c)(3).

\textsuperscript{7} Id. § 501(b).

\textsuperscript{8} Treas. Reg. §1.513-2(a); see also Jeffrey S. Tenenbaum, UBIT: A Comprehensive Overview for Nonprofits, 34 TAX’N EXEMPTS 4, 5 (2022).


\textsuperscript{10} Bills, supra note 5, at *1.

\textsuperscript{11} Id. at *1. Bills specifically discusses how the IRS treats gift shops not as a single business activity but interprets the sale of each item as having the potential to generate unrelated business income. Therefore, the sale of each type of product must be analyzed. See id. at *3.

\textsuperscript{12} James J. Fishman, How Big is Too Big: Should Certain Higher Educational Endowments’ Net Investment Income be Subject to Tax?, 28 CORNELL J.L. & PUB. POL’Y 159, 177 (2018).
employers fall under UBIT. Another common way nonprofit organizations are subject to UBIT is from advertising income. Finally, similar to a museum gift shop, income generated from selling merchandise must be assessed on an item-by-item basis to determine if the sale of that item is substantially related to the organization’s tax-exempt purposes.

An organization is mostly left to its own devices to determine if its income qualifies as unrelated business income and if it is subsequently required to file the relevant paperwork and pay UBIT taxes, unless it is willing to pay a fee for the Internal Revenue Service (IRS) to issue a determination. It can be particularly challenging to determine if an organization’s income production falls under the “substantially related” prong. Income is typically considered “substantially related” if it “contribute[s] importantly to the accomplishment of the organization’s exempt purposes other than through the production of income.” However, it can be difficult for organizations to determine whether certain activities are in fact “substantially related” to the charitable purposes of the organization. This is especially true because there are a variety of “safe harbor” exceptions to the unrelated business income tax, such as rental income and royalties. If an organization holds significant doubt about whether it owed taxes

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14 Tenenbaum, supra note 8, at 5.


18 Even large, well-resourced organizations have struggled with such a determination. For example, the Sierra Club sold t-shirts with its logo and a federal court determined that such income was taxable, as the business of manufacturing and selling was not substantially related to the organization’s environmental tax-exempt purposes, although a safe harbor exception would apply if the Sierra Club licensed the designs to a manufacturer in exchange for a royalty fee. Tenenbaum, supra note 8, at 7; see Sierra Club, Inc. v. Comm’r, 86 F.3d 1526, 1535 (9th Cir. 1996). The question of determining what was substantially related was so hotly contested that it made it to the Ninth Circuit Court of Appeals. This was recently litigated in federal court on behalf of the Mayo Clinic, where it was determined that the medical center was entitled to a $11.5 million refund for taxes paid under UBIT. There, the court held that the nonprofit’s administrative functions served its underlying educational purposes and even if not, requiring that such services exclusively remain educational would cause every academic institution to fail qualification. Mayo Clinic v. United States, No. 16-CV-03113, 2022 WL 17103262, at *35–36 (D. Minn. Nov. 22, 2022), appeal docketed (8th Cir. May 22, 2023).

19 Tenenbaum, supra note 8, at 5.
on income, it can submit both a fee and a written request to the IRS and receive a ruling on its tax-exempt status in a private letter ruling (PLR).\textsuperscript{20} Despite all the complexities in determining whether UBIT is owed, it only generates a minimal amount of revenue. In 2015, UBIT revenue only accounted for 0.01 percent of the IRS’ total collections.\textsuperscript{21}

PLRs, which only apply to the specific taxpayer who submitted the inquiry, are an interpretation of tax law as determined by an IRS official.\textsuperscript{22} For example, despite the general belief that museum gift shops generate taxable income, in 2014, the IRS published an anonymized PLR for a museum, determining that specific toys in its gift shop were considered related income to its charitable purposes and therefore were not taxable income.\textsuperscript{23} This PLR indicates that an organization may be able to negotiate its own, personalized exemption from UBIT, even within income producing areas typically expected to be subject to taxation by tax professionals.\textsuperscript{24} The fact that organizations can receive what is essentially a personalized exemption based on an IRS official’s interpretation of the law further complicates an already complex area of tax law overflowing with rules and exceptions. For a fee (which can range between $3,000 and $8,500 for nonprofits with income under $1 million) any tax-exempt organization can submit a request for a PLR in an attempt to avoid certain income taxes.\textsuperscript{25} To do so, in the PLR, the taxpayer would argue that the income generating act is in fact exempt and not subject to UBIT.\textsuperscript{26} But just because an organization can submit such a request does not automatically mean that all organizations have the money to pay the required IRS fees or lawyers’ fees necessary to submit an accurate and convincing PLR.\textsuperscript{27}


\textsuperscript{22} Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts, supra note 20.


\textsuperscript{24} See id.


\textsuperscript{27} An interview with a lawyer at an organization that assists nonprofits with legal services (including tax-related issues), Lawyers Alliance for New York, has confirmed that UBIT issues have been problematic for nonprofits located in New York City. These organizations are somewhat private regarding their legal and taxation issues. Telephone Interview with Rafi Stern, Staff Att’y, Laws. All. for N.Y. (Oct. 4, 2022).
Nonprofits are a prime example of an organization that may struggle to pay the necessary fees affiliated with PLRs.\textsuperscript{28} Nonprofits make up 10 percent of businesses in the United States—a consistent percentage of the general industry over the last decade.\textsuperscript{29} Between 2000 and 2016, there was a trend in growth as the number of nonprofits registered with the IRS grew from around 819,000 to around 1,430,000.\textsuperscript{30} Tax-exempt organizations registered with the IRS include charitable organizations, churches and other religious entities, private foundations, political organizations, and other nonprofits.\textsuperscript{31} Thirty-five percent of these organizations filed various required tax forms with the IRS, from which the National Center for Charitable Statistics determined that out of public charities that reported gross revenue over $50,000, almost two-thirds reported less than $500,000 in expenses.\textsuperscript{32} This large majority of

\begin{thebibliography}{99}
\bibitem{28} Exempt Organization Types, supra note 28.
\end{thebibliography}
organizations represented less than two percent of industry-
wide nonprofit spending.\textsuperscript{33} These statistics show that most
nonprofit spending comes from a small number of organizations,
meaning that a large number of nonprofits spend comparatively
little within the industry. However, these lesser funded
organizations that make up much of the nonprofit industry
likely have less to spend on PLRs.

Generally, in addition to being underfunded, the typical
nonprofit is also quite small in size—the median nonprofit
employer has only four employees.\textsuperscript{34} Further, nonprofits often do
not employ legal teams and may rely on pro bono services
instead.\textsuperscript{35} Therefore, most of these smaller nonprofits do not
have the same access to legal resources that larger institutions
also subject to UBIT, such as educational institutions or not-for-
profit hospitals, have.\textsuperscript{36} Despite this lack of access to legal
counseling, these smaller nonprofits are still subject to the same
complex tax code as bigger, better resourced organizations.\textsuperscript{37}

This note will argue that the complexities of UBIT
unfairly disadvantage smaller nonprofits because these
organizations do not have access to the necessary legal and
financial resources to easily determine what UBIT taxes they
may owe, due to lack of legal staffing or funding to obtain such

\textsuperscript{33} The Nonprofit Sector in Brief 2019, supra note 32.
\textsuperscript{34} Head, supra note 29.
\textsuperscript{35} J.J. Harwayne Leitner, Nonprofit Organizations Need Nonprofit Lawyers,
2016 BUS. L. TODAY 1, 1 (2016).
\textsuperscript{36} Statistics regarding the number of lawyers typically employed at a small
nonprofit are not prevalent. However, an Association of Corporate Counsel 2021
Benchmark report surveying 493 legal departments in twenty-four industries conducted
by a consulting firm showed that small companies with revenue of less than $1 billion
had, on median, three legal staff members. This indicates that legal roles are less
prevalent in small organizations, especially considering the statistics only include 10
percent of nonprofit organizations. Ass’n Corp. Counsel, Law Department
Management Benchmarking Report 9 (2021). Further, there are a number of
nonprofit organizations that specifically exist to connect volunteer lawyers seeking to
provide pro bono legal services with nonprofits seeking legal assistance, showing that
there is a great need for such services by nonprofits. New York itself has multiple. See
Pro Bono Clearinghouse: Who We Are, N.Y. Lawyers for the Pub. Interest,
https://www.nypli.org/our-work/pro-bono-clearinghouse/ [https://perma.cc/R7DW-
F7KP]; Mission, Lawyers All. N.Y., https://lawyersalliance.org/mission
[https://perma.cc/TX9U-384W]; Legal Support, N.Y. Council of Nonprofits, Inc.,

\textsuperscript{37} For example, small nonprofits are even assessed by the same teams of tax
professionals as larger organizations, as they submit PLRs to the same branch of the
IRS; while comparatively, there are separate divisions for businesses with assets in
excess of $10 million versus smaller businesses with fewer assets. Rev. Proc. 2023-1,
01.pdf [https://perma.cc/EZ77-2ER4]. This indicates institutional-level awareness of the
differences that face for-profit businesses, as compared to the differences that nonprofits
of difference sizes face.
staffing. Further, these organizations are unable to successfully navigate the PLR process given its many complications, depriving them of the opportunity to convince the IRS they should not pay taxes on certain forms of income. Given that minimal revenue is generated for the IRS from UBIT and most organizations have UBIT filings under $100,000, the best solution is to eliminate taxes on unrelated business income that falls below $100,000. Part I examines the nonprofit industry and the resources available to tax-exempt organizations, as well as provide background regarding the purposes and application of tax-exempt statuses for charitable organizations, including examples of the range of organizations that qualify. Part II defines and explores UBIT itself, including the various and complex exceptions to the law, as well as the statistics and data behind how many UBIT tax returns are filed and how much revenue results from these returns. Part III argues how the vagueness of the unrelated business income tax unfairly disadvantages smaller nonprofit 501(c) organizations given the lack of access to financial and legal resources. It specifically explores small nonprofits’ disadvantages due to the complexities in submitting PLR requests, which can pose challenges for organizations without access to legal resources or lawyers. Finally, Part IV proposes that the best solution for this problem is to eliminate the unrelated business income tax for 501(c) organizations that earn less than $100,000 in annual unrelated business gross income.

I. WHAT DOES IT MEAN TO BE A TAX-EXEMPT NONPROFIT ORGANIZATION?

Nonprofit organizations exist to better serve community interests and receive special tax consideration by the US government because of this purpose. It is important to understand both the historical development of how nonprofits were perceived by the US government, as well as the tax law as it typically applies to these organizations.

A. The Nonprofit Landscape

There is a strong history of nonprofit organizations existing as a solution to societal ills in American history. Conceptually, charity dates back to the early parts of human
civilization. In America, “charitable traditions” were influenced by the fact that they predated strong governments, as well as Protestantism. This meant that even before the United States was founded, there was a shared belief that the community, rather than the government, should solve societal ills.

During the late 1800s and early 1900s, there was growing acceptance in American government that charity and business could intertwine. The nonprofit sector continued to grow after 1960, when the government used private nonprofit organizations to carry out social welfare plans, fueled in part by a societal distrust of government. This led to an increase in the complexity of both organizational capabilities and technology needed to manage and run a charitable organization.

The modern mandate of a charitable nonprofit is to invest its profit back into the wider community rather than generate earnings for its managers and creators. The most common industry for nonprofit employers is healthcare, with education services and arts coming in second and third. In New York City, religious and civil organizations are most prevalent, with social services second, healthcare third, and education fourth. Nonprofits allow people to serve their community together, whether it is through providing shelter, education, or food to those in need.

The majority of nonprofit spending is directly funneled back into the community it intends to serve. Nonprofits in the United States spend more than $2 trillion annually—$826

38 Thomas Kelley, Rediscovering Vulgar Charity: A Historical Analysis of America’s Tangled Nonprofit Law, 73 FORD. L. REV. 2437, 2440–41 (2005). In Ancient Egypt, there was the concept of maat (a principle related to social justice regarding dealings with other people). In Mesopotamia, the Code of Hammurabi instructed people to care for those less fortunate. Similarly, Judaism and early Christianity stress the concept of charity. Id.
39 Id. at 2451–52. Protestantism led to a belief that prioritized individual responsibility over state responsibility regarding the welfare of individuals. Id. at 2452.
40 Id. at 2451.
41 Id. at 2456–57.
42 Id. at 2458.
43 Id. at 2459.
45 Head, supra note 29.
48 See NAT’L COUNCIL OF NONPROFITS, supra note 30, at 12, 15.
billion is for wages, on which employees pay taxes.\textsuperscript{49} $1 trillion is spent on goods and services for the benefits of the community, for which nonprofits are subject to sales taxes.\textsuperscript{50} Most nonprofits are small: 97 percent have budgets less than $5 million a year, 92 percent have budgets less than $1 million, and 88 percent have budgets less than $500,000.\textsuperscript{51} In addition, about half of nonprofits have less than a month’s worth of operating expenses reserved.\textsuperscript{52} The nonprofits with the largest amount of financial activity include hospitals and universities.\textsuperscript{53} According to the IRS, tax-exempt organizations with over $10 million in assets filed 8 percent of tax returns but accounted for 87 percent of overall reported revenue whereas smaller charities accounted for 60 percent of tax returns and had negligible amounts of revenue.\textsuperscript{54} Overall, it is clear that within the nonprofit industry, larger amounts of revenue are concentrated within a small number of organizations.\textsuperscript{55}

This disparity is also true regarding the size of nonprofits within the industry: a 2017 study done by the US Department of Labor found that of the nonprofit organizations surveyed, 39 percent had fewer than five employees and 71 percent had fewer than twenty employees.\textsuperscript{56} This means that a large number of the nonprofits that exist in the United States earn little revenue and employ a small number of employees through which they can accomplish charitable missions in addition to any required administrative work.

Smaller nonprofits, given their size and budget, struggle to find legal resources specific to organizational needs. Even if nonprofits are able to find legal help, the lawyers they retain likely do not have specific nonprofit expertise.\textsuperscript{57} This means that

\textsuperscript{49} Id. at 12. In New York City specifically, nonprofits pay $42 billion in wages per year. \textit{The Economic Impact of NYC Nonprofit Organizations,} supra note 46.

\textsuperscript{50} \textsc{Nat’l Council of Nonprofits,} supra note 30, at 12.

\textsuperscript{51} Id. at 17. There is obviously a disparity among the most recognized charities and smaller nonprofits with less name recognition. The top one hundred charities ranked by revenue in 2021 received $54.4 billion in gifts, and includes popular names such as Feeding America, the Salvation Army, Habitat for Humanity, YMCA, Boys & Girls Clubs of America, St. Jude’s Children’s Research Hospital, Mount Sinai Health Systems, American National Red Cross, UNICEF, Mayo Clinic, American Cancer Society, Doctors Without Borders, Planned Parenthood, Make-A-Wish, and World Wildlife Fund. William P. Barrett, \textit{America’s Top 100 Charities,} \textsc{Forbes} (Dec. 16, 2021), https://www.forbes.com/lists/top-charities/?sh=3566b4505550 [https://perma.cc/8PAF-9B4R].

\textsuperscript{52} \textsc{Nat’l Council of Nonprofits,} supra note 30, at 17.


\textsuperscript{54} Id.

\textsuperscript{55} Id.


\textsuperscript{57} See Lettner, supra note 35, at 1.
organizations are ultimately forced to confront legal mistakes and issues because of the failures of counsel.\textsuperscript{58} Specific areas where counsel can fall short include formation, obtaining tax-exempt status, contracting,\textsuperscript{59} conforming to charitable solicitation regulations,\textsuperscript{60} employment law,\textsuperscript{61} avoiding tax-exemption revocation, and finally, the unrelated business income tax.\textsuperscript{62} For example, formation issues can arise if legal counsel fails to apply to the IRS for tax exemption.\textsuperscript{63} Nonprofit organizations have a plethora of legal concerns, which means that UBIT can often be pushed to the back burner and not receive the full legal attention that a complex tax law requires. Even then, lawyers working on these issues for nonprofits tend to be unfamiliar with UBIT’s complexities and can fail to find statutory exceptions for clients, such as the real property exemption, which results in organizations paying unnecessary taxes.\textsuperscript{64}

B. Tax-Exempt Organizations and Purposes

Tax-exempt status is a federal determination under the Internal Revenue Code (IRC), although it is informed by a state law’s determination of whether an organization is considered a nonprofit.\textsuperscript{65} Under the IRC, certain categories of organizations are considered exempt from federal income taxation.\textsuperscript{66} Under 501(c)(3) and 501(c)(4) of the tax code, which are commonly understood to be the categorization for nonprofits (including social welfare clubs), qualifying exempt organizations include organizations “operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes,”\textsuperscript{67} and “organizations not organized for profit but

\textsuperscript{58} Id.
\textsuperscript{59} Contracting issues, in particular, arise regarding donations and how they impact the need for consideration. Id. at 2.
\textsuperscript{60} Solicitation requirements impact marketing raffle usage. Id. at 2.
\textsuperscript{61} Employment law concerns include revenue-based bonus structures and the application of wage laws. Id. at 3.
\textsuperscript{62} See generally id. (outlining the issues most commonly faced by nonprofit organizations given that most nonprofit legal work is provided on a pro bono basis by lawyers who may not specialize in the areas for which they are consulted).
\textsuperscript{63} Id. at 1.
\textsuperscript{64} Id. at 3–4.
\textsuperscript{66} I.R.C. §§ 501(a), 501(c)(1)(A).
\textsuperscript{67} I.R.C. § 501(c)(3).
operated exclusively for the promotion of social welfare.”\textsuperscript{68} Outside of 501(c) entities, other tax-exempt organizations include certain religious organizations, educational entities, amateur sports organizations, hospitals, and other types of healthcare facilities.\textsuperscript{69}

The concept of tax-exempt organizations has long existed in the United States. The main components of the tax-exemption code as we understand it today were developed in the United States between 1894 and 1969.\textsuperscript{70} Congress established the necessary requirements for an organization to be considered tax exempt, as well as what activities were considered taxable.\textsuperscript{71} The Tariff Act of 1894 was the earliest reference to tax-exempt organizations, while the Revenue Act of 1909 specified that tax-exempt organizations were barred from “private inurement.”\textsuperscript{72} The Revenue Act of 1913, which established an income tax system following the passage of the Sixteenth Amendment, provided organizations with the right to be tax exempt.\textsuperscript{73} The modern tax system continued to develop—the Revenue Act of 1943 required that tax-exempt organizations file certain forms with the government.\textsuperscript{74}

The United States granted charitable organizations tax exemption both because of the good they do for the community as well as the unnecessary headaches caused by tax collection.\textsuperscript{75} In recognition of this sentiment, federal tax exemption can apply to organizations that do not seek private benefit.\textsuperscript{76} Because the activities conducted by the organization have a public benefit, they are considered inappropriate for taxation, especially considering the need and desire to promote and encourage these types of activities.\textsuperscript{77} Additionally, taxing certain types of small organizations is viewed as a “sunk cost” because it is more costly to administer the process when little to no tax is due.\textsuperscript{78}

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\textsuperscript{68} I.R.C. § 501(c)(4)(A).
\textsuperscript{69} I.R.C. § 501(d)–(f), (j), (t).
\textsuperscript{71} \textit{Id.}
\textsuperscript{72} \textit{Id.} at 106–07.
\textsuperscript{73} \textit{Id.} The Sixteenth Amendment permitted Congress to collect income tax.
\textsuperscript{74} U.S. Const. amend. XVI.
\textsuperscript{75} Arnberger et al., supra note 70, at 106.
\textsuperscript{76} \textit{Id.} at 27–28.
\textsuperscript{77} \textit{Id.} at 28.
\textsuperscript{78} \textit{Id.} at 30.
cost was even viewed by the 1916 Congress as “a source of annoyance and expense.”

Under modern law, becoming a federal tax-exempt organization is a multistep process. First, state law determines the requirements needed for an organization to become a nonprofit. Depending on the state, additional approval processes are required depending on the industry of the organization, such as for daycares, hospitals, schools, cemeteries, political parties, and mental health facilities. Once the state-level incorporation process is complete, based on the organization’s type and categorization under IRC § 501, it must electronically submit a tax application form to the IRS and pay a fee. 501(c)(3) organizations, with the exception of churches, must apply for exemption within twenty-seven months of its formation date. As a result of its tax-exempt status, an organization must agree to make its application documents and three most recent tax returns public. The timeline to become a tax-exempt organization obviously varies from state-to-state, given that states oversee the incorporation process itself. However, all state organizations receive federal tax exemption through the IRS, which receives more than ninety-five thousand applications for tax exemption each year. At the time of publication, for most nonprofit tax-exempt status applications, there is a six-month delay in the IRS assigning an official to make a determination. Special taxation rules are not limited to

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79 Id.
80 Before Applying for Tax-Exempt Status, supra note 65. For example, in New York, the Not-for-Profit Corporation law governs the process. The organization must file a Certificate of Incorporation with a filing fee to the Department of State. N.Y. DIV. OF CORPS., STATE RECORDS & UNIF. COMMERCIAL CODE, NOT-FOR-PROFIT INCORPORATION INSTRUCTIONS 1 (2018), https://dos.ny.gov/system/files/documents/2018/12/1511-inst.pdf [https://perma.cc/ZAG4-D3YD]. New York state recommends, given the complexity of the process, that the organization consults both an attorney and accountant prior to filing for incorporation. Id.
81 N.Y. NOT-FOR-PROFIT CORP. LAW § 404 (McKinney, Westlaw current through L.2023 chapters 1 to 49, 61 to 104 2023).
84 Application for Recognition of Exemption, supra note 83.
86 Id. As of late February 2023, applications from August requiring Forms 1023, 1024, and 1024-A have yet to be assigned a determination. Organizations applying
federal tax exemption laws, as states also provide nonprofit organizations tax exemption.\textsuperscript{87} However, even though nonprofit organizations are typically not taxed, they are still subject to UBIT, which can cause additional financial burdens and administrative difficulties following the initial troubles of the tax-exemption application process.

II. WHAT EXACTLY IS THE UNRELATED BUSINESS INCOME TAX?

Even by its most basic definition, UBIT is a complex area of tax law that can be difficult to apply to real world tax questions given its vague definitions.\textsuperscript{88} This is further complicated by the many safe harbor exceptions.\textsuperscript{89} Such a complex area of law with numerous exceptions expectedly requires someone with some level of tax expertise to apply it successfully, leaving most nonprofits that lack legal resources in the dark. These organizations are further disadvantaged by the inability to receive uniquely held exceptions via the PLR system.\textsuperscript{90} And despite the complexities of the code, UBIT is not a particularly prevalent source of revenue. This then raises the question . . . what is the point?\textsuperscript{91}

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with Form 1023-EZ have only yet to be assigned if they are postmarked after early February 2023. \textit{Id.}

\textsuperscript{87} Brakman Reiser, \textit{supra} note 44, at 6. In New York, through the Attorney General's Charities Bureau, the state recognizes tax exemption that has been granted by the IRS, although it requires an additional application to the New York State Department of Taxation and Finance via a Form ST-119.1. \textit{FAQs—Tax Exemption, N.Y. STATE OFF. ATTY GEN.}, https://www.charitiesnys.com/faq_taxExemption_new.html [https://perma.cc/U7VT-WZ9V]. In California, an organization can apply for tax-exempt status by mailing in an application via a Form 3500 or submitting an Exemption Request via a Form 3500 if it is paired with an IRS tax-exempt determination. After completing the application, organizations must also pay an additional fee, file missing returns, file a Statement of Information with the Secretary of State and if applicable, file with the Attorney General's Registry of Charitable Trusts. \textit{Charities and Nonprofits, STATE OF CAL. FRANCHISE TAX BD.}, https://www.ftb.ca.gov/file/business/types/charities-nonprofits/index.html [https://perma.cc/U2JZ-MVHF]. Delaware, similar to New York, grants exemption from its corporate income tax for tax-exempt organizations under the IRS. Nonprofits must also register with the Division of Revenue, withhold income taxes on employees working within Delaware, and register with the Delaware Department of Labor. \textit{Non-Profit Corporations, DEL. DIV. OF REVENUE}, https://revenue.delaware.gov/business-tax-forms/non-profit-corporations/ [https://perma.cc/8SWU-ANZX].

\textsuperscript{88} See infra Sections IIA–B.

\textsuperscript{89} See infra Section II.C.

\textsuperscript{90} See infra Section III.C.

\textsuperscript{91} See infra Section II.D.
A. The History and Definition of UBIT

UBIT was first introduced in the IRC in 1950.\textsuperscript{92} UBIT’s purpose is to prevent unfair competition between tax-exempt organizations and for-profit companies—otherwise, tax-exempt organizations could use nontaxed profits to expand their businesses, while for-profit competitors would be unable to do so.\textsuperscript{93} The same Act also disallowed “feeder’ organizations,” which were “operated commercial enterprises from which they passed income to a charitable organization.”\textsuperscript{94} The IRC specifies that UBIT is applicable to charitable organizations, including those as defined under 501(c), 401(a), state colleges and universities, and hospitals.\textsuperscript{95} In addition to the statutory definition, regulatory guidance further specifies that UBIT applies if the trade or business generating income “is not substantially related (other than through the production of funds) to the organization’s performance of its exempt functions.”\textsuperscript{96} Case law further governs how the three prongs of UBIT—(1) trade or business, (2) regularly carried on, and (3) not substantially related—are applied.

Courts directly refer to the IRC when defining “trade or business.”\textsuperscript{97} The Supreme Court has held that, per the tax code, a trade or business is “any activity which is carried on for the production of income from the sale of goods or the performance of services.”\textsuperscript{98} Specifically, the Court held that the American Bar Endowment, a charitable and educational 501(c)(3) organization, was subject to UBIT due to income it generated from its group-insurance policy offerings.\textsuperscript{99} The insurance program was taxable because the dividends it generated were profits and presented the possibility of unfair competition.\textsuperscript{100} Although the insurance program was a “fundraising effort,” the court held that this fact was not “determinative” of whether the income was exempt from UBIT, as “any exempt organization

\textsuperscript{92} Tenenbaum, supra note 8, at 4.


\textsuperscript{94} Arnberger et al., supra note 70, at 107.

\textsuperscript{95} I.R.C. §§ 511, 513. Hospitals specifically must be careful as revenue generated from pharmacy sales to and laboratory testing of nonpatients is considered unrelated business income. Hospital Services Provided to Non-patients, U.C. DAVIS, https://financeandbusiness.ucdavis.edu/finance/tax-reporting-compliance/unrelated/hospital-srves [https://perma.cc/JH8G-BFFJ].

\textsuperscript{96} Treas. Reg. § 1-513.1 (as amended in 2020).


\textsuperscript{98} Id. (quoting I.R.C. § 513(c)).

\textsuperscript{99} Id. at 107, 119.

\textsuperscript{100} Id. at 112, 114.
could . . . ‘[give] away’ its product.’”\textsuperscript{101} If an activity intends to make a profit, it constitutes a trade or business.\textsuperscript{102}

For something to be “regularly carried on,” there must be some sort of “frequency and continuity.”\textsuperscript{103} This requirement exists so that tax-exempt organizations, when competing with nonexempt organizations with commercial activities, are held to the same standard.\textsuperscript{104} This prong applies to income-generating activities that occur on a year-round basis (even if only for one day each week throughout the year) and for a significant portion of a season when operating on a seasonal basis.\textsuperscript{105} However, intermittent income-generating activities can also be considered regularly carried on if they are similar to how nonexempt activities are organized and include noncausal sales that are “systematically and consistently promoted and carried on by the organization.”\textsuperscript{106} Courts have held that a tax-exempt entity does not need to “engage in more than one venture” to be considered regularly carried on, if the magnitude of the singular transaction or venture was large enough or extended over a long enough period of time.\textsuperscript{107} In \textit{Cooper Tire & Rubber Co. Employees’ Retirement Fund}, the leasing of equipment for more than ten years was determined to be regularly carried on.\textsuperscript{108}

The “not substantially related” requirement leads to “an examination of the relationship between the business activities which generate the particular income in question . . . and the accomplishment of the organization’s exempt purposes.”\textsuperscript{109} Business related to exempt purposes must have a substantial “causal relationship to the achievement of exempt purposes,” although this excludes producing income.\textsuperscript{110} The size and extent of the activities are taken into consideration. If the activity is conducted on a “larger scale than is reasonably necessary” for exempt purposes, the excess income is taxable.\textsuperscript{111} According to

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{101} \textit{Id.} at 15.
\item\textsuperscript{102} IRS, \textit{supra} note 15, at 4. The example given is that a pharmacy that regularly supplies both the general public as well as a hospital and its patients “doesn’t lose its identity as a trade or business.” \textit{Id.}
\item\textsuperscript{103} Treas. Reg. § 1-513.1(c) (as amended in 2020).
\item\textsuperscript{104} \textit{Id.}
\item\textsuperscript{105} § 1-513.1(c)(2). The IRS specifically cites managing a parking lot every Saturday for a year as an activity that is regularly conducted. IRS, \textit{supra} note 15, at 4.
\item\textsuperscript{106} § 1-513.1(c)(2)(ii). However, activities such as an annual fundraising dance for charity would not qualify as regularly carried on. § 1-513.1(c)(2)(ii).
\item\textsuperscript{107} \textit{E.g., Cooper Tire & Rubber Co. Empls.’ Ret. Fund v. Comm’r.}, 306 F.2d 20, 21 (6th Cir. 1962) (per curiam).
\item\textsuperscript{108} \textit{Id.}
\item\textsuperscript{109} § 1.513-1(d)(1).
\item\textsuperscript{110} § 1.513-1(d)(2).
\item\textsuperscript{111} § 1.513-1(d)(3). The regulatory code provides multiple examples of substantially related activities to an organization’s exempt purposes, including a
\end{itemize}
\end{footnotesize}
courts, to determine if an activity is substantially related is a fact-based determination made on a case-by-case basis dependent on the exempt purpose, “how the activity contributes to that purpose,” and “the scale on which the activity is conducted.” The most important factors in this determination are (1) the “nature of the activities” as they relate to the organization’s purpose and function and (2) how the organization’s members benefit from the activities due to their identity as members.

B. **UBIT in Practice and Application**

In practice, UBIT is a 21 percent flat corporate income tax rate, although certain deductions are possible. Payment of the unrelated business income tax also requires additional paperwork. If an exempt organization has more than $1,000 in gross income from unrelated business, it must file a Form 990-T. Organizations must also pay estimated tax if they predict that the taxable amount owed from unrelated business income will exceed $500 for the year. If an organization underpays its estimated tax, it is subject to a penalty based on the amount and time period of the underpayment, as well as a quarterly interest rate. These deposits must be made electronically using the Electronic Federal Tax Payment System.

Nonprofits specifically confront UBIT in multiple ways, including when (1) taking advice from business consultants and, in the hopes of raising revenue, have excessive commercial

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performing arts school charging for performances being considered substantially related because the participation in performances is considered educational and the income from the performances derived from something that “importantly” accomplished the school’s exempt purposes. § 1.513-1(f)(4)(i). However, exploitation of exempt functions would not qualify, such as a renowned scientific organization selling its endorsements of laboratory equipment. § 1.513-1(f)(iv).

E.g., La. Credit Union League v. United States, 693 F.2d 525, 535 (5th Cir. 1982) (quoting Hi-Plains Hosp. v. United States, 670 F.2d 528, 531 (5th Cir. 1982)).

Id.

Tenenbaum, *supra* note 8, at 4–6. There is specifically a $1,000 deduction permitted. *Id.*


Id.


activity unrelated to their charitable purposes; (2) conducting sales promotions related to cause marketing and commercial coventures; (3) in a corporate sponsorship; (4) producing debt-financed rental income; and (5) selling merchandise. The Treasury Department provides a plethora of other examples of unrelated business income that is subject to taxation, including museum gift shops, which are determined on an item-by-item basis. Items that relate to where the museum is located or that, while educational in nature, do not contribute specifically to the underlying purpose of the museums’ collection, are considered unrelated.

C. The Exceptions to UBIT

There are still multiple exceptions to UBIT that apply, both statutory and those that would otherwise on the surface appear to be taxable but in fact are not. Statutory safe-harbor exceptions include royalties, rental income on nondebt financed real property, trade show income, and volunteer labor. Underscoring the oddities of the Code itself, other unique statutory exceptions include specific types of bingo games and pole rentals. Some of these exceptions developed

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120 Leitner, supra note 35, at 2–4. Cause marketing and commercial coventure questions arise when, due to the collaboration between a nonprofit and company, sales proceeds from certain items result in donations to the charity. Id. at 2. There is also a real property tax exemption, which requires that tax-exempt organizations “not charge above a relatively minimal amount of rent for maintenance, depreciation, and carrying charges.” See id. at 4.

121 See IRS, supra note 15, at 5–6.

122 Id. at 6. Another example, separate from museum gift shops, is an exempt organization that existed to “foster public interest” in art through events and education, but also “lease[d] studio apartments to artist tenants and operate[d] a dining hall.” It was determined this organization produced business and income unrelated to its exempt purposes. Still other examples of activity that fell under UBIT include a business league’s park-and-shop plan; the health club program of an exempt organization that promoted the “welfare of young people” that charged annual fees similar to local health clubs; and a publicly available miniature golf course managed by an exempt organization that promoted youth welfare. Id. at 4–6. Games of chance are perceived to not further any exempt purpose, although bingo games can qualify for exclusion from being considered unrelated trade or business depending on the jurisdiction in which they occur. Other gambling can also be treated as unrelated if it is performed with volunteer labor, considered public entertainment, and conducted in North Dakota. Id. at 7.

123 I.R.C. § 512(b)(2).
124 § 512(b)(3)–(4).
125 § 513(d)(3).
126 Tenenbaum, supra note 8, at 5. Other exceptions also include work that is “performed for the organization by volunteers without compensation . . . for the convenience of its members, students, patients, officers, or employees,” and the selling of merchandise which had been “received by the organization as gifts or contributions.” Treas. Reg. § 1.513-2(b) (as amended in 1975).
127 I.R.C. § 513(f)–(g).
over time, as the safe harbor exception for trade show income has only applied since 1976. The IRS continued to develop the contours of this exception given the rise of online trade shows and, in a 2004 Revenue Ruling, held that the exception continued to apply if the online show was ancillary to an in-person show, enhanced the in-person show, and was only available during the same limited period as an in-person show.

However, even activities that on the surface would appear to be taxable have been classified as exempt simply because of congressional and IRS interpretation. A prevalent example is college athletics that generate income. Sports such as football and basketball, especially at larger institutions “can make enough money to cover their . . . costs and still produce a profit.” Further, these sports are “operated in a business-like manner,” are regularly carried on, and are arguably not substantially related to an institution’s educational purpose, as the participating student athletes are “selected primarily for their athletic ability rather than their academic ability.” Despite the tenuous relationship between an athletic program and an institution’s educational goals, congressional committee reports in the Revenue Act that created UBIT clearly showed that Congress did not intend the tax to apply to college sports. The IRS now fully backs this viewpoint in its published materials. The IRS describes how a college athletic game between two conference champion teams where admission is charged and broadcasting rights are sold is viewed as related to an exempt athletic conference’s purpose. The IRS argues this is because the educational purposes of intercollegiate athletics do not change in front of an audience, whether in person or if

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128 Tenenbaum, supra note 8, at 8.
129 Id. Tenenbaum highlights how tradeshows held during COVID complicated this matter and that it would be difficult to predict how the IRS would apply this safe harbor exception in that circumstance. Id. at 8–9.
131 Id. at 1095–97.
132 Id. at 1098. However, there is some recent dispute within Congress as to whether these athletic programs should be subject to UBIT, especially in light of exorbitant, multimillion dollar coaching salaries for financially successful athletic programs at schools such as University of Southern California, Rutgers University, and Louisiana State University. The House Ways and Means Committee asked these schools to justify these spending decisions as to whether they further an institution’s tax-exempt purpose. Steve Berkowitz, Congressional Report Sheds Light on Colleges’ Justification for Astronomical Coaches’ Pay, USA TODAY (Dec. 1, 2022, 11:32 AM), https://www.usatoday.com/story/sports/ncaat/2022/12/01/college-pay-millions-taxes-coaching-salaries-congressional-report/10808934002/ [https://perma.cc/KQJ5-ZWBC].
broadcast nationally, as the broadcast is viewed as “contribut[ing] importantly to the accomplishment of [the organization’s] exempt purpose.” 134

Overall, it is clear that the law surrounding UBIT and its exceptions is complex, not only in the letter of the law itself, but also in how it is applied to different taxpayers. Even the explanations provided herein are a simplification of UBIT. It feels unpredictable to determine what trade or business can and cannot be considered substantially related to an exempt organization’s charitable purpose, especially for those not familiar with the law or how it has been applied, such as to income-generating college athletics. This means that an organization could have trouble determining whether it owes tax on income and pay it despite the income not qualifying, leading to money wasted on unnecessary tax payments. Alternatively, if an organization fails to both report and pay taxes the IRS determines it owes, it is subject to a “Failure to Pay Penalty” with an additional charge for interest. 135

Additionally, the law itself is not stagnant. The IRS maintains a webpage version of its publication that discusses future developments, including legislation, regarding the tax. 136 The most recent edition of the publication was published in March 2021. 137 All of this points to the fact that the rules governing UBIT are complex, difficult to understand, and therefore insurmountable. For nonprofits, this can lead to large swaths of time spent analyzing complex legal issues and the potential for unnecessary tax payments. 138

D. By the Numbers: The Prevalence of UBIT

For most businesses, nonprofits included, time is a precious resource. To understand if it is worthwhile for these small organizations to expend the amount of time necessary to

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134 Id. Other “substantially related” ventures that are therefore not subject to UBIT include a hospital’s gift shop, a museum dining facility, and museum greeting cards sold in gift shops that reproduce art from its collection. Id. at 5.


137 IRS, supra note 15, at 1–2. Examples of some recent updates were an updated and redesigned Form 990-T with mandatory e-filing; updated regulations for tax-exempt organizations with more than one unrelated trade or business and relevant calculations (including separate loss deductions); the repeal of transportation fringe benefits for exempt organizations; and an increase of a limit on annual member dues for agricultural associations. Id.

138 See Telephone Interview with Rafi Stern, supra note 27.
grapple with UBIT, one must first understand just how prevalent this form of taxation is and how much tax the government collects from UBIT. Further understanding the number of organizations that file UBIT for small amounts frames the solution to this problem.

There are available statistics through the IRS that indicate the prevalence of unrelated business income filings, including which organizations file them most commonly, the most common categorizations for which organizations file, and a closer look at the amount of taxable income that 501(c)(3) organizations specifically produce. Overall, between 2002 and 2012, over forty-six thousand tax-exempt organizations filed a 990-T (which is required if the organization produced more than $1,000 in unrelated business income), although half of them ultimately did not report tax liability for their unrelated business income.\(^\text{130}\) In this time period, 501(c)(3) organizations accounted for 65 percent of all unrelated business income.\(^\text{140}\)

1. UBIT Filings and Amount of Taxable Income

In 2015, out of 35,011 tax returns with positive amounts of unrelated business income, 64 percent were for income amounts between $1,000 and $10,000.\(^\text{141}\) Another 23 percent were for unrelated income amounts between $10,000 and $100,000, and 9 percent were for unrelated income amounts between $100,000 and $500,000.\(^\text{142}\) Only 2 percent were for amounts between $500,000 and $1,000,000, and 2 percent were for amounts over $1,000,000.\(^\text{143}\) Below is a chart with the same data for 2010–2015.

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\(^\text{130}\) *Statistics of Income: Unrelated Business Income Tax: 2012*, IRS, https://www.irs.gov/taxstats. Note that given the numbers regarding the number of unrelated business income tax returns filed as compared to the number of organizations that filed in a ten-year period, it is a fair assumption that organizations file more than one unrelated business tax return a year, meaning they likely have multiple income-generating ventures that are not substantially related to their charitable purposes.

\(^\text{140}\) *Id.*


\(^\text{142}\) See 2015 UBI by Amount of Taxable Income, supra note 141.

\(^\text{143}\) See *Id.*
Table 1. Taxable Income 2011–2015 by % of Gross UBI Filings

<table>
<thead>
<tr>
<th>Year</th>
<th>Total number of tax returns</th>
<th>1,000 to 10,000</th>
<th>% 10,000 to 100,000</th>
<th>% 100,000 to 500,000</th>
<th>% 500,000 to 1,000,000</th>
<th>% 1,000,000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>35,011</td>
<td>64%</td>
<td>23%</td>
<td>9%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>2014</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2013</td>
<td>23,860</td>
<td>56%</td>
<td>26%</td>
<td>11%</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>2012</td>
<td>22,727</td>
<td>56%</td>
<td>27%</td>
<td>11%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>2011</td>
<td>21,660</td>
<td>56%</td>
<td>27%</td>
<td>11%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>2010</td>
<td>19,874</td>
<td>55%</td>
<td>28%</td>
<td>12%</td>
<td>3%</td>
<td>2%</td>
</tr>
</tbody>
</table>

On average, between 2010 and 2015, 57 percent of UBIT filings were for less than $10,000, 26 percent were for between $10,000 and $100,000, 11 percent were for between $100,000 and $500,000, 3 percent were for between $500,000 and $1,000,000, and 3 percent were for greater than $1,000,000.\(^\text{145}\) Table 1 indicates that the data stays consistent year to year, although there was a large increase in the number of filings between 2013 and 2015.\(^\text{146}\) Although data from recent years is unavailable through the IRS, there is no evidence of a substantial change to indicate that most unrelated business income filings would not still be for amounts less than $100,000.\(^\text{147}\)


\(^\text{145}\) See supra Table 1.
\(^\text{146}\) See id.
\(^\text{147}\) See id.
2. 501(c)(3) UBIT Filings: Total Value

The most common entity that files UBIT returns with a 990-T is a 501(c)(3) organization. In 2015, half of 990-T returns were filed by 501(c)(3) organizations. In 2015, 501(c)(3) organizations accounted for over $1 billion worth of unrelated business taxable income, which was about half of the total amount of taxable income for the year from all types of exempt organizations that filed. In 2015, the total tax collected on unrelated business income, following tax credit reduction, came out to around $350 million for 501(c)(3) organizations. Below is a table tracking this data for 2011 to 2015, excluding 2014 (which was unavailable).

Table 2. Total Taxable Income and UBIT Owed by 501(c)(3) Organizations

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Taxable Income</th>
<th>Total Tax Owed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>$1,129,773,000</td>
<td>$348,221,000</td>
</tr>
<tr>
<td>2013</td>
<td>$898,844,000</td>
<td>$278,773,000</td>
</tr>
<tr>
<td>2012</td>
<td>$855,717,000</td>
<td>$239,963,000</td>
</tr>
<tr>
<td>2011</td>
<td>$728,789,000</td>
<td>$199,237,000</td>
</tr>
</tbody>
</table>

148 See 2015 UBI by Amount of Taxable Income, supra note 141.
150 2015 501(c)(3) Amount of Taxable Income, supra note 149.
Comparatively, the IRS collected over $3.3 trillion dollars in 2015 for all types of income.\textsuperscript{152} This means that of the IRS’ total collection, unrelated business income taxation owed to the US Government amounted to 0.01 percent of its entire collection. It was even less in 2013, 2012, and 2011.\textsuperscript{153} Overall, in 2015, the IRS’ calculated cost of collecting tax was 0.35 cents for every $100 taxable dollars, meaning that to collect the approximately $350 million in UBIT taxes in 2015, it cost the IRS $1,225,000. However, this calculation completely excludes the personnel and manpower it takes to respond to and manage the PLR request process as that data is not available.\textsuperscript{154} Overall, UBIT provides minimal revenue opportunities for the IRS given that it only accounts for 0.01 percent of its revenue and it requires a high level of attention to calculate the tax from both IRS personnel and nonprofits that lack legal resources. Despite this minimal benefit, even the basic components of UBIT are difficult to apply without even considering the complexity of PLR exceptions.\textsuperscript{155} This raises the question of whether the tax is even worth the trouble of collecting, despite the difficulties it causes in application.

III. LEGAL COMPLEXITIES AND RESOURCE ACCESS: THE IMPACT ON SMALLER NONPROFITS

UBIT’s complexities extend beyond the language of the law itself, its interpretation, and its application.\textsuperscript{156} The law is equally complex regarding procedural steps that can be taken to determine if UBIT applies to certain activities carried on by a tax-exempt organization. The PLR submission request system is a manifestation of this complexity because it allows organizations to submit requests regarding whether its specific income stream is subject to UBIT. The PLR system can result in somewhat surprising and favorable rulings and outcomes, underscoring the inequity regarding who is able to receive PLRs. This is because organizations’ inability to submit accurate and compelling requests can vary due to differing access to legal resources.\textsuperscript{157}

\textsuperscript{152} IRS, supra note 21, at 72.
\textsuperscript{153} See id; supra Table 2.
\textsuperscript{154} See infra Part III.
\textsuperscript{155} See supra Sections II.B–C, III.B.
\textsuperscript{156} See supra Part II.
\textsuperscript{157} See infra Section III.B; see also Leitner, supra note 35, at 1.
A. Private Letter Rulings: What Are They and How Do They Work?

Taxpayers can submit PLRs to the IRS to get a determination on their tax-exempt status. PLRs specifically are used when a taxpayer would like to verify “that a prospective transaction will not likely result in a tax violation.” While PLR decisions are not infallible and can be challenged in court, such challenges prove to be an uphill battle for nonprofit organizations. The steps necessary to receive a PLR are republished every year, and the instructions are in a several-hundred page document that applies to all taxpayers, not just nonprofits. PLRs only apply to the requesting taxpayer and its unique tax status. Filing a PLR requires a fee, depending on the type of ruling that is sought, that can range from $275 to $8,500 for nonprofits with a gross income under $1 million. The IRS makes edited versions of these private letters available for public use, editing out “proprietary” information.

Taxpayers (nonprofits and for-profits alike) submit tax queries to different members within the IRS based off guidance from the IRS website and may call the general office number to ask questions, including to confirm the jurisdiction under which a question falls. Generally, when requesting a PLR, a

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159 Id.
160 See generally United States v. Am. Bar Endowment, 477 U.S. 105 (1986) (holding that the IRS’ determination that the American Bar Endowment’s insurance plan was subject to the unrelated business income tax because it was a trade or business).
163 Rev. Proc. 2023-1, 2023-1 I.R.B. 1, 85–86, https://www.irs.gov/pub/irs-irsb/irb23-01.pdf [https://perma.cc/EZ77-2ER4]. The most expensive form of revenue ruling is for a prefiling agreement at $181,500, which is for organizations with revenue greater than $1 million. The second highest fee for organizations with revenue greater than $1 million costs $38,000. Id.
164 Written Determinations, IRS (Aug. 9, 2022), https://www.irs.gov/written-determinations [https://perma.cc/TYR5-UN97]. This essentially means that all PLRs available for public consumption are anonymized and do not share the name of the requesting taxpayer.
165 Rev. Proc. 2023-1, 2023-1 I.R.B. 1, 10, https://www.irs.gov/pub/irs-irsb/irb23-01.pdf [https://perma.cc/EZ77-2ER4]. The Associate Chief Counsel of Employee Benefits, Exempt Organizations, and Employment Taxes should receive inquiries regarding exempt organizations, including those regarding UBIT, although the IRS notes that some exempt organization questions instead fall under the power of the Commissioner of the Tax Exempt and Government Entities Division—the latter being typically for foundations and noncharitable trusts. Id. at 11. While exempt organizations should typically submit inquiries to the specified Associate Chief Counsel before the fiscal year’s
nonprofit must submit documentation of a wide range of requirements to receive a determination.\textsuperscript{166} First, it must include facts, such as its name, taxpayer identification number, address, contact information, details regarding the organization’s accounting period, a description of the organization’s operations, a description of the transaction at issue as well as business reasons for it, and any other facts related to the organization’s “requested tax treatment.”\textsuperscript{167} The nonprofit must also include any copies of documents related to the transaction in question and any relevant foreign laws governing the transaction.\textsuperscript{168}

Perhaps most difficult, the nonprofit needs to include an analysis of the specific relevant facts or issues, and for this, the IRS Bulletin provides only a very brief description, no more than a paragraph long.\textsuperscript{169} The request must include whether the issue is under any federal court’s review or if it is being considered by the Department of Labor, as well as if the IRS previously ruled on a similar issue specifically for that taxpayer.\textsuperscript{170} The nonprofit must also provide an explanation for its desired outcome, as well as a “[s]tatement of contrary authorities.”\textsuperscript{171} Additionally, it must identify any relevant, pending legislation.\textsuperscript{172} Requests can be submitted via mail, fax, or encrypted email.\textsuperscript{173}

Submitting a PLR is a complex, daunting process and requires someone (whether an attorney, accountant, or any other individual) with the wherewithal and ability to navigate the complex set of requirements. This person must also make a detailed legal analysis, with only minimal guidance on how to do so.\textsuperscript{174} And that is if the organization can even afford to file in the first place. Although the IRS does provide a sample PLR request and filing checklist, the format is not strict.\textsuperscript{175} The 2023 Bulletin, which provides the guidelines for how best to submit a PLR, is over three hundred pages. The formalistic requirements for

\begin{footnotesize}
\begin{enumerate}
\item[	extsuperscript{166}] \textit{Id.} at 23–28 (listing the various documentation required).
\item[	extsuperscript{167}] \textit{Id.} at 23–24.
\item[	extsuperscript{168}] \textit{Id.} at 24.
\item[	extsuperscript{169}] \textit{Id.} at 25.
\item[	extsuperscript{170}] \textit{Id.}
\item[	extsuperscript{171}] \textit{Id.} at 27–28.
\item[	extsuperscript{172}] \textit{Id.} at 28.
\item[	extsuperscript{173}] \textit{Id.} at 36–39.
\item[	extsuperscript{174}] See \textit{id.} at 25.
\item[	extsuperscript{175}] \textit{Id.} at 33.
\end{enumerate}
\end{footnotesize}
submitting a PLR request and receiving a determination are so complex and detailed that it only further puts small nonprofit organizations—often with minimal funding and without specialized legal assistance—at a disadvantage when attempting to submit these requests to the IRS.\textsuperscript{176}

\textbf{B. Private Letter Rulings in Practice}

Despite the complexities, there are advantages to successfully submitting a PLR request seeking exemption from UBIT because tax-exempt organizations receive a personalized analysis regarding whether its income stream is considered unrelated business income.\textsuperscript{177} This results in what seems to be personalized exemptions based on the determination letter’s analysis. These exemptions may appear surprising on their face.

One such example was a PLR issued in July 2014 for a 501(c)(3) museum and research center.\textsuperscript{178} The museum sold solar system toys with accompanying educational pamphlets, books, documentary videos, and newspaper reproductions, and argued that the toys were substantially related to the museum’s educational purpose.\textsuperscript{179} The museum provided literature, photographs, and descriptions about the items for which it was seeking exemptions in its determination request for a PLR.\textsuperscript{180} This additional information supported the museum’s argument that these items should remain tax exempt. The IRS concluded that the only question at issue was whether the sold items were substantially related to the museum’s exempt purposes, and determined that they were because they “depict[ed] items from the museum’s collection and contain[ed] descriptive literature to educate the purchaser as to the significance of the item and its nexus to the educational purpose of the museum.”\textsuperscript{181} The IRS further reasoned that the exempted toys “educate[d] the public about the solar system.”\textsuperscript{182} Given that the museum’s purpose was to educate the public about outer space, the toys were not considered unrelated business income.\textsuperscript{183} In this instance, in part because a child’s toy had an accompanying pamphlet describing its educational purpose, the museum escaped taxation.

\textsuperscript{176} See supra Section I.A.


\textsuperscript{179} Id. at 1–2.

\textsuperscript{180} Id. at 1.

\textsuperscript{181} See id. at 5.

\textsuperscript{182} Id.

\textsuperscript{183} Id.
regardless of whether a child was likely to read such material. The museum received an individualized exemption to sell gift shop toys as nontaxable income simply because it had the legal wherewithal to include an educational pamphlet and the legal and financial ability to submit a PLR.

Another recent and successful example of a PLR request that resulted in an otherwise unexpected exemption involved a 501(c)(3) church. The church rented out its property for which it had obtained a twenty-year mortgage.\textsuperscript{184} While rental income is generally exempted from UBIT, taxes are imposed on income gained from debt-financed property.\textsuperscript{185} However, there is an exception where rental income from debt-financed property is not subject to UBIT if (1) an organization acquired real property with the primary intention to use the land; (2) at the time of the acquisition, the organization owned the neighboring property to the debt-financed land; and (3) the organization did not abandon its intent to use the land within ten years (a fifteen-year period for a church).\textsuperscript{186} Here, not long after the church acquired the neighboring parcels of land, it realized the intended expansion “was not feasible,” and in the year following the purchase, the church leased land on two parcels.\textsuperscript{187} At the time of its submission of a PLR, which requested that the land not be treated as debt-financed property under the neighborhood land-use exemption, the church sought termination of the lease so that it could expand its outdoor gathering space given the COVID-19 pandemic.\textsuperscript{188} The determination letter was found in the church’s favor, finding that the church had not abandoned its original intent to use the land at a later time because it made attempts to improve the land over the years.\textsuperscript{189} This was a fairly generous ruling in favor of the church, given that the church’s actual intent to expand its outdoor space was in response to an unpredictable and unknowable pandemic. The church obtained a favorable exemption outcome because it was able to outline all the small attempts it made over the years to improve the property.\textsuperscript{190}

\textsuperscript{184} I.R.S. Priv. Ltr. Rul. 202225007, at 1 (June 24, 2022).
\textsuperscript{185} I.R.C. §§ 512(b)(3)–(4), 514.
\textsuperscript{186} §§ 514(b)(3)(A), 514(b)(3)(E).
\textsuperscript{188} Id.
\textsuperscript{189} Id. at 8.
\textsuperscript{190} Id. Examples of the improvements the church made over the years included demolishing a building on one parcel so it could be used as a gathering space, working with conservation specialists to select plants for the land, fundraising to support construction, and reaching out to construction companies to discuss developing the property. Id. at 2, 8.
C. The Big Deal: How Private Letter Rulings Specifically Disadvantage Smaller Nonprofit Organizations

Part I concluded by questioning the importance and relevance of UBIT's impact on small nonprofits. The PLRs described above answer that question by illustrating two points. First, the tax law governing UBIT is complex regarding the letter of the law, especially when considering the neighboring property debt-financed exception. And second, the law is equally complex, arbitrary, and unpredictable as applied. This is true given the debatable interpretations necessary to assess if sales items are substantially related to an organization’s exempt purpose (as with the museum example) and if an organization’s intent to maintain debt-financed property for its own use had been maintained (as with the church example). Although not all PLR requests result in beneficial outcomes,\(^{191}\) it is certainly beneficial for an organization to submit a well-argued request in order to receive tax relief if it has the resources.

PLRs are mechanisms through which nonprofits can request and receive what are essentially specialized tax exemptions from the IRS, even if other organizations believe that the exact same taxes are inevitable.\(^{192}\) But in order to do so, an organization would need to know about the PLR process, be able to afford the filing fee, and have the wherewithal to draft and submit a sufficient request for determination. A smaller nonprofit is at a distinct disadvantage because of its size, limited funding, and likely reliance on pro bono legal assistance.\(^ {193}\) Even when small nonprofits have legal help, it is often with lawyers that, while knowledgeable about the existence of UBIT, do not understand the nuances and myriad exceptions that exist.\(^ {194}\) This would mean that any lawyer attempting to assist a smaller nonprofit may not understand the PLR determination system through which they could make an argument in favor of an exemption. This is if an organization is so lucky to have such legal assistance in the first place. Even if one of the smaller nonprofits were able to expend the extensive time needed to submit a procedurally accurate and compelling PLR request, it would be

\(^{191}\) See, e.g., I.R.S. Priv. Ltr. Rul. 202226013 (July 1, 2022) (denying an organization tax exemption as a 501(c)(3) organization).


\(^{193}\) See Nat’l Council of Nonprofits, supra note 30, at 17; Headd, supra note 29; Leitner, supra note 35, at 1.

\(^{194}\) Leitner, supra note 35, at 3.
time diverted from the other legal needs that are more pressing and better related to the organization’s overall purpose.\textsuperscript{195}

Not only that, but the PLR filing fees likely cost a prohibitive amount of money for nonprofits. While the IRS does cap fees for tax-exempt organizations, private letter rulings for unrelated business income questions still cost thousands of dollars.\textsuperscript{196} For organizations with a gross income less than $250,000, the determination letter filing fee is $3,000.\textsuperscript{197} For organizations with a gross income less than $1 million, the determination letter filing fee is $8,500.\textsuperscript{198} Given that over half of all organizations that pay UBIT have taxable unrelated income ranging between $1,000 and $10,000, filing a PLR for most of these organizations in an attempt to achieve an exemption is just as expensive, if not more so, than just paying the taxes owed.\textsuperscript{199} The complexity of applying UBIT, combined with the prohibitive cost of submitting a PLR to receive additional guidance or a potential exception, is a signal that something within nonprofit tax law must change.

IV. ZEROING OUT: A SOLUTION TO EVEN THE PLAYING FIELD

The best solution to the complexity of UBIT and its unfair impact on smaller nonprofits is to eliminate the tax on gross unrelated business income only if, in its entirety, it amounts to less than $100,000 for a 501(c) organization. In crafting the new Code, Congress should limit an organization’s ability to qualify for the exemption. However, overall, this solution would directly benefit nonprofits and even indirectly benefit the IRS. While there are valid concerns to this approach, given the risk of those who might cheat the system and complicated changes to the tax code having unintended consequences, it is still the best solution because of the relief it will provide to nonprofits.

\textsuperscript{195} Such legal needs include avoiding automatic revocation of tax-exempt status, employment law questions, contracting, cause marketing compliance, compliance with charitable solicitation requirements, and other needs as related to daily operations. See generally id. (describing legal needs for nonprofit organizations).


\textsuperscript{197} Id.

\textsuperscript{198} Id. For nonprofits with a revenue higher than $1 million, a determination letter might cost as much as $38,000 regarding the unrelated business income tax. Id. at 85–86.

\textsuperscript{199} See supra Table 1.
A. Limitations of a Higher UBIT Threshold

To successfully implement such a substantial change to the tax code, the updates to the IRC must limit the organizations that receive this specific exemption so that the primary purpose of granting relief to smaller, lesser funded nonprofits is achieved. First, the IRC should permit exemption from UBIT for organizations only if its unrelated business income amount from all its combined unrelated income streams is under $100,000. Once an organization makes more than $100,000 in unrelated business income, the entire amount of income above $1,000 should be taxable (which is the current rule). This limit would ensure that only organizations that generate smaller amounts of unrelated income would benefit from the new tax break. In turn, well-funded nonprofits that routinely bring in large amounts of otherwise taxable income would receive no benefit. In 2015, this proposed tax would have applied to only 4 percent of nonprofits filing UBIT returns.\(^{200}\) Given that these organizations are likely better funded and therefore have improved access to legal resources, it would even the playing field between larger and smaller nonprofits. Second, as has been done in other areas of the IRC, the Code should prohibit organizations from dividing unrelated business income into separate, subsidiary entities in order to fall below the $100,000 cap and receive the tax exemption.\(^{201}\) Both of these limitations would hinder an organization’s ability to find loopholes and assist in benefiting genuinely small nonprofits.

There is, of course, a general concern that allowing nonprofits to generate large amounts of nontaxable income unrelated to an exempt purpose could allow these organizations to compete with for-profit companies, which would directly counter UBIT’s purpose.\(^{202}\) However, despite this risk, eliminating the tax is still in line with the intentions behind tax-exempt status. First, the limitations described above would cap the amount of unrelated business income an organization would consider beneficial. Once a nonprofit passed the $100,000 threshold, it would no longer receive any tax benefit. Second, the 1916 Congress thought collecting taxes from nonprofits was viewed as “a source of annoyance and expense,” indicating that

\(^{200}\) *Supra* Table 1.

\(^{201}\) See I.R.C. § 179(d)(6)(A) (limiting depreciable business assets eligible for deduction at $1,000,000 while also requiring that “all component members of a controlled group . . . be treated as” a single taxpayer. Controlled groups include a parent subsidiary, brother-sister controlled group, and a combined group. I.R.C. § 1563.).

congressional intent was generally not in favor of taxing these types of organizations.\textsuperscript{203}

B. Direct Benefits to Nonprofits

Allowing nonprofits to generate up to $100,000 of nontaxable, unrelated income would benefit a large majority of smaller nonprofit organizations due to decreased tax bills and eliminating the need to either calculate UBIT or submit a PLR request. Eliminating the tax for income up to $100,000 would eliminate UBIT entirely for between 82 percent and 85 percent of all nonprofit organizations that submit UBIT filings.\textsuperscript{204} This would obviously decrease taxes owed by many organizations that currently pay UBIT.

Not only would eliminating the tax help existing nonprofits, it would also continue to foster and encourage the creation of organizations that exist for a public benefit. This is because nonprofits would be permitted to, in small amounts, creatively fundraise without worrying about related tax implications, even if the underlying motivation of these attempts were not substantially related to their charitable purpose.\textsuperscript{205} Given that most nonprofits are community-based groups “serving local needs,” essentially eliminating UBIT would best serve smaller organizations and better the community.\textsuperscript{206}

Further, eliminating the tax at this threshold would also eradicate the difficulties nonprofits face while calculating and reporting UBIT to the IRS. As stated, these smaller organizations rarely have legal assistance with tax questions and even if they do, pro bono legal assistance rarely comes from a lawyer who understands the complexities of UBIT, as well as the complexities of the PLR submission system, should the organization wish to seek a personalized exemption.\textsuperscript{207} And this is if the organization is even able to afford the expense of a PLR in the first place, as it can cost between $3,000 and $8,500, depending on the organization’s gross income.\textsuperscript{208} Entirely eliminating UBIT and its related reporting requirements for most nonprofits would mean that these organizations would no longer have to consider any legal ramifications surrounding the

\textsuperscript{203} Joint Comm. on Tax’N, supra note 75, at 30.
\textsuperscript{204} See supra Table 1.
\textsuperscript{205} See Joint Comm. on Tax’n, supra note 75, at 27.
\textsuperscript{206} Nat’l Council of Nonprofits, supra note 30, at 17.
\textsuperscript{207} See Leitner, supra note 35, at 3–4.
tax. Instead, nonprofits would be able to better focus on legal issues that concern daily operations.

C. Benefits to the IRS

Eliminating the tax would also benefit the IRS. First, it would no longer have to manage the tax returns of a majority of the nonprofits that submit them for small amounts of taxable income. Applying this solution to the data available from 2015, 87 percent of organizations would not have needed to submit tax returns for UBIT, leading to thirty-thousand fewer tax returns in total. Additionally, it would likely also cut down on the number of PLR requests submitted to the IRS, as fewer organizations would be subject to taxation under UBIT. Therefore, IRS officials would no longer need to spend the time to analyze and respond to a subset of UBIT-specific requests.

Further, capping UBIT in this manner would not particularly hamper IRS revenue. Overall, UBIT represents only 0.01 percent of IRS total collections. Even after eliminating UBIT under $100,000, the IRS would still be able to collect UBIT revenue from organizations that excessively profit from unrelated business income, all while minimizing the effort needed to collect taxes by no longer dealing with up to as many as 30,460 fewer returns from organizations that only bring in a small amount of revenue. The IRS already implicitly understands that nonprofit organizations with gross incomes under $1 million have less means, as it charges them between $29,500 and $35,000 less than other organizations for a PLR determination. Overall, the IRS would be able to better focus its resources on other tax areas that would better serve the country, rather than taxing nonprofit organizations that directly serve communities.

D. Concerns with Increasing the UBIT Ceiling

Despite the benefits eliminating UBIT under $100,000 would give to both nonprofits and the IRS, it is important to consider the exemption’s potential complications. Organizations

209 See supra Table 1.
210 See supra Section II.D.1.
211 See supra Section II.D.2.
212 See supra Table 1.
could cheat the system, as well as the potential for other unintended consequences.

1. Cheats to the System

As there is with any tax, there are concerns that some organizations would attempt to cheat the system by finding loopholes to forgo paying taxes. For example, organizations could do so by claiming to be nonprofits but carrying out considerable amounts of substantially unrelated business. However, this can be solved with external protections through journalism, as well as by expanding upon already existing protections to prevent opportunism.

a. External Protections: Journalistic Audits

If an organization grossly cheats the tax system, investigative journalism can act as an external check used to audit and catch obvious instances of fraud. For example, The Daily Beast uncovered the uncouth behavior of Shaun King’s nonprofit, the Grassroots Law Project. An article in The Daily Beast revealed that the Grassroots Law Project, which raised $6.67 million following its fundraising effort in response to George Floyd’s murder in May 2020, only expended $2.6 million in its first year and has been stagnant since. Donors believed they were supporting newly created commissions in District Attorney’s offices for the purpose of “build[ing] brand new pathways for truth, justice, and reconciliation.” However, following 2020, founder Shaun King, who has a history of shadowy fundraising behavior, had a salary in excess of $250,000, twice the median compensation for nonprofit executives. The article further outlined how the nonprofit paid large amounts to financial consultants. Although there have been no official allegations of

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216 Id.

217 Id.

218 Id.

219 Id. The financial consultant firm is based out of the same mail drop as King’s nonprofit. Id.
fraud, a journalist from The Daily Beast was able to expose the Grassroots Law Project’s shadowy and below-board behavior, casting rightful doubt on a man who had been considered a darling of the American social justice movement.\textsuperscript{220}

The precedent set by this article is critical. Journalism is a solid mechanism through which fraudulent behavior can be discovered and then later audited, especially when larger amounts of money are at stake. Trying unscrupulous nonprofits and their founders in the press is an important means to an end. By uncovering and publicizing below-board behavior, journalists can warn the public not to donate to or engage with suspect organizations and encourage the IRS to revoke its tax-exempt status.

\textit{b. Expanding Existing Statutory Protections}

Additionally, some protections are already in place to prevent organizations from cheating the system. First, the Revenue Act of 1950 specifically limited for-profit organizations from creating “feeder” nonprofit organizations.\textsuperscript{221} This limitation means that commercial enterprises cannot simply pass income through nonprofit entities.\textsuperscript{222} Additionally, the IRS can audit an organization’s finances and accounting to confirm that it is correctly reporting information for tax purposes.\textsuperscript{223} Therefore, the IRS could audit organizations suspected of manipulating UBIT. Finally, organizations that earn too much unrelated business income are already subject to lose 501(c)(3) tax-exempt status.\textsuperscript{224}

In addition to existing protections, the IRS could also add in further statutory or regulatory safeguards. First, the IRS could add in a requirement that in order for unrelated business income to remain nontaxable, it cannot exceed a certain percentage of an exempt organization’s budget. Specifics of what this percentage should be would require further research regarding the average ratio of the amount of UBIT organizations file as compared with budget sizes of those organizations.\textsuperscript{225} The IRS could also clarify how an organization might be subject to

\textsuperscript{220} See id.
\textsuperscript{221} Arnberger et al., supra note 70, at 107.
\textsuperscript{222} Id.
\textsuperscript{225} See SOI Tax Statis—Exempt Organizations’ Unrelated Business Income (UBI) Tax Statistics, supra note 144.
losing its tax-exempt status if it has too much income generated through unrelated business. Currently, there is “significant uncertainty as to how” much unrelated business income is considered enough to lose tax-exempt status.\(^{226}\) By clarifying currently vague regulations, the IRS would set clear guidelines and expectations so that nonprofits could both be rid of the current burdens of UBIT and not be at a risk of losing their tax-exempt status. Overall, even if some organizations would attempt to exploit loopholes in the tax code, it is unfair to punish most organizations just because there is the potential for a few bad apples. If an organization wants to avoid paying taxes, it could find ways to do so with or without UBIT.

2. Unpredictable Outcomes from Changes to a Complex System

There is also the possibility that changing the tax code could lead to unpredictable complications and would require later clarification. Section 104(a)(2), which exempts damages received due to “personal physical injuries or physical sickness,” from gross income is a good example.\(^{227}\) There was initially a dispute as to whether the statute meant to include punitive damages.\(^{228}\) Initially, the IRS published revenue rulings indicating that punitive damages were included but “later changed its mind.”\(^{229}\) Courts similarly struggled.\(^{230}\) Because of the confusion, in 1989, Congress added a clarifying sentence to 104(a), specifying that punitive damages did not qualify under the statute.\(^{231}\) This evidently was not good enough. In 1996, in addition to the clarifying sentence at the end of section 104, Congress directly changed the phrasing in 104(a)(2) itself to exclude punitive damages.\(^{232}\) This shows that Congress can clarify the IRC if previous changes to the Code created too much confusion or had unintended consequences. Further, while it is true that any change can be harmful in unpredictable ways, the IRC must be changed in some capacity because as it stands now,
it unfairly impacts small nonprofit organizations. Even if there are some unpredictable complications, Congress can always close any potential new loopholes with additional, future laws as it often updates and changes the tax code. As evidenced with the 2017 Tax Cuts and Jobs Act, Congress is clearly not afraid of instituting massive overhauls to the tax code.

Overall, despite these potential complications, eliminating UBIT for nonprofits with income generated below $100,000 is the best and simplest solution. The administrative costs saved and benefits given to 87 percent of tax-exempt organizations far outweigh any potential risk, especially considering that these organizations exist primarily for the benefit of the public good. Any alternative solutions, such as distributing a clarifying Revenue Procedure or Treasury Regulations, would place a heavy burden on nonprofits to understand and apply the law all while allowing better resourced organizations to receive PLRs that provide personalized exemptions. Further, the change would also benefit the IRS by cutting down on the number of PLRs submitted as well as the collection of a complex tax that is only a drop in the bucket of IRS revenue. Moreover, even if the change were to frustrate the purpose of nonprofit organizations, Congress could either reinstate UBIT at its current levels or make corrections as needed.

CONCLUSION

Charitable nonprofits are tax exempt pursuant to federal law, although amateur sports organizations, hospitals, and other educational entities are also tax exempt. The purpose of granting exemptions to nonprofits is to support organizations that provide a public benefit and reduce the problems caused by collecting taxes in such small amounts. Smaller charities account for 60 percent of tax returns but produce relatively negligible amounts of revenue. These same organizations struggle to find legal help and often resort to pro bono help where the lawyer may not have the necessary expertise for the

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234 I.R.C. § 501(c)(3)–(4), (d)–(f), (j), (r).
235 Joint Comm. on Tax’n, supra note 75, at 28, 30.
236 Charities and Other Tax-Exempt Organizations, Tax Year 2015, supra note 53.
legal issues that arise.\textsuperscript{237} This is specifically a problem when it comes to UBIT.\textsuperscript{238}

UBIT’s application is determined on a case-by-case basis.\textsuperscript{239} For a steep fee, the IRS offers tax-exempt entities the option of submitting a PLR request where the organization can submit materials to argue that certain income is not considered taxable under UBIT.\textsuperscript{240} UBIT itself, as well as the procedural mechanisms for receiving a PLR, is complex. Further, it only accounts for about 0.01 percent of the IRS’ collections and the vast majority of its filings are for less than $100,000 in taxable income.\textsuperscript{241} This ultimately disadvantages smaller nonprofits, as they (1) have limited access to legal resources to understand the tax implications and (2) likely may not be able to afford submitting a PLR request. Additionally, smaller nonprofits presumably lack the in-house expertise to submit a procedurally accurate request that includes the convincing analysis needed to obtain a UBIT exemption. Given the complexity of the law, the minimal returns it gives the government, and the particularly unfair impact it has on small nonprofits, the best solution is to eliminate UBIT for organizations that have unrelated taxable income in amounts below $100,000. This would eliminate UBIT as a concern for the majority of nonprofit filers and provide particular relief for the many small, local nonprofits ill-equipped to manage the complexity of the law, thereby allowing them to focus on better serving the community. Ultimately, this would better serve local communities and the people who live within them, making the proposed change successful for all involved.

\textit{Rebeka D. Cohan}\textsuperscript{†}

\begin{footnotesize}
\begin{enumerate}
\item[237] Leitner, supra note 35, at 1.
\item[238] Id. at 3.
\item[239] See La. Credit Union League v. United States, 693 F.2d 525, 535 (5th Cir. 1982) (holding that the \textit{not substantially related} prong of UBIT is determined on a case-by-case basis).
\item[240] See supra Section III.B.
\item[241] See supra Section II.D.
\item[†] J.D. Candidate, Brooklyn Law School, 2024; B.A., Barnard College, 2014. Thank you to the \textit{Brooklyn Law Review} editors and staff for all of their hard work to make this publication possible, with special thanks to Abby Fink, Mickaela Founds, Arpi Youssoufian, Aidan McNamara, Eliza Estrella, Paul Tanchajia, and Matt Gilligan. Thank you also to Professor Steven Dean for his invaluable feedback, as well as to Robert Schnur. Finally, thank you to my parents, Nina and Richard Cohan, as well as my brothers Adam, Alex, and Charlie for always supporting me and making my accomplishments possible.
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