

Tax Feature / Judah I. Kupfer, Esq.

Does My Nonprofit Need to Pay Tax? Understanding Unrelated Business Income Tax Part I

If there is one thing that people know about taxes, it is that tax-exempt organizations don't pay federal income tax. That seems simple enough. After all, if they had to pay tax, they wouldn't be "tax-exempt," right? Well, not always. While it is true that under most circumstances, tax-exempt organizations will not be subject to a corporate level income tax that their taxable entity counterparts are required to pay, there are times that they will be subject to income tax, in this context known as the Unrelated Business Income Tax, or "UBIT" for short.

Much to the dismay of business owners, corporations and trusts pay income tax at the corporate/trust level. To ensure that tax-exempt organizations aren't given an unfair advantage, Congress added the UBIT rules to force exempts to pay their fair share when engaged in commercial activity outside the scope of their exempt purposes (as well as on earnings utilizing borrowed funds).

The laws surrounding UBIT are very complex. This article is not meant to cover all scenarios but is intended to provide an overview and alert the reader to the potential UBIT issues. Competent tax counsel should be consulted for further detailed questions. In addition, IRS Publication 598 is a handy resource. In Part One, below, we describe the general rules and some application. In Part Two, published next week, we will see some exceptions to the general rules as well as additional examples of how the rules play out in everyday occurrences (so be sure to read both parts).

When Will an Organization Pay UBIT?

UBIT rules require a tax-exempt organization to pay income tax when the organization regularly carries on a trade or business that is not substantially related to the organization's exempt purposes. Let's discuss each of these elements separately.

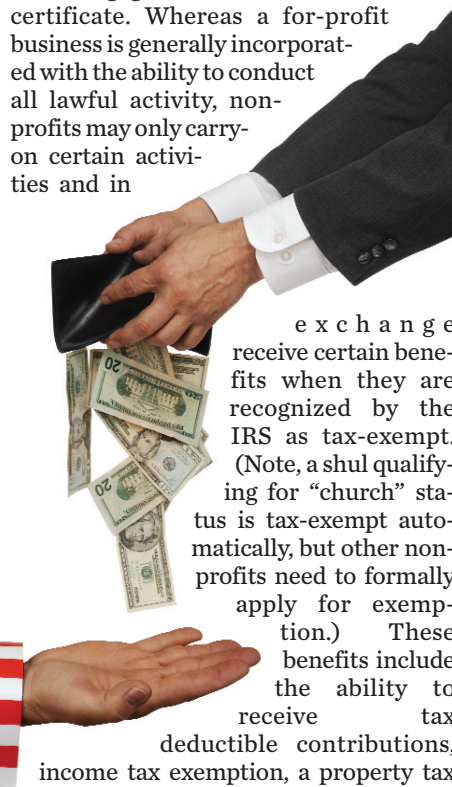
To be subject to UBIT, first, the organization has to carry on a trade or business. This is pretty self-explanatory, but to be sure, trade or business will usually involve the sale of goods or services in exchange for money or something else of value for the purpose of making a profit. Next, the trade or business must be *regularly* carried

While it is true that under most circumstances, tax-exempt organizations will not be subject to a corporate level income tax that their taxable entity counterparts are required to pay, there are times that they will be subject to income tax.



on. This means it takes place frequently or on a continual basis similar to the way the activity would be carried on by a for-profit business. Even a seasonal business can be considered regularly carried on regardless of the large gaps of time in between sales. Third, the trade or business must not be substantially related to the organization's exempt purposes. In other words, the activity doesn't contribute importantly to accomplishing the organization's exempt purposes. What are its exempt purposes? This gets a bit more complex, so let's take a step back and understand some background.

At the time of formation, nonprofits file a certificate (or articles) of incorporation with the secretary of state in the state of incorporation (trusts execute a trust document). The founders of the organization choose from a short list of permissible purposes in which a nonprofit is permitted to engage and includes them in the certificate. Whereas a for-profit business is generally incorporated with the ability to conduct all lawful activity, nonprofits may only carry on certain activities and in



exchange receive certain benefits when they are recognized by the IRS as tax-exempt. (Note, a shul qualifying for "church" status is tax-exempt automatically, but other nonprofits need to formally apply for exemption.) These benefits include the ability to receive tax deductible contributions, income tax exemption, a property tax

exemption, and preferred U.S. postal rates, among others.

The most common exempt purposes are religious, charitable, educational, and scientific. While the tax regulations defining the activities which fall within each of these purposes are lengthy, suffice it to say that a shul's activities will likely fall within religious, charitable and perhaps even educational, and such purposes should have been listed in its formation documents. The nonprofit may only engage in activities that contribute importantly to those exempt purposes it is authorized to conduct — it becomes authorized by including them in its certificate. While a yeshivah's main purpose is educational, many of its activities will also fall within religious and charitable. The activities of most *tzedakah* organizations will fall within "charitable," but if they provide some educational element such as educating the public regarding issues of concern to the broader public, those activities would fall within "educational."

As an easy example, the charging of tuition by a yeshivah is, no doubt, a regularly carried on business. But it is related to its exempt purpose, since parents are paying for the education of their children, education being the name of the game. When business activity is related to the exempt purpose, it may be carried on even substantially, with the organization never having to pay UBIT. Similarly, another easy example is a shul charging its congregants fees for membership and seats. It is a regularly carried on business, but it is related to its exempt purpose — admission to the shul for *tefillah*, which falls squarely within a shul's religious purpose. From these examples we see an interesting point: there is no prohibition for a nonprofit to make money so long as it is doing so by carrying on an activity related to its exempt purposes. (Of course, the organization is restricted with what it may do with that money; generally, it may only use the money to pay reasonable compensation and necessary expenses. For more details on these restrictions, see "*Is Your*

Organization Paying Reasonable Compensation? How to Avoid Excess Benefit Penalties," Hamodia at B42, June 29, 2011 & at B36, July 6, 2011.)

In determining whether an activity is related, we look to the activity itself and not to where the profit from the activity may go. So if an activity itself does not contribute to the organization's exempt purposes, the act of applying the proceeds to fund the organization's exempt purposes does not make the activity related.

To illustrate, what if in an attempt to raise funds, the yeshivah started a retail clothing business located across the street where it sold clothing to the general public at market value. The retail sale of clothing does not fall within any of the yeshivah's exempt purposes, and so it is an unrelated regularly carried-on business activity. As noted above, it will be unrelated regardless of the fact that the proceeds go to benefit the yeshivah's core function of educating students. Once we have a regularly carried on trade or business that is *unrelated*, the next question to ask is whether it is substantial or insubstantial compared to all else the yeshivah does. If it is insubstantial, the yeshivah would be required to pay UBIT to the Internal Revenue Service. This is a tax at the current tax rate for the net profits the organization earns by running the unrelated business. If, however, the yeshivah's business really takes off and becomes substantial as compared to the rest of the activity the yeshivah as a whole conducts, in addition to being required to pay the UBIT, the yeshivah becomes at risk for losing its tax-exempt status since it would no longer be primarily engaged in its tax-exempt purposes as required by section 501(c)(3) of the Internal Revenue Code, the source for its tax exemption.

While weighing whether a trade or business is substantial or insubstantial is very subjective and depends on the specific details of the case at hand, one may want to think of it in terms of which activity is primary and which is secondary. Taking the organization as a whole, the question

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Business News

Ask the Fool

Mutual Fund Basics

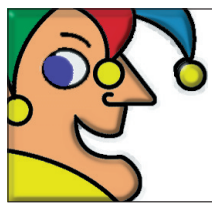
Q How do mutual funds work? — J.R., Pueblo, Colo.

A They feature the pooled money of many investors that is managed by a company of professionals. Mutual funds make sense for most people, since few of us have the time or skills to choose investments carefully. Instead, we can tap the services of pros, who will increase our wealth for a modest fee. At least, that's how it's supposed to work.

There are many kinds of mutual funds. Some invest just in stocks, others in bonds, and some in both. Some focus on large companies, others on small companies, and others on a mix. Some seek income through dividend- or interest-paying securities, and others aggressively seek fast-growing firms. Some specialize in one industry (such as energy or biotechnology) and others in a region (such as Africa or Latin America).

Unfortunately, many professionally managed mutual funds don't do so well for their investors, due to hefty fees or manager problems, such as poor investment choices or a counter-productive focus on short-term results. To combat this, it makes a lot of sense to just opt for broad-market index funds, which tend to have very low fees and invest only in the stocks of major indexes, such as the S&P 500. Over the long run, these have outperformed most managed, non-index funds.

Got a question for the Fool? Send it in — see Write to Us



The Motley Fool

To Educate, Amuse & Enrich

What Is This Thing Called The Motley Fool?

In Elizabethan days, Fools were the only people who could get away with telling the truth to the King or Queen. The Motley Fool tells the truth about investing, and hopes you'll laugh all the way to the bank.

Fool's School

The Buffett and Munger Show

In late April, around 40,000 Berkshire Hathaway shareholders flocked to Omaha to listen to Chairman Warren Buffett and his partner, Charlie Munger, answer their questions for five hours.

Here are some snippets from the annual meeting, paraphrased:

- On America's future: The potential of America has not been used up, but the rest of the world is starting to catch on. Over the next 100 years, we'll have 15, maybe 20, lousy years, but we'll end up far ahead of where we are right now.
- On railroads: They should have a good year, as they're becoming more competitive economically.
- On attractive sectors: Buffett and Munger would both invest considerable time learning more about technology companies if they had many more years ahead of them. Energy, too.
- On currencies: Currency-related

investment is a bet. Almost all currencies have declined in value over time, due to inflation.

• On gold: They remain rather bearish on commodity investing in general, viewing it like this: You buy and hope that someone else is willing to pay more for it later. Take all the gold in the world, put it together in a cube. You can climb on it, fondle it, polish it — it isn't going to do anything.

Buffett recommends buying productive assets (such as a business) instead of speculating in commodities. Munger quipped, "There's something peculiar about buying an asset that will only go up if the world goes to hell."

• On index funds: Buffett thinks most people would do well to buy broad-market index funds (such as those based on the S&P 500 or the total stock market) if they're going to invest consistently over time.

• On taxes: Munger noted that hedge fund managers in America are getting lower tax rates than physics teachers. "That is demented."

My Dumbest Investment

Ponzi Oil

Years ago, two friends in the oil business introduced me to a possible investment — in an oil partnership. I'm a geologist, so I researched the wells and reports and was confident it was going to be very profitable. I sold \$48,000 worth of Exxon stock and bought in. After receiving a few sizable monthly checks, the cash flow began to diminish. The barrel counts were fairly consistent, but excuses were offered for the reduced payouts ... until the receiver took over.

Yes, brother Ponzi had had his way with me. I had certificates of ownership issued by the state of North Dakota, but several others had the same serial numbers on theirs! I received a compensation check from the Treasury for a whopping \$25. Had I kept those Exxon shares, they'd be worth more than \$380,000 today! — M.J., Los Angeles

The Fool Responds: Such ventures are often very speculative. Though they look promising, there's little you can count on. And if crooks are running the show, you'll really be in trouble. Stocks may seem less exciting, but at least their financials tend to be audited.



Do you have an embarrassing lesson learned the hard way? Boil it down to 100 words (or less) and send it to The Motley Fool c/o My Dumbest Investment. Got one that worked? Submit to My Smartest Investment. If we print yours, you'll win a Fool's cap!

LAST WEEK'S TRIVIA ANSWER

You may not have heard of me, but I've been around since 1818 (almost 200 years!) and I'm valued in the stock market at roughly \$11 billion. I was founded in Amsterdam as an import/export trading company. Today, based in New York, I'm a food and agribusiness giant, employing some 32,000 employees in more than 30 nations. I deal in oilseeds, grains, sugarcane, wheat, corn and fertilizers. I process and transport them, serving the food service, farming and biofuel industries, among others. I make margarine in Europe, and process soybeans in China and oilseeds in Brazil. Who am I? (Answer: Bunge)

Write to Us! Send questions for Ask the Fool, Dumbest (or Smartest) Investments (up to 100 words), and your Trivia entries to The Motley Fool, Attn: Newspaper Feature, 2000 Duke St. 4th Fl., Alexandria, VA 22314. Sorry, we can't provide individual financial advice.



Name That Company

Founded in 1899 in Pennsylvania as a mitten and glove company, today I'm a \$10 billion enterprise and the world's largest apparel company. You may have heard of some of my brands:

Wrangler, The North Face, Lee, Vans, Nautica, 7 For All Mankind, Eagle Creek, Eastpak, Ella Moss, JanSport, John Varvatos, Kipling, Lucy, Majestic, Red Kap, Reef, Riders and Splendid. I'm growing rapidly abroad. My name, now abbreviated, used to evoke a famous work by Thackeray. My stock has gained an average of more than 14 percent annually over the past 20 years. Who am I?

Know the answer? Send it to us with Foolish Trivia on the top and you'll be entered into a drawing for a nifty prize!

Does My Nonprofit Need to Pay Tax?

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to ask is whether this is a yeshivah that happens to have a small clothing business or whether this is really a clothing business that also has a yeshivah. This can be measured by many factors including revenue, size and extent of the various activities; because it varies based on the specific case, it would be prudent to make this determination in consultation with a tax counsel. Although it never has been clearly defined, many practitioners agree that as a rule of thumb, an organization's net income generated from unrelated activity should not exceed 20% of its overall net income.

In addition to paying the tax, an organization with \$1,000 or more of gross

income from unrelated business is also required to file a Form 990-T (by the 15th day of the 5th month after the end of its tax year). Note, this filing is required regardless of whether the organization is otherwise required to file a Form 990 (so a shul would not be exempt from this filing). If the organization anticipates paying \$500 or more of UBIT for the year, it is required to pay the tax in quarterly estimated payments.

Part Two Next Week: This article will continue and conclude with Part Two, published next week, which will provide exceptions to the general rules (so if you only read Part One, you will not get the full picture). We will also apply the rules to common scenarios and practices includ-

ing: sales and rentals by *gemachs*, real estate rentals, *simchah* halls, earning interest and dividends, investments in partnerships, LLCs and S-Corporations, dinners, *melaveh malkas* and Chinese auctions, journal ads, renting parking spaces, sales of *sefarim* and *esrogim*, vending machines and cafeterias, and the lease of space for cell-phone towers/antennas.

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Tax Feature / Judah I. Kupfer, Esq.

Does My Nonprofit Need to Pay Tax? Understanding Unrelated Business Income Tax *Part II*

In Part One, published last week, we learned that there are times a nonprofit is required to pay income tax – namely, when it regularly carries on trade or business that is unrelated to the organization's exempt purposes. We noted that earning money from activities that contribute importantly to the organization's exempt purposes will not be subject to tax, even if conducted substantially. However, should the organization earn money by regularly carrying on business that is unrelated to its purposes, if the activity is insubstantial to all else the organization does, it is required to pay unrelated business income tax (UBIT) to the IRS. If, on the other hand, it is substantial, in addition to paying the tax, the organization is at risk of losing its tax-exempt status. We also noted that money earned through unrelated business does not become related simply by applying those funds to activities that further the organization's exempt purposes.

We continue with Part Two, below, where we list several exceptions to the general rule and provide additional examples regarding how the rules of UBIT are applied to real life scenarios. It can't be overemphasized that these rules are complex and specific tax advice should be sought.

Convenience Exception

There are several exceptions where unrelated and regularly carried on business activity will not be subject to UBIT. First, where the business is performed primarily for the convenience of its members, students, patients, officers or employees, UBIT will not apply. For example, a nonprofit hospital's cafeteria is obviously a regularly carried-on business. However, because it is there primarily for the convenience of the patients, employees and guests, its net income would not be subject to UBIT. To the extent it is used by the general public (i.e. those that have no connection to the hospital), its net income generated by outsiders would be subject to UBIT. Additionally, if it did more than necessary so that it can no longer be called a simple convenience, such as if a hospital were to open a five-star restaurant, the net income attributable to anything more than necessary for the convenience of its patients, staff and visitors would be unrelated. A laundry operated by a yeshivah is another example of a business operated for the convenience of its students and, thus, its net income would not be subject to UBIT. Additionally, a yeshivah's vending machines would fall within the convenience exception.

Items sold at a tax-exempt's gift shop are scrutinized on an item by item basis to determine whether the sale of each item is related to the exempt purposes of the organization. The Metropolitan Museum of Art (the "Met"), a tax-exempt organization, provides for an interesting case study. The Met has a gift shop and an on-line store, each of which do a substantial amount of sales, yet it infrequently pays UBIT. Items possess an imprint of art images which is seen as acting in furtherance of the museums educational purposes by making works of art more familiar to a broader segment of the public and, thus, considered to be related to the museum's exempt purposes. However, should souvenir items be sold such as T-shirts or mugs featuring the New



York emblem or the Met logo, such items are considered to not contribute importantly to the accomplishment of the museum's exempt purposes and would be subject to UBIT.

Sale of Donated Property

A second exception: UBIT doesn't apply to the sale of donated property. Thus, sales by thrift shops or bake sales by a tax-exempt organization when the sale goods were donated would not be subject to UBIT. So, for example, if a tax-exempt *gemach* were to accept donations of wedding gowns and subsequently sold them to needy individuals, the net proceeds from such sales would not be subject to UBIT. (Note, if the *gemach* sold or rented the gowns at substantially below market/rental value to needy individuals, the proceeds from the gown sales/rentals would likely be considered related to the organization's "charitable" purposes and would not need this exception.)

If a tax-exempt organization received donated used cars and subsequently sold them to earn money to be applied toward the organization's mission, while the sale of the donated cars would be unrelated trade or business, it would fall within this exception. Applying this rule to our retail clothing store example from Part One, if the store sold only donated items it received, it would also fall within this exception. (It is important to note that the organization's sale of donated property creates limitations to the amount the donor may deduct from his taxes.)

Work Performed By Unpaid Volunteers

A third exception: work performed by unpaid volunteers is not considered an unrelated trade or business. Thus, in our example above, if substantially all of the work at the yeshivah's clothing store were accomplished through the work of unpaid volunteers, it would fall within this exception.

Passive Investments

A fourth exception is income derived from passive investments such as dividends, royalties, interest, and capital gains. Thus, if a tax-exempt company invested in publicly traded stock and received a dividend or sold the stock and realize a capital gain, such dividend/gain is not subject to UBIT. Similarly, if the organization earned interest on its bank account, the interest is not subject to UBIT.

Income derived from the rental of real estate is considered passive and falls within

this exception so long as the organization only rented out the space and did not provide personal services (but note, passive income from the rental of personal property is subject to UBIT). Thus, if an organization derived income from renting hotel rooms, rooms in boarding houses or tourist homes, or space in parking lots or warehouses, this exception would not apply (and the net income would be subject to UBIT) because some element of personal service was provided in addition to the space.

So let's say an organization operated a parking lot for a fee (and assume it did not fall into the convenience exception), this activity would be considered unrelated. If, however, the organization leased a sizeable plot of empty space it owned to a company for a fixed fee to operate a parking lot (and the company handled everything and all the organization provided were typical services generally provided by a landlord), this would be considered passive rental income and would fall within this exception. If, however, the rental fee paid to the organization was tied to the success of the parking company, this would be a joint venture between the organization and the business. The rule is that a joint venture, where the rent or dividend is dependent on the success of the venture, is not considered to be passive. So if the amount paid by the rental company was tied to the success of the business, it would not fall within this exception and would be subject to UBIT.

Please keep in mind that even if one exception is not available, another may apply. To illustrate, if the parking lot were operated primarily for the convenience of the organization's guests and employees, it would fall within the convenience exception (or otherwise be considered related to the purposes of the organization as it may contribute importantly to the use of the organization's facilities). If, however, it were used by members of the general public who had no connection to the organization and simply sought to use the parking facility, the net income generated by them would be subject to UBIT.

To take a more relevant example, let's say an organization housed a hall used for weddings or bar mitzvahs. This is clearly unrelated and regularly carried-on business activity. The question is whether it fits within the rental income (passive investment) exception. The answer depends on the circumstances. If the caterer was a salaried employee of the organization, the net income from the hall should be unrelated and not within this exception since the organization is the one running the hall and

so the income would not be passive. If, however, the caterer was not an employee of the organization but independent and paid a fixed rental fee to the organization for use of the hall, the net income would be considered passive, so long as the services provided by the organization were merely typical landlord services such as repairs, normal maintenance, heat and hot water, cleaning of public entrances, exits, stairways and lobbies, and the collection of trash. If, however, the organization provided such services as cleaning or laundry, it would not be considered passive income. If the arrangement was somewhere in the middle, for instance if the caterer was independent but paid the organization based on the amount the hall is used, it would be a joint venture and not within the exception. In either case, if the hall was owned by a yeshivah that rents it out for *shivurim* or other similar events, such events would, in certain circumstances, be considered related to its exempt purposes.

To illustrate the passive investment exception further, if the organization were a partner in a partnership (or LLC) engaged in unrelated business (even as a silent partner) or if it owned S-Corp stock (any S-Corp stock regardless of whether the business of the S-Corp was related to the purposes of the organization), it would have to report the income from its partnership and S-Corp holdings as unrelated taxable income. If however, the organization (or the partnership in which the organization was a partner) owned stock in a corporation and received a dividend, such dividend would fall within this passive investment exception.

The tax regulations explicitly state that the rental of space in a warehouse or storage garage does not fit within the passive investment exception and will be subject to the general UBIT rules. They also make clear that the income an organization generates by renting space on its building roof to cell-phone carriers, by placing cell towers or antennae, does not fall within the passive investment exception as the rules treat it as the rental of personal property, which we have seen, does not get the benefit of this exception.

It is important to note that this passive investment exception generally does not apply to any income from a passive investment that was acquired through debt financing, i.e. borrowed funds such as a mortgage. So if the organization borrowed in order to conduct unrelated passive investments, the net income earned from the investments would be subject to UBIT in proportion to the debt on the property, and if substantial, may risk the exempt status of the organization. (These rules in particular are complex and tax counsel should be consulted.)

Low Cost Items

Some organizations send to potential donors a low-cost item, such as a coffee mug or key chain, sporting the organization's logo to help induce people to donate. Under this exception, such a distribution will not be seen as a sale (when the donor ends up making a donation) if the donor did not request the distribution, the distribution is made without the express consent of the

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Ask the Fool

\$400 Million Donuts?

Q I read that Dunkin' Donuts is planning a \$400 million initial public offering (IPO). With close to 10,000 locations worldwide, shouldn't the company be worth more than that? Starbucks has a market cap of more than \$25 billion. — M.R., Denver

A When a company first issues shares to the public, it often sells off just a portion of itself, in order to raise money. If Dunkin' Donuts were selling all of itself, that would indeed reflect a total value of \$400 million. But if it's selling just 10 percent, then the implied value is \$4 billion. Once the shares debut and are trading in the market, their price will reflect how investors are valuing the company.

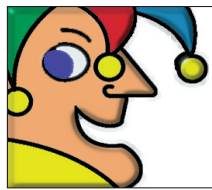
Q Which brokerages charge very low commissions to buy or sell stock? — N.C., Watertown, Wis.

A Trading commissions are as low as \$8 to \$10 per trade at E*TRADE, Fidelity, Charles Schwab and TD Ameritrade. It's \$7 at Scottrade and Firstrade, and you can find even lower rates elsewhere.

Look at more than commissions, though. After all, if you buy or sell stocks only a few times a year, finding the lowest commission rate won't save you all that much and other brokerage features might be more valuable to you. Meanwhile, some brokerages have been charging quarterly account fees just for having an account with them. These are often waived if your account is large enough.

When shopping for a brokerage, look at all the fees it charges and consider its conveniences (such as local branches, a wide variety of mutual funds or check-writing services) and how well it meets your needs.

Got a question for the Fool? Send it in — see Write to Us



The Motley Fool

To Educate, Amuse & Enrich

What Is This Thing Called The Motley Fool?
In Elizabethan days, Fools were the only people who could get away with telling the truth to the King or Queen. The Motley Fool tells the truth about investing, and hopes you'll laugh all the way to the bank.

Fool's School

Nuggets From Omaha

Here are some words of wisdom from superinvestors Warren Buffett and Charlie Munger from the recent Berkshire Hathaway annual meeting, paraphrased:

- On housing: Buffett expects the housing market to improve this year. (It's an important factor for him, as Berkshire Hathaway owns companies that sell furniture, bricks, flooring and manufactured homes, and it owns a major real estate brokerage firm, as well.)
- On bailouts: It's one thing to bail out an institution that has social value, but another thing to bail out its shareholders and managers. Said Buffett: "I think that any institution that requires bailing out by society should see its CEO and its spouse left dead broke."
- On nuclear power: Buffett said: "I think nuclear power is an important part of the world's equation in dealing with its problems. ... I think it's safe, and I don't think it's going anywhere in the United States because of [Japan]."
- On perspective: Don't be looking to make a deal your best one ever. Market conditions and opportunity costs will be different at different times. Don't compare past and recent deals. Just focus on making a satisfactory deal, one that's the best that you can do at the time.
- On what young people should study: Do anything you can do to improve your own skills — you never know when it's going to pay off later on. The one diploma Buffett has hanging on his wall is from a Dale Carnegie course on public speaking. Communication skills are what he most recommends developing.

My Dumbest Investment

Phones and Metal Mining

One of my worst investments has been in Qiao Xing Universal Resources. When I bought it a few years ago, it felt like a no-brainer. It was a Chinese company making mobile phones, but I soon learned that it was expanding into mining for metals. That seemed strange, adding a business line completely different from making cell phones. At the time of my purchase, China was the hot-stock nation, and I could see the popularity of mobile phones continuing to grow rapidly in the world. I was not able to see, though, how the phone market would become super competitive and that smartphones would become widespread. More research on my part might have made this clearer. — R.H., Arlington, Texas

The Fool Responds: It's never enough for a company to be in an exciting business such as something technology-related, or operating in an exciting region, such as population-rich China.

You always need to evaluate a company's health, competitive advantages, growth prospects and price. Some companies with diverse business lines do well — look at GE — but you're right to wonder about any shift in focus.



Do you have an embarrassing lesson learned the hard way? Boil it down to 100 words (or less) and send it to The Motley Fool c/o My Dumbest Investment. Got one that worked? Submit to My Smartest Investment. If we print yours, you'll win a Fool's cap!

The Motley Fool Take

CVS' Coming Catalysts

CVS Caremark (NYSE: CVS) has been on a roll lately, despite its controversial and thus far unsuccessful attempt to combine the pharmacy benefit management business of Caremark with its retail pharmacy business.

There are several catalysts that can turbocharge CVS' stock in the coming years. For starters, pharmacy companies should see higher profit margins and increased profitability amid a wave of generic drug introductions between now and 2015.

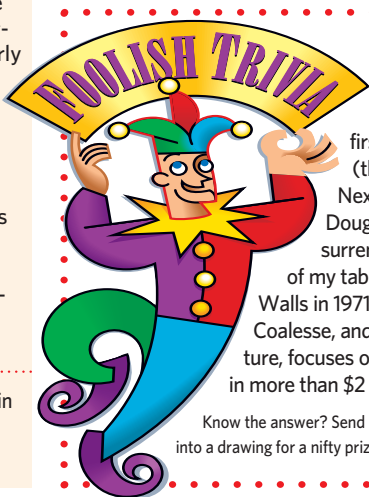
The patents on most of the top-selling drugs in 2010, such as Lipitor and Plavix, are scheduled to expire over the next several years.

Not only will the drugs that CVS retails in the coming years be more profitable, but it will also sell more of them to an aging U.S. population. According to the Census Bureau, the number of U.S. residents age 65 and older is expected to more than double by the middle of the next century, to 80 million.

CVS can use its expanding customer base and higher-margin products to generate outstanding shareholder returns over the next several years. While other companies will also benefit from these trends, CVS is cheaper than many on a number of metrics, such as P/E and price-to-book value ratios.

Furthermore, CVS' earnings have been held back by the lackluster performance of its Caremark benefit management business. Any improvement there, or divestiture of the division, could propel CVS stock further.

Name That Company



Born in Grand Rapids, Mich., in 1912, I'm the world leader in office furnishings. My first patent, in 1914, was for a steel wastebasket (then-standard straw ones were fire hazards). Next came fireproof desks for a skyscraper. Gen. Douglas MacArthur and Japanese officials signed surrender documents ending World War II on one of my tables on the USS Missouri. I introduced Movable Walls in 1971. Today I sport three main brands -- Turnstone, Coalesse, and my namesake. One of my sub-brands, Nurture, focuses on space and health-care environments. I rake in more than \$2 billion annually. Who am I?

Know the answer? Send it to us with Foolish Trivia on the top and you'll be entered into a drawing for a nifty prize!

LAST WEEK'S TRIVIA ANSWER

Founded in 1899 in Pennsylvania as a mitten and glove company, today I'm a \$10 billion enterprise and the world's largest apparel company. You may have heard of some of my brands: Wrangler, The North Face, Lee, Vans, Nautica, 7 For All Mankind, Eagle Creek, Eastpak, Ella Moss, JanSport, John Varvatos, Kipling, Lucy, Majestic, Red Kap, Reef, Riders and Splendid. I'm growing rapidly abroad. My stock has gained an average of more than 14 percent annually over the past 20 years. Who am I? (Answer: VF Corp.)

Write to Us! Send questions for Ask the Fool, Dumbest (or Smartest) Investments (up to 100 words), and your Trivia entries to The Motley Fool, Attn: Newspaper Feature, 2000 Duke St. 4th Fl., Alexandria, VA 22314. Sorry, we can't provide individual financial advice.



Does My Nonprofit Need to Pay Tax?

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recipient, and the item is accompanied by a request for a charitable contribution to the organization along with a statement that the recipient may keep the item regardless of whether he or she makes a contribution.

Some Additional Examples

The tax regulations make it clear that "income derived from the conduct of an annual dance or similar fundraising event for charity would not be income from trade or business regularly carried on." Thus, should an organization host an annual dinner, *melaveh malkah*, Chinese auction or similar event solely for fundraising purposes, the net income derived therefrom (as well as the income generated by journal ads) should not be subject to UBIT as they are not considered to be "regularly carried on." (Raffles conducted at more frequent intervals may be subject to more stringent rules.)

If a yeshivah were to publish and sell *seforim* with scholarly works of its *rabbeim* and students, such works would be consid-

ered related to the yeshivah's exempt purposes. There would, thus, be no issue if the yeshivah turned a profit on the sales, even if conducted substantially, and no UBIT would need to be paid. Similarly, if a yeshivah sold *seforim* to its students as needed for their studies, such sales would be related business activity.

If a shul sold *lulavim* and *esrogim* before *Succos*, such sales should be considered related to its exempt "religious" purposes. If, however, it sold matzah and wine before *Pesach*, since such items are sold by commercial retailers, such sales would be unrelated and subject to UBIT. To reiterate, the fact that the proceeds from the sales are used to support the exempt purposes of the shul is irrelevant and would not make an otherwise unrelated activity to be related.

If an organization sold its mailing lists or other data to an outside commercial entity, such sales would be unrelated and subject to UBIT. Similarly if the organization maintained a website or periodical, the advertising revenue it generated would generally be unrelated and subject to UBIT. (An excep-

tion exists, though, for "qualified sponsorships" — please seek addition guidance if this may apply to your situation.) However, advertising income generated by ads in a student-run yearbook would be considered related.

State Requirements

Thus far we discussed requirements to file and pay UBIT to the federal government. States also have their own requirements. For example, organizations that are subject to federal tax on unrelated business income are taxable under Article 13 of the New York State Tax Law, if they pursue those unrelated business activities in New York State. To report those taxes, the organization must file Form CT-13, *Unrelated Business Income Tax Return*. The rules of states vary and so specific state laws should be consulted to determine your organization's state tax liability.

Conclusion

To ensure that tax-exempt organizations aren't given an unfair competitive advantage over for-profit commercial entities, Congress added the UBIT rules to force exemptions to pay their fair share when

engaged in commercial activity outside the scope of their exempt purposes. When that activity is so substantial, however, organizations are at risk of also losing their tax-exempt status, since at that point, they no longer operate primarily in furtherance of their exempt purposes as required under Section 501(c)(3). The rules surrounding UBIT are complex. This article has outlined some of the key concepts, but specific advice should be sought from competent tax counsel.

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