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The Importance of Transfer Pricing for Nonprofits & a UBI Update

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Meet the Presenters



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Agenda

Transfer Pricing

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- What is transfer pricing?
- Common transactions to be analyzed
- U.S. transfer pricing regulations & penalties
- What is Unrelated Business Income (UBI)?
- How do you identify potential UBI?
- How do the siloing rules impact your organization?

What Is Transfer Pricing?

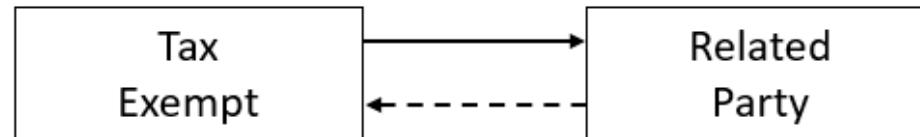
- Transfer pricing involves transactions between related parties, such as
 - Intercompany services
 - Intercompany sale of tangible goods
 - Intercompany sharing/licensing of intangible property
 - Intercompany financing
- U.S. transfer pricing regulations abide by the arm's-length standard
 - Payments between related parties should be consistent with payments between unrelated parties – treating related parties as they are not related

What Is Transfer Pricing?

- Transfer pricing is most commonly analyzed & documented by multinational enterprises; however, the transfer pricing rules also apply to
 - Nonprofit & related for-profit entities
 - Common ownership, but U.S. tax returns are not consolidated
 - C-corporation/LLC structure
 - Related parties that want an objective analysis for intercompany payments
 - State tax purposes

Depiction of Intercompany Transactions

- The provision of management & operational services by a tax-exempt entity on behalf of its related party



Legend:

————→ Provision of Services

- - - - -> Payment for Services

Advantages of Documenting Transfer Prices

- In addition to meeting the requirements of the IRS, having a transfer pricing study presents other advantages
 - Proves out the transfer prices used
 - Potentially reduce the effective tax rate of the overall organization
 - Provides support to membership
 - Provides support to third-party partners, *e.g.*, another cooperative
 - Risk to reputation

Why Is Transfer Pricing Needed?

- Taxpayers must prepare documentation that is contemporaneous with the filing of the tax return
 - Burden of proof of correct transfer prices is on the taxpayer
 - 10 principal documents must be satisfied
- Transfer pricing documentation must be provided to the IRS within 30 days of the request for the transfer pricing documentation by the IRS
 - Agents are required to request the documentation at the opening conference of the tax exam

Transfer Pricing Penalties

- If an adjustment is made to a taxpayer's transfer pricing results by the IRS, the IRS can also levy penalties if proper transfer pricing documentation was not maintained
 - Having robust contemporaneous documentation in place allows the taxpayer to avoid penalties
 - More importantly, it can mitigate against an adjustment to taxable income & imposition of interest

Agenda

Transfer Pricing & UBI

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- What is Unrelated Business Income (UBI)?

- How do you identify potential UBI?

- What are common UBI sources for exempt organizations?

- How will the siloing rules affect you?

What Is Unrelated Business Income (UBI)?

- Unrelated business income (UBI) is the income from a trade or business regularly conducted by an exempt organization & not substantially related to its exempt purpose
- UBI criteria
 - Activity must be a trade or business,
 - Activity must be regularly carried on, &
 - Activity is not substantially related to the organization's exempt purposes
- All three criteria must be met for an activity to create UBI

Income Excluded From UBI

- Dividends, interest, annuities, & other investment income
 - Not excluded if received from controlled entity
 - Not excluded if debt-financed
 - Not excluded if from S-Corporation
- Royalties
 - Not excluded if received from controlled entity
 - Not excluded if debt-financed
- Gains & losses from disposition of property
 - Not excluded if debt-financed property

Income Excluded From UBI

- Rents
 - Not excluded if based on net profit
 - Mixed leases
 - If personal property is between >10% & <50%, real property lease is excluded
 - If personal property is >50%, none are excludable
 - If personal services are rendered, not excludable
 - Not excluded if received from controlled entity
 - Not excluded if debt-financed

How Do You Identify Potential UBI?

- Identify & analyze income from activities – consider these
 - Receive any income (other than dividends) from an organization in which it has more than 50% ownership interest, whether direct or indirect (controlled corporation)?
 - Sell advertising in a publication, newsletter, website, or other media?
 - Receive income generated by assets financed with debt?
 - Provide management or administrative services for a fee?
 - Have ownership in a joint venture, *i.e.*, partnership, S-Corp?
 - Have sales or provide services to nonmembers?

UBI Next Steps

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- Determine expenses directly connected
- Determine any other allowed expenses
- Specific deduction of \$1,000
- Compute federal tax & credits
- Maintain 990-T for public disclosure
- Consider required state apportionments & state filings

Changes From Tax Cuts & Jobs Act

- New corporate tax rate – 21%
- UBI siloing
- Net operating loss (NOLs) carryovers

UBI Siloing

- **IRC 512(a)(6) –special rule for organization with more than one unrelated trade or business**
- In the case of any organization with more than one unrelated trade or business
 - Unrelated business taxable income (UBTI), including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business & without regard to subsection (b)(12),
 - UBTI of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business, less a specific deduction under subsection (b)(12), &
 - For purposes of subparagraph (B), UBTI with respect to any such trade or business shall not be less than zero
- Losses from one activity cannot offset income from another

IRS Enforcement Efforts

- The IRS has addressed perceived abuses related to transfer pricing & exempt organizations
 - Abuses by tax-exempt organizations in allocating expenses related to UBI
 - Abuses by tax-exempt organizations in relation to their dealings with for-profit subsidiaries & related parties
- IRS has focused on profit motive & limiting NOL carryforwards

Benefits of Going Through a Transfer Pricing Study

- Safeguarding exempt status
- Potential tax savings through proper transfer pricing planning
- Avoidance of adjustments to taxable income & potential penalties/interest
- Avoidance of negative publicity associated with the potential adjustment to income of a related taxable entity

Questions?

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