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IRS Confirms that a Charity May Provide Consulting Services for a Fee to Social Sector Organizations Without Incurring UBIT

Facing increasing pressure to earn revenue rather than rely solely on donations for support, Section 501(c)(3) organizations often consider leveraging their expertise to provide technical assistance or consulting services to other charities. Generally, these services would be considered an unrelated trade or business subject to unrelated business income tax (UBIT), even if the “clients” served are also nonprofit organizations.

Earlier this week, the IRS released a [private letter ruling](#) concluding that Section 501(c)(3) organizations may indeed charge reasonable fees for project-based technical assistance services provided to other charities and government agencies (collectively referred to as “social sector” organizations) without incurring UBIT in certain circumstances. This ruling appears to apply the reasoning previously set forth in a pair of 2008 rulings that were addressed to community foundations. In the 2008 rulings, the IRS distinguished strategic grant-making services (related) from routine administrative and clerical services (unrelated).

While private letter rulings cannot be relied upon as precedent, they provide useful insight into the IRS’s views on particular legal issues, which can aid in structuring transactions. In this case, the 2017 ruling offers charities welcome clarity regarding the factors that should be present to ensure that reasonable

advisory fees will be treated as exempt function revenue and, therefore, not taxable income.

Legal Framework

Under the UBIT rules in Sections 511 through 513 of the Internal Revenue Code of 1986, as amended, a Section 501(c)(3) organization’s unrelated business taxable income is subject to tax. Generally, income will be treated as derived from an unrelated trade or business if: (1) it is income from trade or business, (2) the trade or business is regularly carried on by the organization and (3) the conduct of the trade or business is not substantially related to the organization’s exempt purposes. To be “substantially related” to an organization’s exempt purposes, an activity itself must “contribute importantly” to the accomplishment of the organization’s exempt purposes.

The IRS has historically held that providing consulting services to unrelated Section 501(c)(3) organizations for a fee equal to or more than the cost of the services does not further an exempt purpose. In Revenue Ruling 72-369, for example, the IRS reasoned that providing managerial and consulting services on a regular basis for a fee is a trade or business that is ordinarily carried on for profit. The fact that the services

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were provided at cost and solely for Section 501(c)(3) organizations was not sufficient to characterize the activity as charitable. Similarly, in *B.S.W. Group, Inc. v. Commissioner*, a 1978 case, the Tax Court held that a corporation formed to provide consulting services to nonprofit organizations was not exempt under Section 501(c)(3) of the Code because its activities constituted a trade or business ordinarily carried on by for-profit, commercial entities.

The 2008 Community Foundation Rulings

In 2008, the IRS refined its stance on these types of services when it issued a pair of private letter rulings ([PLR 200832027](#) and [PLR 200832028](#)) that addressed whether payments received by a community foundation for providing grant-making, administrative and other clerical services to charities were taxable. The grant-making services included development of grant-making guidelines and procedures, research on potential grantees, review and evaluation of grant requests, and grants oversight. The administrative and clerical services included preparing grant checks, fielding of day-to-day inquiries from potential grantees and coordinating private foundations' board and grant committee meetings.

The IRS ruled that the grant-making services were narrowly and uniquely tailored to achieve the community foundations' charitable purposes. The community foundations' exempt function was to issue grants that support charitable activities benefiting the citizens of its region, and its grant-making services had been "uniquely developed" to address the specific needs and concerns of the charitable community. Therefore, the reasonable fees charged for those services would not be subject to UBIT. In contrast, the IRS found that the administrative and clerical services

were not narrowly tailored to achieve the community foundations' exempt purpose. Also, the administrative and clerical services did not require any skills unique to the charitable sector or either organization. The IRS thus held that fees for these administrative and clerical services would be subject to UBIT.

Fees for Technical Assistance Projects

In the 2017 letter ruling, the IRS applied the same reasoning and provided further insight on the types of services that would be deemed to further the service provider's own charitable purposes.

In this case, a private operating foundation charged reasonable fees to provide "technical assistance" to social sector organizations — specifically, nonprofits, foundations, government agencies and community organizations. The foundation's stated purpose was to improve the lives of low-income children and their families in its state, and it furthered this purpose through the collection, analysis, interpretation and sharing of a city's neighborhood data to improve community decision-making. The "technical assistance" services were additional data analysis services that could not be accomplished through the publicly available tools on the foundation's website. Client social sector organizations sought technical assistance because they did not have the in-house technical or subject-matter expertise to run that type of analysis.

The IRS ruled that the technical assistance services were substantially related to the foundation's exempt purpose and reasonable fees earned from such services would not be subject to UBIT. Distinguishing the services in this ruling from Revenue Ruling 72-369 and *B.S.W. Group*, the IRS considered the following factors to weigh in the foundation's favor:

- The technical assistance services were an element of the foundation's exempt data activities, and performing the data analysis and interpretation services related to each project gave the foundation access to new data in furtherance of its own charitable mission.
- The foundation's screening process ensured that it would only undertake projects that would provide valuable research and data to serve its own charitable mission.
- The foundation made the results of each project publicly available on its website.
- The foundation required that its clients never sell the results of any project or use the results for any purpose other than the exempt purpose for which the foundation agreed to provide its products or services; namely, to improve the lives of low-income children and their families.
- The foundation's services differed from those commercially available because the foundation had access to raw data not available to commercial ventures, and its activities were performed by employees who had developed particular knowledge and extensive understanding of issues facing low-income children and their families in the city metro region.
- Unlike the organizations in *B.S.W. Group* and Revenue Ruling 72-369, which did not appear to charge any fee less than cost, the foundation in this case would determine on a case-by-case basis whether to charge a fee below cost. In fact, the foundation adopted a policy of not charging any fee for projects that required less than four hours of program staff time.

Unlike in *B.S.W. Group* and Revenue Ruling 72-369, where the consulting services in question served the individual needs of the clients but were not themselves inherently charitable and did not further the charitable purpose of the organization providing them, the IRS concluded, based on the facts above, that the foundation's provision of technical assistance furthered the foundation's own charitable purposes because the foundation used the resulting data and analysis for its own research and grant-making purposes.

Based on this ruling and the prior 2008 rulings, there appears to be a narrow set of circumstances in which the IRS will view reasonable fees for services to other charitable and governmental organizations as a related activity and not subject to UBIT. However, because of the highly fact-specific nature of this analysis, charities should consult their tax advisers before structuring similar arrangements.

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