Proposal: Local Business Ads on SCRO's Website

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Background: In an effort to make SCRO's website more useful to the local community, we have considered listing local businesses on the website. In general, the board is inclined to support this idea. However, questions have been raised about whether it would be legal, given our nonprofit status, to charge for those listings. The alternative is to list businesses for no charge, or not at all.

Pending action: Consider 1) including local business ads on SCRO's website and 2) charging for placement of those ads.

Discussion

The key issue in this matter is whether SCRO can earn revenue from placing ads on our website without jeopardizing our 501(c)(4) nonprofit status. A Google search retrieved the following results:

> As a 501(c)(4) nonprofit, you can earn revenue from website ads, but the activity is likely considered an "unrelated trade or business" by the IRS. To protect your tax-exempt status, this income must remain an insubstantial part of your total revenue, and you will have to pay Unrelated Business Income Tax (UBIT) on it. The key is ensuring that the advertising does not overshadow your organization's primary purpose of promoting social welfare.
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> **Tax treatment: Unrelated Business Income (UBI)**
> The IRS uses a three-part test to determine if an activity, like running website ads, generates UBI:
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> 1. **Is it a trade or business?** Yes, selling advertising space is considered a commercial activity.
> 2. **Is it regularly carried on?** Yes, if the advertising is a continuous presence on your website, it meets this criterion.
> 3. **Is it not substantially related to your exempt purpose?** For most nonprofits, advertising is not directly connected to the organization's mission. The IRS notes that the generation of funds alone does not make a business activity related to an organization's exempt purpose.
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> If all three conditions are met, the advertising income is considered UBI and is subject to UBIT.
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> **Protecting your 501(c)(4) status**
> To avoid jeopardizing your 501(c)(4) status, you must ensure that the advertising activity does not become the primary purpose of your organization. Here are key considerations:
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> - **Keep it insubstantial.** The percentage of your total revenue derived from UBI is a key metric. While there is no defined percentage, if UBI becomes "excessive," the IRS may challenge your tax-exempt status. Your primary activities must always be in pursuit of your social welfare mission.
> - **Be careful with political activity.** 501(c)(4) organizations can engage in some political activities, unlike 501(c)(3)s, but they must not be their primary purpose. Be

cautious that advertising on your website, or the overall revenue strategy, is not perceived as participation in a political campaign.
- **Consider sponsorships vs. advertising.** The IRS distinguishes between commercial advertising and tax-free "qualified sponsorship payments". To be a qualified sponsorship, the payment cannot include "a substantial return benefit," such as promotional messages or calls to action. A simple acknowledgment of the sponsor's name, logo, and a value-neutral description of their products is typically acceptable.

What to do if you have UBI
If you earn UBI from website ads, take the following steps to ensure compliance with IRS regulations:
- **File Form 990-T:** If your organization's gross income from unrelated business activities is $1,000 or more, you must file Form 990-T and pay any UBIT owed.
- **Pay estimated taxes:** If you expect your tax liability to be $500 or more for the year, you will need to make quarterly estimated tax payments.
- **Maintain proper records:** Keep detailed records of your income and expenses for all unrelated business activities.

My conclusion from these Google results:
- My layperson’s option is that placing business ads on our website is substantially related to the purpose of our organization, which is, in part, to provide timely communication and cooperative endeavors to foster a sense community, predictability, and stability. This is especially true given there are no other venues offering a list of businesses available to those living or owning property in the Ranches subdivision. Thus, I believe that revenue would not be considered Unrelated Business Revenue (UBI) and would not be subject to the UBI Tax.
- Furthermore, if we limit the ads to business name, logo, and a value-neutral description of their products, the ads may qualify as tax-free “qualified sponsorship payments.” Thus, this may also provide an exemption from the UBI tax.
- However, if I am wrong about that:
    - We would not have to pay any tax until the gross revenue hit $1,000 in a given year.
    - We may be able to deduct the cost of operating the website from the UBI amount.
    - The tax rate (federal and state combined) on the net UBI amount would be just over 25%. That still leaves us with at least 75% of that revenue, which seems worthwhile.
- My concern would be that the revenue could become substantial compared to our other revenue, which, at this point, is solely membership dues. We could help counter that by increasing our membership (new members and returning members) and/or by increasing membership dues.
- My other concern is that, if we were to offer “sponsorship” discounts to SCRO members, we may be violating the IRS laws concerning the inurement of private individuals/entities. Thus, it would be best if everyone paid the same rates.
- I think we need to seek professional advice on this, either from a CPA or an attorney

Three proposed options:
1. Do not allow businesses to advertise on the website until we consult with a professional.
2. Allow businesses to advertise on (or sponsor) the website but do not charge a fee (or an incredibly small fee) until we consult with a professional.
3. Allow businesses to advertise/sponsor for a reasonable fee and deal with the tax and classification concerns when we file our tax returns.