

Unrelated Business Income Taxation of Charitable Organizations

– A Legal Research Guide –

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I. Introduction

A. Objective and Scope of this Guide

The federal law of tax-exempt organizations is a wide one and the same is true of the rules that provide for the partial taxation of these organizations. Thus, the guide at hand does not intend to give a comprehensive overview of the law of all different types of tax-exempt organizations but is rather limited to the treatment of charitable organizations.

This guide's objective is first to provide a short overview of the taxation of charitable organizations under the unrelated business income tax (commonly known as UBIT) rules. Second and primarily, it shall provide useful assistance for those who want to go further into this exciting area of law or – as Bruce Hopkins calls it – “the dreadnought of the law of tax-exempt organizations”¹.

B. Legal Background

1. Tax-Exemption of Charitable Organizations

Subchapter F of Chapter 1 of Subtitle A of the Internal Revenue Code² (26 U.S.C. or I.R.C. and “the Code”, respectively) deals with organizations exempt from Federal income tax. To the extent that it is of interest as to the narrow topic of this research guide, I.R.C. § 501 reads as follows:

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation

An organization described in subsection (c) ... shall be exempt from taxation under this subtitle

(c) List of exempt organizations

The following organizations are referred to in subsection (a):

¹ Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, p. 40, for full citation see chapter III.A.2 on page 20.

² The Code's today's status goes back to the Tax Reform Act of 1986 as amended, P.L. 99-514, 100 Stat. 2085, approved 10/20/1986.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (...), or for the prevention of cruelty to children or animals

Usually, the organizations mentioned in I.R.C. § 501(c)(3) are simply referred to as *charitable organizations*.³

2. Partial Taxation of Unrelated Business Income of Charitable Organizations

Charitable organizations are subject to tax, however, if and to the extent that they are generating net income derived from unrelated business activities, i.e. activities that are not substantially related to their tax-exempt charitable purposes. Generally, an activity is taxable as an unrelated one where the activity is

1. a trade or business,
2. the business is regularly carried on,
3. and the conduct of the business is not substantially related to the organization's performance of its exempt function.

The authority for taxation of unrelated business activities lies in I.R.C. § 501(b) which states:

(b) Tax on unrelated business income and certain other activities

An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in part[] ... III ... of this subchapter.

I.R.C. § 501(b) is only the starting-point for taxation of charitable organizations. The true core of the UBIT law are the sections §§ 511 to 515 in Part III of Subchapter F of Chapter 1 of Subtitle A of the I.R.C. to which I.R.C. § 501(b) refers.

³ 26 C.F.R. § 1.513-1(b).

3. Development of the UBIT Law⁴

(a) The Law before the Introduction of the UBIT

Prior to the enactment of the UBIT provisions in 1950, charitable organizations were tax-exempt even if conducting a business as long as its profits were dedicated to their exempt purposes (commonly referred to as “destination of income test”). Relying on this broad tax privilege, in the 1930’s and 1940’s several exempt organizations began engaging in commercial activities, either directly or through separate entities (known as “feeder organizations”).⁵ Other nonprofits engaged in sale-and-lease-back transactions generating tax-free rental income for the organization and capital gain treatment and deductions for the transferor.⁶

When finally *C.F. Mueller Co. v. Commissioner*⁷ was working its way through the courts, Congress debated the first UBIT bill. In *C.F. Mueller v. Commissioner*, the court held that C.F. Mueller Co., then the nation’s largest manufacturer of noodles and macaroni, qualified for tax-exemption because its pasta profits were distributed to its sole shareholder, New York University, for the exclusive benefit of its School of Law. The case prompted Representative John Dingell to warn that unless action was taken “the macaroni monopoly will be in the hands of the university ... and eventually all the noodles produced in this country will be produced by ... universities.”⁸

(b) Rationales for the Introduction of the UBIT rules

The primary objective of the UBIT rules was and still is today to eliminate a source of unfair competition with for-profit businesses by taxing income from business activities of tax-exempt organizations in the same way as income generated by nonexempt businesses with which they compete.⁹ However, “while the equalization of competition between taxable and tax-exempt entities was a major goal of the unrelated income tax, it was by no means the statute’s sole

⁴ The Internal Revenue Service (IRS) offers a short history of the development of the UBIT law under chapter 7.27.4.1.2 of its Exempt Organizations Tax Manual. It is available online under <http://www.irs.gov/irm/part7/ch12s02.html> [last access on October 9, 2004]. Useful hints can also be found in Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, pp. 39 ff.

⁵ J. Fishman/S. Schwarz, *Taxation of Nonprofit Organizations*, p. 565 f., for full citation see chapter III.A.2 on page 20.

⁶ J. Fishman/S. Schwarz, *Taxation of Nonprofit Organizations*, pp. 566 and 643 f.

⁷ *C.F. Mueller Co. v. Commissioner*, 190 F.2d 120 (3rd Cir. 1951).

⁸ Hearings before the House Committee on Ways and Means, 81st Congress, 2d Session 579-80 (1950).

⁹ H.R. No. 2319, 81st Congress, 2d Session. 36-37 (1950); S.R. No. 2375, 81st Congress, 2d Session 28-29 (1950); S.R. No. 94-938, 94th Congress, 2d Session 601 (1976).

objective”¹⁰. Other and maybe even larger goals were to produce revenues to finance the Korean War and, more generally, to achieve equity in the tax system.¹¹

(c) The First UBIT Rules

The earliest UBIT provisions enacted by the Revenue Act of 1950¹² imposed a tax on the unrelated business income of most – but not all – tax-exempt organizations. Churches, for example, were not subject to the new tax.

In general, any kind of passive income was excluded from UBIT. The principle underlying this statutory scheme was that the business endeavors must be active ones for competition between for-profit (taxable) organizations and tax-exempt organizations to result.¹³ As long as tax-exempt organizations acquire income as a result of mere passive activities which do not result in serious competition for taxable businesses, there is no reason for taxation of otherwise tax-exempt entities. However, as to sale-and-lease-back transactions of tax-exempt organizations, Congress responded and imposed the UBIT on rentals from specific leases of property financed with borrowed funds.

Congress also revoked the privileged tax status of feeder organizations.

(d) Amendments

The Tax Reform Act of 1969 finally extended the UBIT to churches as well as other organizations previously excluded from the UBIT under the Act of 1950. Astonishingly, it was the National Council of Churches and the United States Catholic Conference themselves that urged Congress to eliminate the UBIT church exemption.¹⁴

To prevent charitable organizations from circumventing the early unrelated debt-financed income rules by more and more sophisticated transactions¹⁵, Congress now included in unrelated business taxable income *any* passive investment income where it was generated from property financed with borrowed funds.

¹⁰ *American Medical Ass’n v. United States*, 887 F.2d 760, 772 (7th Cir. 1989).

¹¹ *Louisiana Credit Union League v. United States*, 693 F.2d 525, 540 (5th Cir. 1982); see also President Truman’s message to Congress, 96 Cong. Rec. 769, 771 (1950).

¹² Revenue Act of 1950, 81 Cong. Ch. 994, P.L. 81-814, 64 Stat. 906, approved 09/23/1950.

¹³ Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, p. 830.

¹⁴ J. Fishman/S. Schwarz, *Taxation of Nonprofit Organizations*, p. 567.

¹⁵ For a brief description of these typical transactions see Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, p. 877 f.

The 1969 legislation left untouched, however, any business activities that were substantially related to the organization's exempt purpose, even if they were in direct competition with a for-profit taxpayer.

Several amendments have been enacted in the subsequent years after 1969. Minor post 1969 changes in the law of UBIT have generally been based on successful lobbyist activities of particular tax-exempt sub-sectors. The last amendment which resulted in major changes in content occurred in 1997. The Taxpayer Relief Act of 1997 significantly changed and tightened the law regarding the unrelated business income received from controlled organizations after Congress had realized that the pre 1998-law had been written too narrowly and so could easily be circumvented.

C. General Research Strategies

An intensive look at the proper provisions of the *Internal Revenue Code* provides a first overview of what the UBIT provisions are about. However, the reader will soon realize that without annotations, the language of the Code with its various and very specific provisions does not become clear, at least for the most part. So, besides studying the Code, first of all, *general secondary sources* should be consulted to get a broader overview of the applicable law (see infra chapter III.A on page 20). Not until the main features are clear, one should rely on *secondary literature* dealing with more *specific* parts of the unrelated business income tax rules (see infra chapter III.B on page 21 **Fehler! Verweisquelle konnte nicht gefunden werden.**).

Those who have gained a basic understanding of the applicable law, should go deeper into the complicated world of the I.R.C.. And indeed, the Code is the main source of legal research as the UBIT law is – like the entire U.S. tax law area – dominated by statutes rather than cases. Numerous Treasury Department *regulations*, Internal Revenue Service *revenue rulings*, *revenue procedures*, *private letter rulings* and other publications accompany the Code and support the reader with a lot of helpful information how to interpret the language of the respective code sections (see infra chapter II.D on page 16 and chapter II.E on page 18).

This guide's intent is to rely mainly on internet research in order to provide everybody with remote research possibilities without need to rely on preference libraries in the U.S.. However, a mere online research does not work for all those who need basic instructions by secondary literature available only in libraries on the spot.

II. Primary Sources

As mentioned above, primary sources are the most dominant research sources in the tax law field. The same is true with regard to the UBIT rules.

A. Statutes

The relevant provisions as to the UBIT law are I.R.C. §§ 511 – 515, 26 U.S.C.A. §§ 511 – 515 dealing with the “taxation of business income of certain exempt organizations”.

1. Research Sources

Up-to-date provisions are, among others, available online over *Westlaw’s U.S.C.A.* or *LexisNexis’ U.S.C.S.* An excellent, reliable, and free online source of the U.S.C. can be found on the websites of the *Legal Information Institute (LII) of Cornell Law School* (<http://www4.law.cornell.edu/uscode/>). Unfortunately, it does not provide a hierarchical table of contents, though. Besides, as this area of law is under permanent pressure of legislative change, it is not recommended to rely on the U.S.C. without checking for recent updates with the help of the U.S.C. Classification Tables (for instructions how to do this online click on the “Updates” button next to the section of the Code found on the sites of LII).

2. The UBIT Provisions of the I.R.C.

In a nutshell and as far as charitable organizations are concerned, today’s UBIT provisions are as follows:

(a) I.R.C § 511. Imposition of Tax on Unrelated Business Income of Charitable ... Organizations

Under I.R.C. § 511 charitable organizations are subject to tax at the corporate rate on their income that is unrelated to their exempt purpose. Charitable trusts are taxed at the individual rate.

(b) I.R.C. § 512. Unrelated Business Taxable Income

I.R.C. § 512(a) defines the term “unrelated business taxable income” as the gross income an exempt organization receives from regularly carrying on a trade or business unrelated to its exempt purpose minus any deductions for expenses that relate directly to the conduct of the trade or business.

Subsection (b) of I.R.C. § 512 contains numerous modifications with which the unrelated business taxable income must be computed. Above all, subsection (b) excludes from unrelated business taxable income most forms of passive income such as dividends, interest, payments with respect to securities loans, royalties, rents, etc. See I.R.C. § 512(b)(1), (2), and (3). Exclusions are also provided for income from research activities (I.R.C. § 512(b)(7), (8), and (9)). Deductions directly connected with all these classes of income are disallowed.

Passive income is included, however, if a charitable organization receives payments from another organization under its control to the extent the payment reduces the net unrelated income of the controlled entity. See I.R.C. § 512(b)(13). Irrespective of its characterization as passive income, income from so called debt-financed property as defined in I.R.C. § 514 must be included, too. See I.R.C. § 512(b)(4).

Subsections (c) and (e) of I.R.C. § 512 finally provide special rules for tax-exempt organizations which carry on a trade or business through a partnership interest and hold stock in an S corporation, respectively.

(c) I.R.C. § 513. Unrelated Trade or Business

According to I.R.C. § 513(a), the term “unrelated trade or business” means a trade or business not substantially related to the organization’s exempt purpose. The need of the organization for the revenue derived from a business or the use it makes of the profits derived from it cannot be used as a basis for demonstrating relatedness.

I.R.C. § 513(c) places particular emphasis on the fact that the term “trade or business” also includes advertising and other activities carried on for the production of income. These activities are treated as a trade or business even where they are carried on within a larger aggregate of similar activities that are related to the organization’s exempt purpose (e.g., the sale of advertisement in periodicals distributed by the organization as an unrelated trade or business even though the distribution is related to the organization’s exempt functions). When an activity carried on for profit constitutes an unrelated trade or business, it does not matter if it actually does not make any profit.

The term “unrelated trade or business” does not include, however, any trade or business in which substantially all the work is performed by volunteers; which is carried on primarily for the convenience of the organization’s members, employees, patients, or other individuals; or which is the selling of merchandise that the organization has received as gifts or contributions. See I.R.C. § 513(a)(1), (2), and (3).

I.R.C. §513(d) and the following subsections finally deal with various exceptions from the term “unrelated trade or business”. Subject to these exceptions are, for example, the conduct of entertainment at fairs and expositions; trade show activities; certain bingo games; the distribution of low-cost articles that are incidental to the solicitation of charitable contributions; or qualified sponsorship payments.

(d) I.R.C. § 514. Unrelated debt-financed Income

A certain percentage of the income generated from debt-financed property is taxable as unrelated business income. I.R.C. §§ 512(b)(4), 514(a)(1). I.R.C. § 514(b) defines the term “debt-financed property” as property held to produce income with respect to which there is an acquisition indebtedness (see I.R.C. §514(c)) during the taxable year. Among other things, the term does not include property used primarily to fulfill an organization’s exempt purposes. I.R.C. §514(b)(1)(A).

Correspondingly, a certain percentage of the deductions directly connected with the debt-financed income or property can be offset against gross income. See I.R.C. §§ 512(b)(4), 514(a)(2).

(e) I.R.C. § 515. Taxes of Foreign Countries and Possessions of the United States

According to I.R.C. § 515, organizations subject to the UBIT are entitled to a credit for taxes imposed by a foreign country or a U.S. possession.

(f) Amendments as to I.R.C. §§ 511 – 515

Except for I.R.C. § 515 which essentially has been unchanged since its enactment as § 424 by the Revenue Act of 1950, the UBIT provisions have been amended by the following Acts (found on Westlaw, under “Amendments” following the respective provision¹⁶):

(1) I.R.C. § 511

- P.L. 100-647, 102 Stat. 3342, approved 11/10/1988.
- P.L. 97-248, 96 Stat. 324, approved 09/3/1982.
- P.L. 95-600, 92 Stat. 2763, approved 11/6/1978.

¹⁶ The list on Westlaw does not cover amendments before 1958, though. So, above all the first enactment of the UBIT law by the Revenue Act of 1950 (see FN 12) and the enactment of the Internal Revenue Code of 1954, 83 Cong. Ch. 736, 68A Stat. 3, approved 08/16/1954 are missing.

- P.L. 95-30, 91 Stat. 126, approved 05/23/1977.
- P.L. 91-172, 83 Stat. 487, approved 12/30/1969.
- P.L. 89-352, 80 Stat. 4, approved 02/02/1966.
- P.L. 86-667, 74 Stat. 534, approved 07/14/1960.

(2) *I.R.C. § 512*

- P.L. 105-206, 112 Stat. 685, approved 07/22/1998.
- P.L. 105-34, 111 Stat. 788, approved 08/05/1997.
- P.L. 104-188, 110 Stat. 1755, approved 08/20/1996.
- P.L. 103-66, 107 Stat. 312, approved 08/10/1993.
- P.L. 101-508, 104 Stat. 1388, approved 11/05/1990.
- P.L. 100-647, 102 Stat. 3342, approved 11/10/1988.
- P.L. 100-203, 101 Stat. 1330, approved 12/22/1987.
- P.L. 99-514, 100 Stat. 2085, approved 10/22/1986.
- P.L. 98-369, 98 Stat. 494, approved 07/18/1984.
- P.L. 97-448, 96 Stat. 2365, approved 01/12/1983.
- P.L. 95-345, 92 Stat. 481, approved 08/15/1978.
- P.L. 94-568, 90 Stat. 2697, approved 10/20/1976.
- P.L. 92-418, 86 Stat. 656, approved 08/29/1972.
- P.L. 91-172, 83 Stat. 487, approved 12/30/1969.
- P.L. 89-809, 80 Stat. 1539, approved 11/13/1966.
- P.L. 88-380, 78 Stat. 333, approved 07/17/1964.
- P.L. 85-367, 72 Stat. 80, approved 04/07/1958.

(3) *I.R.C. § 513*

- P.L. 105-34, 111 Stat. 788, approved 08/05/1997.
- P.L. 103-66, 107 Stat. 312, approved 08/10/1993.
- P.L. 99-514, 100 Stat. 2085, approved 10/22/1986.
- P.L. 96-605, 94 Stat. 3521, approved 12/28/1980.
- P.L. 95-502, 92 Stat. 1693, approved 10/21/1978.
- P.L. 94-455, 90 Stat. 1520, approved 10/04/1976.
- P.L. 91-172, 83 Stat. 487, approved 12/30/1969.

- P.L. 86-667, 74 Stat. 534, approved 07/14/1960.

(4) *I.R.C. § 514*

- P.L. 103-66, 107 Stat. 312, approved 08/10/1993.
- P.L. 101-239, 103 Stat. 2106, approved 12/19/1989.
- P.L. 100-647, 102 Stat. 3342, approved 11/10/1988.
- P.L. 100-203, 101 Stat. 1330, approved 12/22/1987.
- P.L. 99-514, 100 Stat. 2085, approved 10/22/1986.
- P.L. 98-369, 98 Stat. 494, approved 07/18/1984.
- P.L. 96-605, 94 Stat. 3521, approved 12/28/1980.
- P.L. 95-345, 92 Stat. 481, approved 08/15/1978.
- P.L. 94-455, 90 Stat. 1520, approved 10/04/1976.
- P.L. 93-625, 88 Stat. 2108, approved 01/03/1975.
- P.L. 91-172, 83 Stat. 487, approved 12/30/1969.
- P.L. 86-667, 74 Stat. 534, approved 07/14/1960.

B. Legislative History

1. Research Sources

To find out the legislative intent behind the acts enacting or amending the UBIT rules, the *U.S. Code Congressional and Administrative News (U.S.C.C.A.N.)* and *LexisNexis' Congressional Information Service (CIS)* are the favorite research sources. The full-text CIS databases are offered online and for free by the San Francisco Public Library website (<http://www.sfpl.org> > Articals and Databases > Government/LexisNexis Congressional).¹⁷ The CIS' online index goes back to 1970, its online historical index even to 1789. The U.S.C.C.A.N. database is available on Westlaw (database USCCAN and USCCAN-REP for a direct search for legislative history reports by Public Law numbers, respectively).

The governmental Thomas website (<http://Thomas.loc.gov>) also can be very useful. Unlike the San Francisco Public Library's website, there is no registration required and it is free, too.

¹⁷ One has to apply for a free library card at first, though. See <http://sfpl.lib.ca.us/services/librarycard.htm> [last access on October 9, 2004].

However, it is not as sophisticated and comprehensive as CIS and goes back to P.L. No. 93 only.¹⁸

2. Legislative History for P.L. 105-34

Researching CIS online and U.S.C.C.A.N. for the 1997's P.L. 105-34¹⁹, for example, results in the following references:

(a) CIS Online

- P.L. 105-34, 111 Stat. 788, CIS-No: 97-PL105-34, approved 08/05/1997 (Taxpayer Relief Act of 1997).
- House Bill belonging to P.L. 105-34: 105 H.R. 2014.
- House Bill Tracking Report: 105 Bill Tracking H.R. 2014 providing – among other things – a comprehensive legislative chronology.
- The CIS Legislative History Document 105 CIS Legis. Hist. P.L. 34 essentially lists:
 - a summary of the Act,
 - all the relevant debates of Congress in full-text,
 - the House and Senate Reports in full-text. Reports directly related to 105 H.R. 2014 and 105 S. 949, respectively, are as follows:
 - S. Rpt. 105-33, June 20, 1997, CIS NO: 97-S363-2
 - H. Rpt. 105-148, 06/24/1997, CIS NO: 97-H263-3
 - H. Conf. Rpt. 105-220, 07/30/1997, CIS NO: 97-H263-6,
 - other related reports in full-text,
 - all relevant hearings in full-text,
 - full-text committee prints, and miscellaneous documents and publications.

(b) U.S.C.C.A.N.

Unlike the book edition²⁰, Westlaw's USCCAN-REP database provides all the three reports mentioned above in full-text. The reports are also listed under the headline "Historical and Statutory Notes" following the respective Code section.

¹⁸ It can be useful to start with Thomas if researching is made by Public Law number and if the number is between 93 and 99 because CIS' online research function requires a Public Law number of 100 and higher.

¹⁹ See supra chapter II.A.2(f)(2) and II.A.2(f)(3) on page 9.

²⁰ See 1997 U.S.C.C.A.N. 678. The Senate Report is cited but the full-text is missing.

Besides the general USCCAN database and the reporter database USCCAN-REP, there are further specific USCCAN databases providing comprehensive legal history information:²¹

- USCCAN-EO: Executive Orders (coverage begins with 1936).
- USCCAN-TABLE: Legislative History Table (coverage begins not until the 106th Congress, though).
- USCCAN-MEMBER: Members of the Executive and Legislative Branches (same coverage as USCCAN-TABLE).
- USCCAN-MSG: Presidential Messages and Signing Statements (coverage begins with 1986).
- USCCAN-PROC: Presidential Proclamations (coverage begins with 1984).
- USCCAN-PL: Public Laws (coverage begins with 1973).
- USCCAN-SESS: Session Highlights (same coverage as USCCAN-TABLE).

C. Cases

1. Research Sources

There are hundreds of cases dealing with the UBIT law. The best starting-point to get familiar with the UBIT rules from the courts' perspective, is to read the selection of cases provided by Fishman/Schwarz's casebook:

- James J. Fishman/Stephen Schwarz, *Taxation of Nonprofit Organizations – Cases and Materials*, New York 2003, ISBN 1-58778-595-1, pp. 562 ff.

Further research directed to more specific contents is available over Westlaw's "Notes of Decisions" link (on the left hand side of the respective Code section) providing a good index. If one has found an interesting case, it can be shepardized of course either by using Westlaw's KeySearch function or LexisNexis' Shepard's function.

²¹ Within the limitations of this research guide, the research results by using the mentioned databases are not listed here.

2. A Small Selection of Important Cases

(a) Cases Dealing with the History of the UBIT

(1) 'Destination of Income Test' before the UBIT was Introduced

- *Trinidad v. Sagrada Orden*, 263 U.S. 578 (1924), 44 S.Ct. 204, 68 L.Ed. 458.

The Court ruled that the charitable organization qualified for tax exemption, holding that the earliest predecessor of I.R.C. § 501(c)(3) permitted exempt organizations to have net income and said “nothing about the source of the income, but makes the destination the ultimate test of exemption.”²² In discussing the organization’s income from the sale of wines and chocolates, the court observed that all goods sold by Sagrada Orden were either for religious use or incidental to the charity’s missionary activities.

- *Roche’s Beach v. Commissioner*, 96 F.2d 776 (2nd Cir. 1938).

The Court upheld the exempt status of a corporation operating a large bathing beach business. The organization’s revenues all were paid over to a charitable foundation. The court held that a corporation engaged exclusively in commercial activities qualified for tax-exempt status so long as all of its net profits were turned over to a legitimate charitable organizations.

Judge Learned Hand dissented. He believed that a “business subsidiary”²³ should not be exempt, without regard to where its income was destined.

- *C.F. Mueller Co. v. Commissioner*, 190 F.2d 120 (3rd Cir. 1951).

See the discussion in the text accompanying FN 7.

(2) Rationales for the Introduction of the UBIT

- *American Medical Ass’n v. United States*, 887 F.2d 760 (7th Cir. 1989).

See the discussion in the text accompanying FN 10.

- *Louisiana Credit Union League v. United States*, 693 F.2d 525 (5th Cir. 1982).

See the discussion in the text accompanying FN 11.

(3) Rationales for Tightening the Debt-Financed Income Rules in 1969

- *Commissioner v. Brown*, 380 U.S. 563 (1965), 85 S.Ct. 1162, 14 L.Ed.2d 75.

²² *Trinidad v. Sagrada Orden*, 263 U.S. 578, 581 (1924); 44 S.Ct. 204, 205; 68 L.Ed. 458, 460.

²³ *Roche’s Beach v. Commissioner*, 96 F.2d 776, 779 (2nd Cir. 1938).

In this case the Supreme Court endorsed a new form of abusive debt-financed acquisition by tax-exempt organizations that resulted in preferable tax treatment to all involved parties.

The Court held that where all of the corporation's stock, which had substantially appreciated in value, was transferred to a tax-exempt institute for price which was payable to taxpayers, stockholders, from earnings of company and the institute simultaneously with transfer liquidated company and leased assets for five years to a new corporation which was to pay to the institute 80% of its operating profits with 90% thereof to be paid over to taxpayers, transfer was a sale, and taxpayers were entitled to capital gains treatment on proceeds which were not taxable as ordinary income on basis that there had been no risk-shifting to institute.

- *University Hill Foundation v. Commissioner*, 51 T.C. 548 (1969), rev'd, 446 F.2d 701 (10th Cir. 1971), cert. den., 405 U.S. 965 (1972), 92 S.Ct. 1172, 31 L.Ed.2d 240.

The case dealt with a nonprofit corporation which purchased 24 going businesses between 1945 and 1954 and leased the assets to newly formed operating companies in which the former owners acquired minority interests. The court held that the organization was not a "feeder organization" as defined in I.R.C. § 502 and that the rent which the organization received from its lessees was not unrelated business taxable income as defined in I.R.C. § 512.

- *Anderson Dairy, Inc. v. Commissioner*, 39 T.C. 1027 (1963); *Shiffman v. Commissioner*, 32 T.C. 1073 (1959); and *Ohio Furnace Co., Inc. v. Commissioner*, 25 T.C. 179 (1955).

Similar to *University Hill Foundation v. Commissioner*, these cases dealt with abusive debt-financed transactions in which tax-exempt organizations were using their tax privileges to purchase businesses on credit, while contributing little themselves to the transaction other than their tax exemption. The courts upheld these transactions as bona fide sales of capital assets.

(b) Today's Law

(1) The Nature of an Unrelated Trade or Business

- *United States v. American College of Physicians*, 475 U.S. 834 (1986), 106 S.Ct. 1591, 89 L.Ed.2d 841.

The United States Supreme Court held that there is no per se rule requiring taxation of income from all commercial advertisements of all tax-exempt journals without a specific analysis of the circumstances. Commercial advertisements in medical organization's journal, however, were not substantially related to the journal's educational purposes, and thus were taxable.

- *Hi-Plains Hospital v. United States*, 670 F.2d 528 (5th Cir. 1982).

The Court of Appeals held that pharmaceutical sales by a hospital pharmacy to nonhospital private patients of doctors located in the hospital were not subject to tax as being income generated by an unrelated trade or business, where such sales contributed importantly to attracting and holding doctors in a community which had lacked any medical services for eight years before the hospital was established, which was essential to tax-exempt purpose of providing the hospital, and where there was no indication that sales were conducted on a larger scale than reasonably necessary. However, the court held the finding not erroneous that the sale of drugs to the general public was not itself an exempt activity.

- *National Collegiate Athletic Ass'n v. Commissioner*, 914 F.2d 1417 (10th Cir. 1990).

The Court of Appeals held that the involvement of the National Collegiate Athletic Association (NCAA) in the sale of advertisements placed in the program for the games of the Men's Division I Basketball Championship was not a regularly carried on business so as to make the revenue therefrom taxable as unrelated business income.

(2) Exclusions from Unrelated Business Taxable Income

- *Sierra Club, Inc. v. Commissioner*, 86 F.3d 1526 (9th Cir. 1996).

A tax-exempt organization challenged the determination that income from rental of mailing lists and from participation in affinity credit card program constituted unrelated business taxable income. The Court of Appeals held that (1) "royalties" excluded from unrelated business taxable income were defined as payments received for the right to use intangible property rights, and such definition did not include payments for services; and (2) payments received by tax-exempt organization for one-time rentals of its mailing lists were "royalties".

(3) Computation and Planning Issues

- *Rensselaer Polytechnic Institute v. Commissioner*, 732 F.2d 1058 (2nd Cir. 1984).

The court held that taxpayer's method of allocating fixed costs of college field house which was used for both tax exempt purposes and for production of unrelated business income, whereby costs were allocated between the two types of activities on basis of relative times of actual use was "reasonable" within meaning of regulation providing that such expenses attributable to such dual use facilities shall be allocated between the two uses on a reasonable basis.

(4) *Unrelated Debt-Financed Income*

- *Bartels Trust v. United States*, 209 F.3d 147 (2nd Cir. 2000), cert. denied, 531 U.S. 978 (2000), 121 S.Ct. 426, 148 L.Ed.2d 435.

A tax-exempt trust brought action seeking refund of unrelated business income tax paid on income derived from margin-financed securities. The Court of Appeals held that (1) income derived from margin-financed securities is to be treated as income derived from an unrelated trade or business; (2) government need not show unfair competition to impose UBIT; (3) income from debt-financed property that was subject to UBIT was not limited to periodic income; and (4) income was not excepted from UBIT as substantially related to trust's exempt purpose.

(5) *Partnerships and S-Corporations*

- *Service Bolt & Nut Co. v. Commissioner*, 78 T.C. 812 (1982).

Two tax-exempt trusts held limited partnership interests in several partnerships engaging in the wholesale fastener distribution business. *The court held that they realized unrelated business taxable income from their distributive shares of income from such partnerships.*

D. Regulations

1. Research Sources

If, as usually, the proper citation of useful Treasury Regulations is not available, the relevant regulations in full-text can be found on Westlaw over the CFR database by using the "Table of Contents" function, choosing the proper path (Title 26, Chapter I, Subchapter A, Part 1, "Normal Taxes and Surtaxes", "Exempt Organizations", "Taxation of Business Income of Certain Exempt Organizations"), and then choosing the respective C.F.R. section.

A much easier and more comfortable way, however, is to use Westlaw's RIA-USTR database (United States Tax Reporter). Its "Table of Contents" function is structured by I.R.C. sections so that the relevant provisions I.R.C. §§ 511 – 515 can easily be found. Every Code section is accompanied by a submenu providing the relevant Treasury Regulations. A similar alternative is offered by CCH's Standard Federal Income Tax Reporter (available online under <http://www.ggu.edu/lawlibrary> > "Online Legal Databases" > "CCH Internet Tax Research Network (OmniTax)").

A free access to the current C.F.R. is offered by <http://www.gpoaccess.gov/cfr/index.html> [last access on October 10, 2004] (click on "Browse and/or search the CFR" to choose Title 26 of the C.F.R.). For updating the C.F.R., the Federal Register should be used. It is online at <http://www.gpoaccess.gov/fr/index.html> [last access on October 10, 2004]. A quite new service, called "e-CFR", provides the C.F.R. on a currently updated version. It can be found at <http://www.gpoaccess.gov/ecfr/index.html> [last access on October 10, 2004].²⁴

2. The Relevant Regulations for I.R.C. §§ 511 to 515

- As to I.R.C. § 511:
26 C.F.R. §§ 1.511-1 to 4 (final regulations).
- As to I.R.C. § 512:
26 C.F.R. §§ 1.512(a)-1, 1.512(a)-2, 1.512(a)-4, 1.512(b)-1, 1.512(c)-1 (final regulations), and 26 C.F.R. §§ 1.512(a)-5T (temporary regulations).
- As to I.R.C. § 513:
26 C.F.R. §§ 1.513-1 to 7 (final regulations).
- As to I.R.C. § 514:
26 C.F.R. §§ 1.514(a)-1 and 2, (b)-1, (c)-1 and 2, (d)-1, (e)-1, (f)-1, and (g)-1 (final regulations).
- As to I.R.C. § 515:
So far, there are no regulations published as to I.R.C. § 515.

²⁴ The e-CFR project is a demonstration project still in its beta phase, though.

E. Administrative Documents

1. Research Sources

Bruce R. Hopkins' "The Law of Tax-Exempt Organizations" accompanied by its 2004 supplement lists numerous administrative documents ruling on the UBIT in its footnotes.²⁵ It is an easy way to find administrative documents properly related to specific subjects of the UBIT law.

- Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, 8th Edition 2003, ISBN 0-471-26820-8; 2004 Supplement, ISBN 0-471-46465-1.

On Westlaw a huge number of IRS documents related to the relevant UBIT provisions can be found (see the link "Agency Opinions and Decisions" on the left hand side of the chosen section). On LexisNexis, the research can be performed by using the database "IRS Bulletins, Letter Rulings, and Memoranda Decision". The IRS' "Exempt Organizations Continuing Professional Education (CPE) Technical Instruction Program[s]" from 1999 until today which provide important insight on the IRS' strategy on current issues, are available over Westlaw's FTX-EOTIP database. The 2002 volume includes a chapter on the UBIT provisions.

CCH's Tax Research Network/OmniTax also provides comprehensive databases of administrative documents. Chapter 27 of Part 7 of the Internal Revenue Manual (IRM), for example, contains the Exempt Organizations Tax Manual with several sections dealing explicitly with the UBIT rules. The database "IRS Publications" contains all the IRS publications which generally are a good starting-point to get a broad overview of how the IRS is going to interpret and apply the UBIT provisions.

Revenue Rulings back to 1954 are available at <http://www.taxlinks.com/rulings/findinglist/revrulmaster.htm> [last access on October 18, 2004]. A comprehensive stock of free documents is available also directly on the IRS website at <http://www.irs.gov>.²⁶

²⁵ Bruce R. Hopkins, *The Law of Tax-Exempt Organizations*, chapters 26 to 29.

²⁶ The Internal Revenue Manual (IRM), for example, can be found under: <http://www.irs.gov/irm/part7/index.html>; the IRS Publication 598 under: <http://www.irs.gov/pub/irs-pdf/p598.pdf> [last access on October 10, 2004].

2. Exemplary List of useful Administrative Documents

There are presumably thousands of IRS documents dealing with questions of the UBIT law. So, only an exemplary list can be provided here.

For determination, for example, whether an activity by tax-exempt organizations is an *unrelated* business, the following administrative documents may be useful:

- IRS Publication 598: “Tax on Unrelated Business Income of Exempt Organizations”.
- “Unrelated Business Income Tax – General Rules”, online IRS document at <http://www.irs.gov/charities/article/0,,id=96104,00.html> [last access on October 18, 2004].
- “Unrelated Business Income Tax – Special Rules”, online IRS document at <http://www.irs.gov/charities/article/0,,id=96106,00.html> [last access on October 18, 2004].
- Rev. Rul. 78-385, 1978-2 C.B. 174 (presentation of commercial programs and the sale of air time).
- Rev. Rul. 79-361, 1979-2 C.B. 237 (operation of a miniature golf course in a commercial manner).
- Rev. Rul. 68-46, 1968-1 C.B. 260 (operation of dining facilities for the general public).
- Rev. Rul. 73-587, 1973-2 C.B. 192 (provision of pet boarding services, for pets owned by the general public).
- Rev. Rul. 76-296, 1976-2 C.B. 141 (carrying on of commercially sponsored research).
- PLR 7839042 (publication of academic works).
- PLR 8303001 (provision of veterinary services for a fee).
- PLR 8433010 (distribution of business directories to new residents in a community).
- TAM 8226019 (operation of a commuting program by a labor union for its members).
- TAM 8437014 (sale of work uniforms by a union).
- TAM 8446004 (operation of a central payroll and records system).
- TAM 200047049 (use by the public of a golf course).
- Internal Revenue Manual (IRM), Section 5.4 ff. of Chapter 27 of Part 7.

III. Secondary Sources

A. General Secondary Sources

There are some secondary sources dealing with the law of tax-exempt organizations which also cover the UBIT law. This literature which approaches the UBIT rules in a very general matter is useful when beginning a research of the still unfamiliar subject. On the other side, these sources generally give many references to literature on more specific parts of the UBIT law for continuing research.

For general research on Westlaw it is recommended not to follow the link “Treatises and Forms” on the left hand side of each I.R.C. section because, basically, the results presented are too specific. The researcher should rather look for relevant treatises by using Westlaw’s databases (e.g., type “tax-exempt organizations” in the “search these databases” field). However, Westlaw and LexisNexis as well as the local preference libraries provide only a limited number of useful treatises on the UBIT subject. So, a search of the huge online catalog of the Library of Congress²⁷ at <http://catalog.loc.gov/> may be advisable.

1. “In a Nutshell”-Books/Dictionaries

- CCH’s 2003 U.S. Master Tax Guide, ISBN 0-8080-0850-1, pp. 655 ff. (the newest edition is also available online on CCH’s Tax Research Network/OmniTax).
- Robert Sellers Smith, West’s Tax Law Dictionary, 2004 Edition, ISBN 0-314-11335-5, pp. 989 f. (topic “Unrelated Business Income Tax” and “Unrelated Business Taxable Income”). Also online available over Westlaw’s database “DITAXWTDB”).
- Westlaw’s online “Black’s Law Dictionary”, 8th Edition 2004 (database “BLACKS”; use the “terms and connectors” search and type in “Unrelated Business Income Tax”).

2. Books and Treatises

- Bruce R. Hopkins, The Law of Tax-Exempt Organizations, 8th Edition 2003, ISBN 0-471-26820-8; 2004 Supplement, ISBN 0-471-46465-1, Chapter 26 to 29.

²⁷ The Library of Congress is said to be the largest library in the world. See <http://www.loc.gov/about/> [last access on October 17, 2004].

- James J. Fishman/Stephen Schwarz, *Taxation of Nonprofit Organizations*, 2003, ISBN 1-58778-595-1, Chapter 5.
- Jody Blazek, *Tax Planning and Compliance for Tax-Exempt Organizations*, 4th Edition 2004, ISBN 1-732-302-2300, Chapter 21.
- Hill/Mancino, *Taxation of Exempt Organizations*, Part E (online available over Westlaw's database WGL-TEO).

B. Specific Secondary Sources

The following secondary sources are generally, however not always, dealing with more specific parts of the UBIT law.

1. Legal Encyclopedias

Westlaw and LexisNexis offer references to several legal encyclopedias following the relevant Code sections. Exemplary, only a shortened selection of those related to I.R.C. § 511 is listed in what follows:

(a) American Jurisprudence (Am. Jur.)

- Am. Jur. 2d, *Federal Taxation* (2004) § 5914: *Estimated Taxes of Tax-Exempt Organizations and Private Foundations*.
- Am. Jur. 2d, *Federal Taxation* (2004) § 20643: *Unrelated Business Income Tax*.
- Am. Jur. 2d, *Federal Taxation* (2004) § 20645: *Feeder Organizations Carrying on a Trade or Business*.
- Am. Jur. 2d, *Federal Taxation* (2004) § 20876: *Imposition of Unrelated Business Income Tax (UBIT)*.
- Am. Jur. 2d, *Federal Taxation* (2004) § 20877: *Tax Rates and Credits for Unrelated Business Income*.
- Am. Jur. 2d, *Federal Taxation* (2004) § 20879: *Computing Unrelated Business Taxable Income (UBTI)*.

(b) Corpus Juris Secundum (CJS)

- 47A C.J.S. *Internal Revenue* § 473: *Taxation of Business Income of Certain Exempt Organizations*.

(c) American Law Reports (A.L.R.)

- 70 A.L.R. Fed. 229: When Will Income Received by Organization Exempt from Federal Income Tax Under § 501 of Internal Revenue Code of 1954 (26 U.S.C.A. § 501) be Deemed Income from Unrelated Trade or Business Taxable Under §§ 511-13.

2. Annotations / Explanations

Annotations and explanations to the respective UBIT Code sections can be found either in CCH's Standard Federal Income Tax Reporter (online on CCH's Internet Tax Research Network/OmniTax) or in Westlaw's RIA United States Tax Reporter (online database RIA- USTR).²⁸

3. Law Review Articles and other Periodicals

(a) Westlaw / LexisNexis

Unless otherwise noted, the following law review articles are provided by Westlaw and LexisNexis with regard to I.R.C. § 511.²⁹

- James R. Walker, *A primer on unrelated business income tax*, 26 Colo. Law. 37 (Feb. 1997).
- Wendy Gerzog Shaller, *Churches and their enviable tax status*, 51 U. Pitt. L. Rev. 345 (1990).
- David Williams, II, *Financing a college education: A taxing dilemma*, 50 Ohio St. L. J. 561 (1989).
- Bazil Facchina, Evan A. Showell and Jan E. Stone, *Privileges & exemptions enjoyed by nonprofit organizations*, 28 U.S.F. L. Rev. 85 (1993).
- Theodore T. Myre, Jr., *Significant tax issues in hospital related joint ventures*, 75 Ky. L. J. 559 (1986-87).
- Mark Larson, *Tax exempt organizations and unrelated debt financed income: Does the problem persist?*, 61 N.D. L. Rev. 31 (1985).
- Donald C. Haley, *Taxation of the unrelated business activities of exempt organizations: Where do we stand? Where do we seem to be headed?*, 7 Akron Tax J. 61 (1990).

²⁸ See supra, chapter II.D.1 on page 16.

²⁹ Westlaw, for example, provides a link to a comprehensive list of law reviews related to specific Code sections on the left hand side of the respective Code section (link "Law Reviews").

- Deirdre Dessingue Halloran, *UBIT Update*, 36 Cath. Law. 39 (1995).
- Richard A. Van Wert, *Retail Sales by Exempt Organizations: When Will They be Subject to the UBT?*, 56 J Taxation 104 (February 1982).
- Donald L. Sharpe, *Unfair Competition and the Tax on Income Destined for Charity: Forty-Six Years Later*, 3 Fla. Tax Rev. 367, 380-383 (1996) [Reference by James J. Fishman/Stephen Schwarz, *Taxation of Nonprofit Organizations*, p. 566 FN 8].
- Stephen Schwarz, *Limiting Religious Tax Exemptions: When Should the Church Render Unto Caesar?*, 29 U. Fla. L. Rev. 50, 94-96 (1976) [Reference by James J. Fishman/Stephen Schwarz, *Taxation of Nonprofit Organizations*, p. 567 FN 12].

(b) Other Databases

Numerous full-text law review articles can also be found on HeinOnline³⁰ (for example, use the “Author/Title Search” and type “unrelated business income tax”). Useful citations for continuous otherwise research can be found on LegalTrac³¹.

4. Newsletters and Practice/Planning Guides

- “The Nonprofit Counsel”, ISSN: 1542-8419, is a monthly newsletter written by Bruce R. Hopkins. It deals with current developments in the nonprofit tax law field. Unfortunately, it is neither available at online databases nor in the GGU law library.³² Another monthly newsletter is Tax Analysts’ “Exempt Organization Tax Review” which is provided by LexisNexis.
- Westlaw offers a Nonprofit GAAP Practice Manual over its database WGL-NPGAAPMAN. Guidance from a planning perspective is given by Jody Blazek, *Tax Planning and Compliance for Tax-Exempt Organizations*,³³ and online by Chapter 15, Part 3 of Matthew Bender’s “Planning Tax-Exempt Organizations” available on LexisNexis.

³⁰ You get access to HeinOnline via the GGU Law Library website: <http://www.ggu.edu/lawlibrary/onlinedbases> [last access on October 11, 2004].

³¹ For information how to get access to LegalTrac, see FN 30.

³² The libraries of U.C. Hastings (<http://hopac.uchastings.edu/search>), University of San Francisco (http://www.usfca.edu/law_library), and Berkeley University of California (<http://lawcat.berkeley.edu>) do not have it either. However, subscription of the newsletter is possible online at <http://www.wiley.com/WileyCDA/WileyTitle/productCd-NPC.html> [last access to all mentioned websites on October 17, 2004].

³³ See supra chapter III.A.2 on page 20.

- The relevant tax return form 990-T can be found on the IRS website at <http://www.irs.gov/pub/irs-pdf/f990t.pdf>. Instructions for form 990-T are available at <http://www.irs.gov/pub/irs-pdf/i990t.pdf>. The latest form 990-T filing developments are online at <http://www.irs.gov/charities/article/0,,id=113424,00.html> [last access to all mentioned websites on October 18, 2004].

IV. Computerized Research

Research in the first three chapters has already been heavily based on online sources like Westlaw and LexisNexis to allow an easy remote research not requiring access to a local preference U.S. library. Besides all the online sources that have been mentioned earlier, there are several other computerized online and offline research sources that can be of great help for research purposes. If access to the GGU law library is available, its online catalog, too, may broaden the research possibilities.

A. Online

1. Lexis and Westlaw

In general, it does not make much difference whether Westlaw or LexisNexis is used for the legal research. For the most part, the choice of either of the two resources is a question of the researcher's personal taste and his or her access to the one or the other service.

Even though Westlaw generally provides more references to legal encyclopedias than LexisNexis does and even though, on the other side, LexisNexis offers the worthwhile Tax Analysts and Matthew Bender publications not provided by Westlaw, the research should finally be successful whatever service is relied on, if it is supported by other sources, e.g. those as follows:

2. Other Internet Sources

In addition to the online databases offered by GGU³⁴ and the sources earlier mentioned throughout the text, there are some other online sources that are available for free.

(a) Findlaw.com / LexisOne.com

Findlaw.com offers, among other things, U.S. Supreme Court decisions back to 1893.³⁵ Upon free registration, www.lexisone.com provides U.S. Supreme Court cases even since 1790.³⁶

³⁴ See <http://www.ggu.edu/lawlibrary/onlinedbases> [last access on October 17, 2004]; Essentially, the relevant databases are (1) CCH Internet Tax Research Network/OmniTax, (2) HeinOnline, (3) LegalTrac, (4) Matthew Bender Authority, and (5) Westlaw and LexisNexis.

³⁵ See <http://www.findlaw.com/casecode/supreme.html> [last access on October 17, 2004].

³⁶ See <http://www.lexisone.com/lx1/caselaw/freecaselaw?action=FCLDisplayCaseSearchForm&l1loc=L1E> [last access on October 17, 2004].

(b) Nonprofitlawcenter.com

The website <http://www.nonprofitlawcenter.com>, hosted and written by Bruce R. Hopkins, provides useful information on the law of tax-exempt organizations, including current developments of the law with references for continuing research.

(c) Google.com etc.

Of course, research can be performed by using [google.com](http://www.google.com) or other search engines. For example, type in the search field “unrelated business income tax” and the result will be numerous references to related – more or less useful – websites.

3. Library Catalogs**(a) Offline Libraries**

GGU library’s GOLDPAC online catalog is available at <http://library.ggu.edu> [last access on October 18, 2004]. Using the “Advanced Keyword Search” and typing “nonprofit organizations” in the “Subject” field from the drop-down menu and “tax” as another keyword should bring some good results. For other libraries in the Bay Area see above, footnote 32 and chapter II.B.1 on page 10. What all these libraries have in common, however, is a relatively small offer of general books and treatises³⁷ related to tax-exempt organizations and the UBIT law, respectively. The much broader stock of materials of the Library of Congress has been mentioned earlier.³⁸

For an international library research with the main but not sole focus on German libraries use <http://www5.digibib.net/> [last access on October 18, 2004] (for English language click on the “English” button on the top right hand side).

(b) Online Library

A library providing access to a comprehensive online collection of books and other documents is Questia at <http://www.questia.com> [last access on October 18, 2004]. Its stock of relevant UBIT books is narrow, though. Besides, a monthly subscription fee may apply for most full-text documents.³⁹

³⁷ See supra chapter III.A.2 on page 20.

³⁸ See supra chapter III.A on page 20.

³⁹ See <http://www.questia.com/RegistrationMediator.qst?action=displayRegistrationForm> [last access on October 18, 2004].

B. Offline

Tax Analysts' CD-Rom "OneDisc"⁴⁰ provides a cheap as well as comprehensive and user-friendly research resource whose contents are very good linked to each other. Every Code section, for example, refers directly to the relevant regulations and annotations. Tax Analysts also offer a research DVD with even more useful content than "OneDisc". It is much more expensive, however.⁴¹

⁴⁰ See <http://www.taxanalysts.com/www/website.nsf/Web/Onedisc?OpenDocument> [last access on October 17, 2004]. Tax Analysts offers a substantial student discount not published on its website (\$19.99 + \$4.95 for shipping and handling; to get the discount, write directly to Jeff_Cottrell@tax.org).

⁴¹ So far, a student offer for the DVD is not available.

V. Other Expert Knowledge

For further information on the UBIT law you may want to contact directly an expert. Bruce R. Hopkins, lawyer with Polsinelli Shalton Welte Suelthaus, PC, in Kansas City, MO and mentioned several times throughout this research guide, is one. You can reach him at:

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Kansas City, Missouri 64112-1805

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E-Mail: bhopkins@pswslaw.com.

For comments or questions with respect to this research guide or the U.S. nonprofit tax law in general please feel also free to contact me:

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