



April 11, 2013

Community Arts Q&A Series

Income-Generating Activities, Part One: Sales of Tickets & Admission Fees to Performances / Events

As part of its Community Arts initiative, Lawyers Alliance is providing a series of Q&As to help community arts organizations better understand how the law applies to them. For additional in-depth information on these topics, please see our publication entitled Advising Nonprofits or check out our ongoing live webinar and workshop series.

* * *

As part of their income-generating activities, community arts organizations often stage performances, art exhibits, or other fundraising galas and special events. What are the legal issues that arise when community arts organizations charge admission fees for performing arts events or art exhibits as part of their regular programming? Do these issues differ when the event is a special, one-time fundraiser such as an annual gala, benefit, or fundraising dinner? Note that the specific facts and circumstances of any income-generating activity conducted by a nonprofit should be reviewed carefully by legal counsel.

This memo addresses the following common questions relating to ticket sales and admission fees:

- Is the cost of a ticket to an event staged by an exempt arts organization as part of its regular programming considered tax deductible?
- Is the cost of a ticket to an event staged by an exempt arts organization as part of its regular programming considered tax deductible if it goes unused?
- Is the cost of a ticket to a special fundraising event considered tax deductible?
- Does a nonprofit arts group need to document the tax deductibility of a ticket for a ticket-holder?
- How does an organization determine the cost of an event for purposes of advising ticket-holders as to tax-deductibility?
- Is my exempt nonprofit community arts group subject to UBIT?
- Is income that is raised through the sale of tickets to my exempt nonprofit's regular performances subject to UBIT?
- Is income that is raised through the sale of tickets to my exempt nonprofit's special fundraising event subject to UBIT?

- Is income generated from the sale of tickets to my nonprofit's regular or special performances subject to New York State sales tax?

Issue #1: Tax Deductibility for Ticket-Holders

Question: *Is the cost of a ticket to an event staged by an exempt arts organization as part of its regular programming considered tax deductible?*

Answer: A nonprofit's "regular" programming might include concerts, theater productions, art exhibits, dance performances, or other arts events. These are events that are regularly scheduled to further the organization's mission and are not one-time special fundraisers for the nonprofit. The cost of tickets to these events is *not* considered a charitable gift, but instead represents a payment for value. Thus, so long as the nonprofit is charging its standard admission price, no portion of the ticket price or admission fee will be deductible.

Example: A nonprofit group whose mission is to introduce NYC children to opera stages three children's operas each year in unique locations. In May, the group is staging a series of performances of *Little Red Riding Hood* in a large playground in Washington Heights. The group charges \$10 for adult tickets and \$5 for children's tickets to its performances. Ticket-holders likely cannot deduct these tickets because the performance is part of the nonprofit's regular programming and the ticket charge represents payment for value.

Question: *Is the cost of a ticket to an event staged by an exempt arts organization as part of its regular programming considered tax deductible if it goes unused?*

Answer: No, unused tickets to a nonprofit's regular performances are not tax deductible. The IRS has clearly stated that the test of deductibility is not whether the ticket-holder uses the ticket, but whether the ticket-holder accepted the right to attend the performance. However, if the ticket-holder donates the unused ticket back to the nonprofit for resale, the ticket will be considered tax deductible by that ticket-holder.

Example: A nonprofit Broadway theater company is staging a performance of the musical *Hair*, which is slated to run for three months. A couple from Minnesota buys two tickets online well in advance of their chosen performance date in January. The couple then decides to go to Bermuda on their annual vacation instead. The theater company has a policy on its website that permits ticket-holders to donate their tickets as tax-deductible contributions at least two days prior to the performance date. Thus, the donated tickets, although unused by the couple, will be considered tax deductible.

Question: *Is the cost of a ticket to a special fundraising event considered tax deductible?*

Answer: Special fundraising events include annual dinners, galas, unique performances, or other events not part of an organization's regular programming. The cost of a ticket to these

kinds of events is deductible only to the extent the price exceeds the fair market value of the entertainment and anything else of value received by the ticket-holder.

Example: A nonprofit children's ballet company whose mission it is to introduce ballet to NYC public school children stages a one-time gala performance of *The Nutcracker* in the Metropolitan Opera, in which the children are the dancers. The ballet company invites law firm partners, corporate CEOs, and other high-profile business people. Tickets cost \$1,000, and a three-course meal is served during the intermissions in the Met's upper-level restaurant. The dinner is valued at \$150 and the ballet performance is valued at \$20 (a reasonable estimate based on similar performances in the City). Thus, \$830 of the \$1,000 ticket price will likely be tax-deductible.

Question: *Does a nonprofit arts group need to document the tax deductibility of a ticket for a ticket-holder?*

Answer: Yes, if a ticket-holder pays more than \$75 for an event and that payment is partly a donation and partly in exchange for goods or services, the nonprofit must provide the ticket-holder with a written statement. The statement must (i) state that the ticket-holder can only deduct the amount of the payment that exceeds the fair market value of the goods or services received and (ii) provide a good-faith estimate of the fair market value of those goods or services. The nonprofit can deliver this written statement to the ticket-holder either when it solicits the ticket-holder's payment or when it receives that payment. Beyond this written statement, the nonprofit should not attempt to advise donors as to the deductibility of their contributions.

Example: So, in the ballet company example above, the nonprofit must give the ticket-holder a written statement that indicates that (i) the ticket-holder can only deduct the amount of the payment that exceeds the fair market value of the goods or services received and (ii) the estimated value of the goods or services received is \$170 (*i.e.*, \$150 for the dinner and \$20 for the performance).

Question: *How does an organization determine the cost of an event for purposes of advising ticket-holders as to tax-deductibility?*

Answer: The cost to the nonprofit of staging the event or providing the services is not relevant when determining fair market value. Rather, the nonprofit should use the fair market value of the event or services to determine the cost of the event. If an event has an established value, that value must be used, even when the actual cost to the nonprofit of staging the event is substantially lower or higher. When there is no available market value for the services or goods provided, the nonprofit should make a good faith effort to estimate their value, using a measure other than cost. However, if the service is generally not available on a commercial basis, then no value need be provided.

Example: In the ballet company example above, the Metropolitan Opera restaurant has agreed to donate 50% of all food and beverage costs for the event. However, the ballet company must use the actual cost of eating a three-course meal at the Metropolitan Opera when reporting the fair market value to ticket-holders, notwithstanding the Met's generous donation. Thus, even

though the cost of the dinner to the nonprofit is substantially lower than what it would normally be, the fair market value of dinner at the Met comes out to \$150 (based on set menu prices with wine and tip). To value the performance, the ballet company looked at similar dance performances being performed by informally-trained children in the NYC area and estimated the fair market value to be \$20.

Issue #2: Unrelated Business Income Tax (“UBIT”)

Question: Is my exempt nonprofit community arts group subject to UBIT?

Answer: Even though a community arts organization is recognized as tax exempt, it may still need to pay unrelated business income tax (“UBIT”) on certain income. An organization’s UBIT liability will differ depending on the circumstances of each event. For most organizations, an activity is considered an “unrelated business”, and therefore subject to UBIT, if the activity (i) is a trade or business,¹ (ii) is regularly carried on,² and (iii) is not substantially related to furthering the exempt purpose of the organization.³ Note that the Internal Revenue Code excludes any trade or business in which substantially all the work is performed for the organization without compensation (*e.g.*, a volunteer-operated bake sale).

Question: Is income that is raised through the sale of tickets to my exempt nonprofit’s regular performances subject to UBIT?

Answer: Exempt organizations will not be taxed on income that results from activities that are substantially related to the charitable, educational, or other purpose that serves as the basis for their tax exemption.

Example: A community theater group that is formed for the purpose of bringing Shakespeare to New York City neighborhoods will likely not be taxed on proceeds from the sale of tickets to its monthly “Shakespeare in the Boroughs” performances.

Question: Is income that is raised through the sale of tickets to my exempt nonprofit’s special fundraising event subject to UBIT?

¹ A trade or business generally includes any activity carried on for the production of income from performing services or selling goods.

² Activities of an exempt organization ordinarily are considered regularly carried on if they show a frequency and continuity, and are pursued in a manner similar to, comparable commercial activities of nonexempt organizations.

³ A trade or business is related to an organization’s exempt purposes only when the conduct of the business activities has a causal relationship to achieving the organization’s exempt purposes. In other words, the activity must not only produce income for the organization, it must also substantially contribute to the achievement of the organization’s exempt purpose. To be substantially related, the activities that generate the income must contribute importantly to accomplishing the organization’s exempt purposes.

Answer: Although fundraising activities that are conducted on an ongoing basis may satisfy all three prongs of the UBIT test described above, the IRS normally does not subject income generated from fundraising activities to UBIT. In addition, in the case of income generated from, for example, a one-time gala performance, a nonprofit will not be subject to UBIT because the activity is not “regularly carried on”.

Example: A NYC nonprofit community choir sells tickets to its annual gala performance, targeting law firms and corporations. Even though the gala is not substantially related to the group’s mission of bringing music to nursing homes, the income generated will likely not be subject to UBIT.

Issue #3: New York State Sales Tax

Question: *Is income generated from the sale of tickets to my nonprofit’s regular or special performances subject to New York State sales tax?*

Answer: Organizations who have applied to the New York State Department of Taxation and been granted New York State tax-exempt status will be exempt from New York State sales tax. With respect to sales of tickets by an exempt organization, any admission fees charged will be exempt from sales tax if all of the proceeds inure exclusively to the benefit of the exempt organization.

Example: A NYC nonprofit visual arts group sells tickets to its annual fundraising exhibit, targeting law firms and corporations. If all of the proceeds from ticket sales are used exclusively for the benefit of the arts group, the income from the ticket sales will be exempt from sales tax.

This memo is meant to provide general information only, not legal advice. Please contact Judith Moldover at Lawyers Alliance for New York at (212) 219-1800 x 250 or visit our website www.lawyersalliance.org for further information.

Lawyers Alliance for New York is the leading provider of business and transactional legal services for nonprofit organizations that are improving the quality of life in New York City neighborhoods. Our network of pro bono lawyers from law firms and corporations and staff of experienced attorneys collaborate to deliver expert corporate, tax, real estate, employment, intellectual property, and other legal services to community organizations. By connecting lawyers, nonprofits, and communities, we help nonprofits to develop affordable housing, stimulate economic development, promote community arts, and operate and advocate for vital programs for children and young people, the elderly, and other low-income New Yorkers.