REMINDER

UBIT Basics

This condensed article from Venable, one of the top law firms in the nation, explains the basics of Unrelated Business Income Tax, or UBIT, which is a common tax situation faced by non-profit organizations such as chambers of commerce. Income your chamber receives from advertising, trade show booth sales and other sources typically is, or should be, reported as UBIT. Make sure your income is properly identified and accounted for to remain consistent with IRS guidelines. See the complete article at http://goo.gl/BsqsI.

A tax-exempt organization such as a chamber of commerce is generally exempt from federal corporate income tax on income derived from activities that are substantially related to the chamber's tax-exempt purposes. However, your chamber may be subject to a federal corporate income tax on income derived from unrelated trade or business activities. This is known as the Unrelated Business Income Tax or UBIT.

Definitions

An "unrelated trade or business" is any activity that meets all of the following three conditions:

- The activity must be a trade or business
- The trade or business must be regularly carried on; and
- The trade or business must not be substantially related to the purposes for which the organization was recognized as exempt from federal income tax.

An activity is considered a "trade or business" if the activity is carried on for the production of income from the sale of goods or the performance of services. Note that it is immaterial whether the activity generates a profit for purposes of determining whether the gross revenue derived from the activity is subject to UBIT. Further, if an organization engages in a substantial amount of non-exempt activities, it could potentially lose its tax-exempt status even if those activities do not generate a profit.

In determining whether an activity is "regularly carried on," the IRS will examine whether the activity is conducted often and continuously and how it is pursued. The IRS will compare these factors with the same or similar business activity of non-tax-exempt organizations. Discontinuous or periodic activities are generally not considered to be regularly carried on. However, periodic activities that are seasonal in nature will be considered to be regularly carried on if an exempt organization's periodic participation in such activities coincides with the participation of taxable businesses.

For an activity to be "substantially related" to the tax-exempt organization's exempt purposes, it must contribute importantly to the accomplishment of one or more of the organization's exempt purposes. If an activity is substantially related to the tax-exempt organization's exempt purposes, then the income from that activity will not be subject to UBIT. The organization's need to generate money to use for tax-exempt purposes is not sufficient to qualify as "substantially related."

Some Exceptions

Subject to certain limitations, the following are among the activities specifically excluded from the definition of unrelated business income : dividends, interest, and annuity income; royalties; certain capital gains; rents from non-debt financed real property; certain research-generated income; qualified corporate sponsorship payments; qualified convention or trade show income; income generated from volunteer labor; sales from donated merchandise; a trade or business carried on by a 501(c)(3) organization primarily for the convenience of its members, students, patients, officers, or employees; the exchange or rental of member and donor lists among other organizations tax-exempt under 501(c)(3).

Payment and Deductions

Organizations that generate at least $1,000 of gross unrelated business income must file a Form 990-T, Exempt Organization Business Income Tax Return, to report unrelated business income and pay any tax due. The organization must file Form 990-T in conjunction with its annual information return (i.e., Form 990, Form 990-EZ, or Form 990-PF). An organization may take a number of tax deductions when computing UBIT.

Protecting Tax-Exempt Status

A tax-exempt organization could jeopardize its tax-exempt status if the gross revenue, net income, and/or staff time devoted to unrelated business activities is "substantial" in relation to the organization's tax-exempt functions. To avoid jeopardizing its tax-exempt status, an organization substantially engaged in one or more unrelated business activities should consider creating one or more taxable corporate subsidiaries in which to house and carry out such activities. Such subsidiaries are separate but affiliated organizations, generally wholly-owned by the parent tax-exempt organization. A subsidiary will pay corporate income tax on its net income. But the tax-exempt parent's exempt status will remain. Moreover, the subsidiary can remit the after-tax profits to its parent as tax-free dividends. Note that using a pass-through entity – such as an LLC – to house unrelated business activities will not necessarily offer the same tax-related protections as a subsidiary organized as a C corporation.

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