# Section V

UNRELATED

BUSINESS

INCOME

# UNRELATED BUSINESS INCOME

While each exempt organization must be operated primarily for its exempt purposes, it will be permitted to carry on certain unrelated business activities without jeopardizing its exempt status. However, it will be subject to an income tax on the net income from those activities. This is true regardless of how income is being spent. The issue that determines taxability is how income is earned.

The income tax is calculated almost identically to the tax for profit sector organizations. Tax rates are the same rates that apply to profit sector counterparts (corporations, etc.).

Exempt organizations will be subject to unrelated business income tax unless the activities that they carry on are substantially related (defines below) to their exempt purpose or meet one of the other specific exemptions.

**Substantially Related**
An activity will be substantially related, and therefore exempt from UBI, if it contributes importantly to accomplishing the purpose and the scope of activities for which the exemption was granted to the organization (for example, sale of books containing information regarding the organization's mission would normally be considered related.)

It is important to note that an organization's need for monies to carry on its activities is ***not*** enough to make an activity related to its exempt purpose.

**Regularly Carried On**
To be considered unrelated business, an activity must be regularly carried on.

The regulations refer to activities which are *regularly carried on* including activities which take place one or days a week throughout the year or for a period of a few months each year. Activities that are *not regularly carried on* including activities that occur as a single annual event or for a brief time such as two weeks annually.

**Corporate Sponsorships**
Corporate sponsorships are treated as non-taxable contributions except when the sponsorship takes on too many characteristics of advertising. When this happens, amounts received by the non-profit can be taxed as Unrelated Business Income.

IRS has recently issued final regulations about what qualifies as non-taxable sponsorship. While these new regulations are similar to the earlier, proposed regulations, there are some positive changes. The long-standing principle that qualitative or comparative descriptions of the sponsors' products must be avoided has been changed by these regulations that now allow established promotional logos or slogans, even if they do contain qualitative or comparative descriptions of the sponsor's products. For example: if Nestles established slogan was "N-E-S-T-L-E-S-Nestles makes the very best-chocolate," that comparative statement would be allowable and would not trigger Unrelated Business Income. Also, the old "tainting rule" which said that if any part of the sponsor's payment is advertising, it is all advertising, is now gone. The final regulation also confirms that if a sponsor makes a payment to a non-profit subject to an agreement that the non-profit will not use a competitor's products or services, Unrelated Business Income results.

**Debt-Financed Real Property**
Internal Revenue Code Section 514 imposes tax on debt-financed real property rental income and on

profit from sales of debt-financed real property. Debt-financed property is "property" which was purchased with some type of loan or mortgage.

For real property rental income, the debt-financed portion is based on the relationship of average debt to average basis (asset cost plus additions, less depreciation).

In the case of sales of debt-financed property, the highest debt during the previous year is compared to basis to determine the taxable portion of sale profits.

The debt-financed income rules also apply to other assets such as securities that are acquired with debt.

Rentals of personal property are also subject to UBIT regardless of whether the property is debt-financed.

**Other Exclusions from UBIT**

In addition to related and occasional activities, the following are specifically excluded from the definition of Unrelated Trade or Business:

- An activity that is performed solely by volunteers without any compensation.
- An activity that is carried on primarily for the convenience of an organization's members, students, patients, officers or employees.
- An activity that consists of selling items that have been contributed to the organization.
- Distribution of low cost articles by a charity (items with a cost not in excess of $7.40-this amount is indexed for inflation).
- Income from trade shows or conventions.
- Income from Bingo where it is not carried on by for profits organizations.
- Income from renting mailing lists or donor lists to another 501(c)(3).
- Income from research for governmental agencies or conducted by a college or university or done by an organization which does primary fundamental research and makes its findings available to the general public.
- $1,000 specific exclusion.
- Passive income.
  Most passive income is excluded from the computation of unrelated business income, including:
  - Dividends
  - Interest
  - Royalties
  - Gains from the sale of property
  - Real property rental income

**Types of Unrelated Business Income**

***Advertising Revenue***

Most advertising revenue is unrelated business taxable income unless it is not regularly carried on. Advertising will be subject to tax even when related products or services are advertised.
*Example*: Revenue received from advertising in an organization's monthly newsletter.