



This article presents general guidelines for Georgia nonprofit organizations and should not be construed as legal advice. Always consult an attorney to address your particular situation.

UBIT: Four Letters Your Nonprofit Needs to Know

Organizations that have Section 501(c)(3) status from the Internal Revenue Service do not have to pay Federal income taxes, right? Not exactly. There is an exception to the exemption for income from an unrelated trade or business, known as “unrelated business income” or UBI. UBI is income from a trade or business (including fundraising) that is regularly carried on by an exempt organization and that is not substantially related to the organization’s exempt purpose or function. If an organization receives UBI that does not qualify for one of the exceptions, exclusions or deductions listed below, then the organization will have to pay taxes on the UBI. This tax is called “unrelated business income tax,” or UBIT.

A small amount of UBI in relation to an organization’s exempt activity will not impact the organization’s 501(c)(3) status; however, a substantial amount of UBI in relation to the exempt activity may jeopardize the organization’s 501(c)(3) status.

When determining whether your organization has to pay UBIT, the first question is whether the income is UBI. All three of the following elements must be in place in order for income to be considered UBI. The income must result from:

1. A trade or business,
2. regularly carried on, and
3. not substantially related to the institution's exempt purposes.

Ask the following questions to determine whether income is UBI:

- Is the income a result of a trade or business?
 - The term “trade or business” generally includes any activity carried on in order to generate income from the selling goods or performing services.
- Is the trade or business regularly carried on?
 - Does the business show a frequency and continuity?
 - And is the business pursued in a manner similar to that of for profit businesses?
- Is the business substantially related to the exempt purpose?
 - Does the business contribute importantly to accomplishing the organization’s exempt purpose (its mission) *other than through raising funds?*

EXCEPTIONS TO UBI

There are certain activities that are specifically excluded from definition of UBI and are therefore not taxable, including:

- Activities conducted by volunteers (for example, a car wash staffed by volunteers)
- Activities conducted for the convenience of members (for example, a tax-exempt hospital operates a cafeteria which is patronized by staff, patients and visitors)
- Sale of donated merchandise (for example, a thrift store)
- Qualified sponsorship payments (for example, a charity receives a payment from a sponsor and, in return, promises to use the sponsor’s name or logo in acknowledging the sponsor’s support for an event)

- Bingo games
- Exchange or rental of member lists

EXCLUSIONS AND DEDUCTIONS TO UBIT

In addition to the exceptions discussed above, the IRS allows certain other exclusions and deductions in calculating UBIT.

Exclusions include, but are not limited to, income from:

- Interest and dividends
- Royalties
- Certain rents from real property (not including rents from debt-financed property)
- Income from research
- Certain gains and losses from disposition of property

Allowable deductions in calculating UBIT include certain expenses, depreciation and similar items directly connected with carrying on an unrelated trade or business. Additional allowable deductions include:

- Net operating loss deduction (deducting an unrelated business loss in a previous or current tax year)
- Charitable contributions made by the organization
- A specific deduction allowing up to \$1000 of UBI without tax

PAYING UBIT

Organizations with gross income of \$1000 or more from UBI must file Form 990-T annually. Like Form 990, the Form 990-T is due by the 15th day of the 5th month following the end of the organization's fiscal year.

SEEK HELP

For additional information on UBIT, you can view the virtual workshop at www.stayexempt.org.

Determining whether and when your organization may owe UBIT can be a complicated task. Be sure to get help from a knowledgeable attorney, accountant or other professional if you think your activities may include UBI.