



Avoid Tax Liability in Unrelated Business Income

By Kristen Shaw, CPA

Every nonprofit faces budget challenges. At one time or another, most organizations consider new ideas for raising funds. Any time your organization looks outside its normal fund-raising activities to generate revenue, you need to be aware of potential income tax liability as a result of the unrelated business income tax, or UBIT.

Your organization's tax exemption covers any activity that is substantially related to the charitable educational or other purpose that forms the basis upon which the IRS granted the exemption, even if the activity is a business activity.

The basic idea is that nonprofit organizations would have an unfair advantage if the tax exemption applied to activities that compete with commercial, tax-paying businesses. However, the rules governing unrelated business activities can be quite complex, and sometimes depend on the type of tax-exempt organization involved.

For example, a publicly supported charity that owns stock in a corporation that operates an unrelated commercial manufacturing business is generally not taxed on dividends it receives from that corporation. However, if the same business operates as an LLC, the charity's share of the business profits is subject to UBIT.

In other words, selling your organization's membership lists to business firms or selling advertising in your annual yearbook or other publication is unrelated business income.

On the other hand, profits from a business activity substantially related to the organization's exempt purpose aren't subject to UBIT. An example of a related business activity includes sales of works of art or reproductions at a gift shop operated by an art museum.

However, the sale of souvenir items of the city in which the museum is located would produce unrelated business income.



Kristen Shaw, CPA
Director

Kristen oversees the auditing function at Wheeler, Wolfenden & Dwares, Certified Public Accountants.

She has extensive experience helping various nonprofit organizations reach their financial goals.

Please feel free to contact Kristen with any questions.

Wheeler, Wolfenden & Dwares, CPAs
4550 New Linden Hill Road
Suite 201 • Linden Park
Wilmington, DE 19808

Tele: (302) 254-8240
Fax: (302) 254-8244

Email:
Kshaw@wwd-cpa.com

Website:
www.wwd-cpa.com

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A business activity isn't substantially related to an organization's exempt purpose if it doesn't contribute importantly to accomplishing that purpose—other than through the production of funds.

Some activities are specifically excluded from the definition of unrelated business.

For example, an annual tag sale or thrift store staffed by volunteers and selling goods contributed to the organization are not considered unrelated business activities.

Investment income, such as dividends, interest, annuities, royalties and rents from real property, is normally excluded from UBIT. However, investment income is subject to UBIT to the extent it's derived from debt-financed property.

Your organization will not be liable for taxes on all unrelated business activities—only on those that make a profit. The profits are called unrelated business taxable income or UBTI.

Special allocation rules apply when calculating UBTI from advertising or publishing activities.

Failure to identify and pay UBIT can result in your nonprofit being assessed back taxes, interest and penalties.

Organizations operating an unrelated business must file form 990-T, Exempt Organization Business Income Tax Return, whether a tax is due or not.

If you have any concerns about whether the activities of your nonprofit could be subject to UBIT, our tax advisers would be pleased to review the situation with you.