



Church Financial Hot Topic

Unrelated Business Income Taxes (UBIT)

Churches may engage in income-producing activities unrelated to their tax-exempt purposes, as long as the unrelated activities are not a substantial part of the organization's activities. However, the net income from such activities will be subject to the UBIT if the following three conditions are met:

- (a) the activity constitutes a trade or business,
- (b) the trade or business is regularly carried on, and
- (c) the trade or business is not substantially related to the church's exempt purpose. (The fact that the organization uses the income to further its charitable or religious purposes does not make the activity substantially related to its exempt purposes.)

Exceptions to the UBIT - Even if an activity meets the above three criteria, the income may not be subject to tax if it meets one of the following exceptions:

- (a) substantially all of the work in operating the trade or business is performed by volunteers;
- (b) the activity is conducted by the organization primarily for the convenience of its members; or
- (c) the trade or business involves the selling of merchandise substantially all of which was donated.

In general, rents from real property, royalties, capital gains, interest and dividends are not subject to the unrelated business income tax *unless financed with borrowed money*.

Examples of Unrelated Trade or Business Activities

Advertising - Many churches sell advertising in their publications or other forms of public communication. Generally, income from the sale of advertising is unrelated trade or business income. This may include the sale of advertising space in weekly bulletins, magazines or journals, golf tournaments, or websites.

Gaming - Most forms of gaming, if regularly carried on, may be considered the conduct of an unrelated trade or business. This can include raffles.

Sale of Merchandise and Publications - The sale of merchandise and publications can be considered the conduct of an unrelated trade or business if the items involved do not have a substantial relationship to the exempt purposes of the church.

Rental Income - Generally, income derived from the rental of real property and incidental personal property is excluded from unrelated business income. However, there are certain situations in which rental income may be unrelated business taxable income:

- (a) If a church rents out property on which there is debt outstanding (for example, a mortgage note), the rental income may constitute unrelated debt-financed income subject to UBIT. (However, if a church acquires debt-financed land for use in its exempt purposes within 15 years of the time of acquisition, then income from the rental of the land may not constitute unrelated business income.);
- (b) If personal services are rendered in connection with the rental, then the income may be unrelated business taxable income, or;
- (c) If a church charges for the use of the individual parking spaces, the income may be unrelated business taxable income.

Parking Lots - If a church owns a parking lot that is used by church members and visitors while attending church services, any parking fee paid to the church would not be subject to UBIT. However, if a church operates a parking lot that is used by members of the general public, parking fees would be taxable, as this activity would not be substantially related to the church's exempt purpose, and parking fees are not treated as rent from real property. If the church enters into a lease with a third party who operates the church's parking lot and pays rent to the church, such payments would not be subject to tax, as they would constitute rent from real property. Whether an income-producing activity is an unrelated trade or business activity depends on all the facts and circumstances. For more information, see IRS Publication 598, *Tax on UBIT of Exempt Organizations*.

Tax on Income-Producing Activities - If a church has gross income of \$1,000 or more for any taxable year from the conduct of any unrelated trade or business, it is required to file IRS Form 990-T, *Exempt Organization Business Income Tax Return*, for that year.

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