

Chapter 11: Unrelated Business Income

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11.100: Introduction

Even though a church is recognized as tax-exempt, certain sources of income can create a tax liability for the congregation. If a congregation has income that has “little or no relationship to its exempt purpose except to provide funds to carry out those purposes,” the congregation has unrelated business income.

What are the ramifications of having unrelated business income? The organization may be required to file an annual income tax return, Form 990-T and pay income tax due on this unrelated business income. See video about unrelated business income at stayexempt.irs.gov, found under the “Existing Organizations” tab.

11.105: Definition

Three factors must exist for an activity to be defined as a source of “unrelated business income.” These are:

1. The activity must be engaged in as a trade or business,
2. The trade or business must be regularly carried on, and
3. The trade or business must be substantially unrelated to the organization’s exempt purpose or function.

11.110: Filing Requirements

A Form 990-T is required to be filed whenever unrelated gross income exceeds \$1,000. Income tax may be due with this Form 990-T if net income from the activity exists. In addition, one \$1,000 deduction is allowed before the income tax liability is computed.

The net income from an activity is the gross receipts less all expenses directly related to the production of this income. Salaries, supplies, depreciation, etc., are deducted in determining net income.

The income and related losses from individual business activities will need to be reported separately and losses from one may not be used to offset income from other business activities. This means that it is important to carefully track the expenses involved in producing the unrelated business income (UBI), so that those expenses can be used to offset any gains from that activity. However, losses that exceed gains from any single activity can be carried forward indefinitely to reduce gains realized in future years.

11.111: Public Disclosure of Form 990-T

The most recent three years of Forms 990-T are subject to the same public disclosure requirements as an exempt organization’s application for exemptions (see 8.150).

Posting these on the internet alleviates the burden of providing copies on an individual basis to those who write or call for them. The posted files must be exact replicas (as filed with the IRS), accessible at no charge and accompanied with instructions for downloading without special software or hardware.

Activities Which ARE Unrelated

1. Soliciting, selling and publishing commercial advertising in an exempt organization periodical (see 11.118).
2. Operating a commercial parking lot, even if one day each week.
3. Operating a concession stand on a seasonal basis.
4. Selling greeting cards on a regular basis that do not contribute importantly to achieving the organization’s exempt purpose.
5. Rental of member lists to commercial firms (see 11.116).
6. Rental of real estate that is debt-financed (see 11.120).
7. Raffles, bingo and other games of chance (see 11.130).
8. Conducting travel tours similar to commercial ones (see 11.119).
9. Certain employee fringe benefits for which a deduction is disallowed under IRC Sec 274 and has not been treated as taxable compensation (qualified transportation and commuting benefits; parking facility used in connection with qualified parking).

Activities Which ARE NOT Unrelated

1. Rental of member lists to other charitable and religious organizations.
2. Selling Christian books on a regular basis, solely for the convenience of members where the product contributes importantly to the organization’s exempt purpose.
3. Tickets sold to an annual soup supper, dance or musical endeavor.
4. A thrift shop that consists of selling merchandise, substantially all of which has been received by the organization as gifts or contributions.
5. Gain or loss on the sale of real property.
6. Rental of real estate that is not debt-financed (see 11.120).
7. A fellowship event at which attendance prizes are drawn and awarded (see 11.138).
8. Travel tours substantially related to the organization’s exempt purpose (see 11.119).

11.115:

Examples of Unrelated Business Activities

It is important that congregations properly determine which activities the IRS considers to be unrelated. The following two tables present examples of activities that ARE and ARE NOT considered unrelated.

11.116:

Royalties and Licensing Fees Versus Partnership Agreements

Royalty income from mailing list rentals, affinity credit cards or other fundraising programs (e.g., tower rental agreements with mobile telecommunication companies) can be kept free from unrelated business income tax as long as your congregation takes only a passive role. Activities typically subject to unrelated business income tax include the following: a partnership or joint venture between the congregation and for-profit that shares in the activity's management, profits and losses; any arrangement that gives the congregation sufficient control over the for-profit (e.g., developing, monitoring, or controlling the for-profit's promotional and marketing activities); or an agreement providing endorsements or services that are important to the for-profit's success.

General Guidance on How to Protect Licensing Fees from Unrelated Business Income Tax

1. Mailing lists should only be made available for rental on a selective basis.
2. Devote minimal staff time and cost to maintain and market the mailing list.
3. Do not provide specific services such as advertising, promotion or endorsement. Specifically state this in the agreement, allowing the for-profit to design its own materials and do all soliciting.

If the organization is involved in any of the above activities, or similar ones, carefully examine your specific situation to assure compliance with all tax laws or consult your legal or financial adviser.

For a more comprehensive discussion of unrelated business income for churches or schools, obtain IRS Publication 598, *"Tax on Unrelated Business Income of Exempt Organizations."*

11.117:

Excluded Trade or Business Activities

Any activity (either related or unrelated) in which substantially all the work is done by volunteers is not considered an unrelated business activity. Thus, the income from it is not taxable. Conversely, an unrelated activity done with the use of compensated workers (including youth) paid in cash or "in kind" may subject the organization to unrelated business income tax. (See school and church youth group example in CTM Section 9.220.)

11.118:

Advertising Versus Qualified Sponsorship Payments

Soliciting and receiving qualified sponsorship payments is not an unrelated trade or business activity and the payments are not subject to unrelated business income tax. A "qualified sponsorship payment" is any payment made by a business to support the exempt organization's activities for which it will receive nothing in return other than the use or acknowledgement of the business' name, logo or product lines in connection with the organization's activities. However, the payment is treated as advertising, if in return for it, this same information is published in a periodical (e.g., a monthly newspaper) as opposed to material directly related to the sponsored event (e.g., a program or brochure distributed at the event).

Payments for advertising are treated different from sponsorship payments. In addition to the above exception, advertising includes messages containing qualitative or comparative language, price information, or other indications of savings or value; endorsements; and inducements to purchase, sell or use the products or services. Payments for advertising are subject to unrelated business income tax.

11.119:

Travel Tours

While conducting a travel tour is not in and of itself an exempt activity, its income is not necessarily taxable. Typically, a church-sponsored tour includes the following attributes: significant time spent in organized study, destinations related to religion or education, planning or leadership by clergy or appropriately trained lay persons, and mandatory participation in the tour's central activities. Structured in this manner, the tour is nontaxable because it is importantly connected to the church's exempt purpose.

However, a tour that is structured more like a commercial one (*even if its purpose is to raise funds for use in other religious activities*) is considered an unrelated activity — subject to income tax. When gross receipts exceed \$1,000, all of its financial transactions must be reported to IRS on Form 990-T.

11.120:

Debt-Financed Property

"Debt-financed" property means any income-producing property on which the church owes money, such as a mortgage. For example, rent from an apartment house is not taxable unless the church owed debts it would not have except for the property.

Under certain circumstances, property acquired by a church for its use for exempt purposes in the future is not treated as "debt-financed." If the church's use of the property for its exempt purposes will begin within 15 years from the date the property is acquired, income

from the property is not treated as income from “debt-financed” property. An example of this is a church purchasing land by mortgage for a new church building and renting that land while collecting a building fund. As long as the exempt use of property begins within 15 years, any rental income from the property falls within the exception and is not taxable.

However, the church must establish to the satisfaction of the IRS within the first five years that the use of the acquired land for exempt purposes is reasonably certain before the 15-year period expires.

Also, if substantially all (85 percent or more) of a property is used for the church’s exempt purpose, the property is not treated as “debt-financed” property.

11.130: Raffles, Bingo and Other Games of Chance

Although federal law does not regulate non-profit gaming activities, it may impose certain tax burdens for the winner and the congregation operating the activity. For the winner, the value of prizes received is includable in his or her gross income. For the congregation, the unrelated business activity may be subject to income tax or a wagering excise tax. Regardless of the tax consequences, the congregation has certain IRS-prescribed reporting and withholding responsibilities (see *IRS Publication 3079, Gaming Publication for Tax-Exempt Organizations*). With respect to state regulations, refer to Chapter 12.800.

11.132: Designing the Game to Avoid UBIT

Clearly, the congregation may avoid unrelated business income tax consequences under any of the following circumstances: 1) the activity is not regularly carried on; 2) volunteers perform substantially all the work; or 3) the activity is restricted to the “traditional” form of bingo.

11.134: Wagering Excise Tax

This is a special tax imposed on all wagers—0.25 percent if the wagers are authorized under state laws; 2.0 percent if unauthorized under state laws.

A “wager” includes a bet placed in a lottery conducted for profit.

However, the IRS does not include within this definition wagering or drawings conducted by an exempt organization if no part of the net proceeds from such wagering or drawing inures to the benefit of any private individual. Thus, a congregation may avoid the wagering excise tax under certain circumstances. To qualify under this exception, someone must not conduct the activity other than the congregation itself. Merely “sponsoring” a lottery conducted by a third party does not exempt the wagers from the excise tax.

11.136: Withholding and Reporting Requirements

Awards of any single prize having a value of \$600 or more but not more than \$5,000 requires the filing of Form W-2G with the IRS. If the winner does not provide a Social Security number (SSN), 24 percent backup withholding is required on any award of \$600 or more.

If a single prize exceeds \$5,000, and the amount of the winnings is 300 times the amount wagered, then a Form W-2G must be filed and 24 percent gambling withholding is required. For example, a \$100 chance to win \$30,000 or more is subject to 24 percent gambling withholding.

With respect to non-cash prizes over \$5,000 (e.g., a raffle of a new car or house) the congregation has two options to meet the gambling withholding requirement. First, the winner could pay the amount of the 24 percent withholding to the congregation, which would report and pay to IRS. Second, the congregation could pay the

3232 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0238	
PAYER'S name, street address, city or town, province or state, country, and ZIP or foreign postal code		1 Reportable winnings	2 Date won
		\$	
PAYER'S federal identification number PAYER'S telephone number		3 Type of wager	4 Federal income tax withheld
		\$	\$
WINNER'S name		5 Transaction	6 Race
		7 Winnings from identical wagers	8 Cashier
Street address (including apt. no.)		\$	9 Winner's taxpayer identification no.
		11 First I.D.	10 Window
City or town, province or state, country, and ZIP or foreign postal code		12 Second I.D.	
		13 State/Payer's state identification no.	14 State winnings
Signature ▶		\$	15 State income tax withheld
		\$	16 Local winnings
Date ▶		\$	17 Local income tax withheld
		\$	18 Name of locality
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.		2018 Form W-2G Certain Gambling Winnings	
		For Privacy Act and Paperwork Reduction Act Notice, see the 2018 General Instructions for Certain Information Returns. File with Form 1096 Copy A For Internal Revenue Service Center	
Form W-2G Cat. No. 10138V www.irs.gov/w2g Department of the Treasury - Internal Revenue Service		Do Not Cut or Separate Forms on This Page – Do Not Cut or Separate Forms on This Page	

<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED				OMB No. 1545-0115	
PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Rents		2018	
		\$			
		2 Royalties			
		\$		Form 1099-MISC	
		3 Other income		4 Federal income tax withheld	
		\$		\$	
PAYER'S TIN	RECIPIENT'S TIN	5 Fishing boat proceeds		6 Medical and health care payments	
		\$		\$	
RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		7 Nonemployee compensation		8 Substitute payments in lieu of dividends or interest	
		\$		\$	
		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>		10 Crop insurance proceeds	
		11		12	
Account number (see instructions)		FATCA filing requirement <input type="checkbox"/>		13 Excess golden parachute payments	
				\$	
14 Gross proceeds paid to an attorney				\$	
15a Section 409A deferrals		15b Section 409A income		16 State tax withheld	
\$		\$		\$	
				17 State/Payer's state no.	
				\$	
				18 State income	
				\$	
Form 1099-MISC		www.irs.gov/Form1099MISC		Department of the Treasury - Internal Revenue Service	

**Miscellaneous
Income**

**Copy 1
For State Tax
Department**

withholding due on behalf of the winner, grossing up his or her Form W-2G by the amount of the payment. The increase in the winner's income for your payment is also subject to tax, thus increasing the amount of additional taxes you must pay. To calculate the reportable prize amount, you divide the prize value by a factor of .76 (for example, value divided by .76). Next, multiply that result by 24 percent to figure the total withholding taxes you must pay.

If the winner does not cooperate regarding the taxes, the congregation can withhold the prize.

If the withheld income tax is \$2,500 or greater, you must deposit those taxes using the Electronic Federal Tax Payment System (EFTPS) separate from payroll taxes, if any. For more information about the EFTPS, visit *eftps.gov*. Any lesser tax liability on gambling winnings may be reported on *Form 945, Annual Return of Withheld Federal Income Tax*.

**11.138:
Attendance Prizes (No Wagers)**

Games of chance consist of three parts: 1) a prize; 2) the element of chance; and 3) consideration, or payment for the right to participate. Where there is no wager required, then usually the event will not be considered a game of chance and therefore not subject to the same gaming regulations described in *paragraph 11.136*.

If an attendance prize is \$600 or more, Form 1099-MISC, Box 3, should be used to report the prize, but no withholding is required unless the individual fails to provide his or her Social Security number. In that case, 24 percent backup withholding applies. Income tax withheld on these types of prizes must be reported on Form 945, Annual Return of Withheld Federal Income Tax. For more information, including the deposit requirements for backup withholding, refer to *IRS Publication 15*.

**11.140:
Reporting Cash Receipts Over \$10,000**

In a 12-month period, if you receive trade or business cash receipts (other than contributions) from a single transaction exceeding \$10,000, it must be reported to IRS on Form 8300. For more information about your filing requirements, refer to *IRS Publication 1544*.

Form **945**

Department of the Treasury
Internal Revenue Service

Annual Return of Withheld Federal Income Tax

▶ For withholding reported on Forms 1099 and W-2G.

▶ For more information on income tax withholding, see Pub. 15 and Pub. 15-A.

▶ Go to www.irs.gov/Form945 for instructions and the latest information.

OMB No. 1545-1430

2017

Type or Print	Name (as distinguished from trade name)	Employer identification number (EIN)	If address is different from prior return, check here. ▶ <input type="checkbox"/>
	Trade name, if any		
	Address (number and street)		
	City or town, state or province, country, and ZIP or foreign postal code		

A If you don't have to file returns in the future, check here and enter date final payments made. ▶ -----

1	Federal income tax withheld from pensions, annuities, IRAs, gambling winnings, etc.	1		
2	Backup withholding	2		
3	Total taxes. If \$2,500 or more, this must equal line 7M below or Form 945-A, line M	3		
4	Total deposits for 2017 , including overpayment applied from a prior year and overpayment applied from Form 945-X	4		
5	Balance due. If line 3 is more than line 4, enter the difference and see the separate instructions	5		
6	Overpayment. If line 4 is more than line 3, enter the difference ▶ \$ _____			

Check one: Apply to next return. Send a refund.

- **All filers:** If line 3 is less than \$2,500, **don't** complete line 7 or Form 945-A.
- **Semiweekly schedule depositors:** Complete Form 945-A and check here ▶
- **Monthly schedule depositors:** Complete line 7, entries A through M, and check here ▶

7 Monthly Summary of Federal Tax Liability. (Don't complete if you were a semiweekly schedule depositor.)					
	Tax liability for month			Tax liability for month	
A January			F June		
B February			G July		
C March			H August		
D April			I September		
E May			J October		
			K November		
			L December		
			M Total liability for year (add lines A through L)		

Third-Party Designee Do you want to allow another person to discuss this return with the IRS? See separate instructions. Yes. Complete the following. No.

Designee's name ▶	Phone no. ▶	Personal identification number (PIN) ▶	<table border="1"> <tr> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> <td style="width: 20px; height: 20px;"></td> </tr> </table>					

Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature ▶	Print Your Name and Title ▶	Date ▶
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Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶				Firm's EIN ▶
	Firm's address ▶				Phone no.