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**Tax Time Coming Up: UBIT Guidelines for 501(C) Organizations**  
by Mark Alcorn

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Characterization of association income is sometimes a tricky subject. Most association executives are well aware of unrelated business income (UBI) principles, but are understandably cautious about characterizing that income. This post will attempt to refresh your understanding of UBI, give you examples of common income characterizations, and provide guidance on when to call on tax and legal advisors with UBI questions. You can find detailed information by clicking here for official IRS documentation [IRS guidelines on UBIT, revised March 2010](#).

## UBI Basics

Although an organization may be exempt from state and federal income tax, it still may be liable for tax on its unrelated business income (UBIT). Unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the performance by the organization of its exempt purpose or function except that the organization needs the profits derived from this activity.

The rationale for taxing UBI is to place for-profit and non-profit entities on equal footing for tax purposes: nonprofits are not allowed the competitive advantage of exemption from tax concerning their programs that are not conducted primarily in furtherance of their exempt purpose.

An exempt organization that has \$1,000 or more gross income from an unrelated business must file [Form 990-T](#), and may be required to pay unrelated business income tax (UBIT), at corporate tax rates. Corporate tax rates are 15% of the first \$50,000 of taxable income; 25% of the next \$25,000 of taxable income; and 34% of taxable income in excess of \$75,000. Additionally, income in excess of \$100,000 is subject to a surtax of 5% until the tax benefit of the lower rate structure is recovered (\$11,750 in tax).

An activity is an unrelated business, and subject to UBIT, if it meets all three of the following requirements:

It is a trade or business,

- that is regularly carried on, and
- that is not substantially related to the furtherance of the exempt purpose of the organization.

The term “trade or business” generally includes any activity carried on for the production of income (that is, the motive is to generate a profit) from selling goods or performing services. Many non-UBI activities of associations could be considered a trade or business.

Business activities are generally considered “regularly carried on” if they show a frequency and continuity, and are pursued in a manner similar to, comparable commercial activities of nonexempt organizations. An annual tradeshow or golf tournament is generally not considered regularly carried on; operation of an insurance brokerage program is regularly carried on.

Determination of whether a business activity is “substantially related” to exempt purposes can be difficult. It requires careful review of the relationship between the activities that generate income and the accomplishment of the organization’s exempt purpose. A trade or business is substantially related to exempt purposes when the business activities are carried out primarily to achieve exempt purposes, not simply for the production of income needed to carry out the exempt purpose. In other words, the activities which generate the income must contribute importantly to the accomplishment of the organization’s exempt purposes to be substantially related.

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## Characterizing UBI

As noted above, characterizing association income can be tricky. There is no “approved list” of activities that are related or unrelated. Each situation must be analyzed based on its own facts. Some situations are simple, and some are so difficult that they lead to litigation. The vast majority of situations are not difficult. The key is to know when to characterize business income yourself, and when to call on an expert.

The following circumstances generally do not constitute an unrelated trade or business:

- All of the work of the trade or business is performed for the organization without compensation. Some fund-raising activities, such as volunteer operated bake sales, may meet this exception.
- The trade or business is carried on by an organization described in section 501(c)(3) organization primarily for the convenience of its members, students, patients, officers or employees. A typical example of this is a cafeteria or coffee shop.
- The trade or business consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many thrift shop operations of exempt organizations would meet this exception.
- Amounts received in exchange for the use of the association’s name or logo (or any valuable intangible right) are royalties. Many association affinity and/or endorsement programs generate royalties that would fall within this exception.
- Trade shows and conventions carried on as part of the association’s exempt purpose. • Associate member dues revenues, provided the associate member category has a genuine purpose other than producing income. The key is the motive of the association: the reasons the association accepts associate members must relate directly to or advance the mission and purposes of the association. That an association member has a right to participate in association activities (not necessarily voting, but valuable activities) may help make the case that associate members are not admitted solely for purposes of generating revenue.
- Revenues from the rental or licensing of membership mailing lists. This does not include an active role in the promotional use of membership lists. It is acceptable for the association to control who rents the list, collect payment and analyze results of the mailing to determine if the mailing was successful.
- Annuities received, in most cases. Consultation with an advisor concerning the taxability of this type of income is recommended.
- Generally, rents from real property and incidental rents from person property leased with real property, except if the property is debt-financed. Consultation with an advisor concerning the taxability of this type of income is recommended.

The following circumstances are generally considered unrelated business activities:

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- Revenues received in exchange for advertising in association publications. Calculation of the UBIT is sometimes exasperatingly complicated. A qualified accountant should be involved in determining the amount of advertising income that should be regarded as UBI. [Incidentally, the line between advertising and acknowledgements of support can be fine, particularly as it relates to sponsorships. Some sponsorship benefits, such as discounted booth or magazine advertising space and logo placements on magazines and trade show banners, are likely to translate into more than mere acknowledgements. Such benefits may be viewed as paid-for advertising, on which the association would owe UBIT.]
- Income generated from subsidiaries or other “controlled” organizations, in most cases. Consultation with an advisor concerning the taxability of this type of income is recommended
- Insurance program revenues, other than royalties. Consultation with an advisor concerning the taxability of this type of income is recommended.

## UBI and Certification Programs

Certification programs can be difficult to characterize as related or unrelated. Certification programs are frequently organized as public benefit entities (generally exempt pursuant to Section 501(c)(3) of the Internal Revenue Code). As a public benefit entity, the organization operate exclusively for public benefit purposes.

A certification program intended at improving competence is likely to be viewed as having a substantially related, public benefit purpose. Conversely, a certification program aimed at enhancing member marketability or the image of the profession is not a public benefit purpose; the genuine exempt purpose of the program is considered merely incidental. The effect of these rules is that the IRS generally regards public benefit corporation certification programs as unrelated, and therefore subject to UBIT.

## UBIT Strategy

Remember, UBI is a good thing. It is better to have had the income and pay taxes on it, than never to have had the income. That said, the less the tax, the better.

As a general rule, all sources of association revenue should be reviewed to identify UBI issues. If the characterization cannot be made readily, careful analysis of the circumstances will be required. The objective is to characterize the income as unrelated or related business income, and file tax returns accordingly.

Agreements relating to income programs should be written to connect the program to the exempt purposes of the association as closely as possible. Also, agreements relating to the income program should, if applicable, be separate for non-UBI and UBI components. For example, an association might have two agreements pertaining to its sponsored insurance program: One for royalties for use of the association's name and logo, and another for fees for administrative services the association will perform under the program. The royalty income should be tax free, and the administrative fees subject to UBIT.

## Limits on UBIT

Not surprisingly, there are limits on how much UBI an association (501(c)(6) exempt) can receive with undermining its tax exemption. An association that is primarily engaged in generating UBI is likely to be viewed as not operating primarily (generally, greater than 50% of resources) for exempt purposes. In such cases the association may wish to establish a for-profit subsidiary to conduct the unrelated activities. If your UBI approaches 30 to 40 percent of total revenues, this issue should be taken very seriously.

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Analysis of how much UBI a charitable organization (501(c)(3) exempt) can receive is more difficult, because a c-3 organization must be organized exclusively for charitable, educational or similar purposes. Authoritative guidance on how much UBI a c-3 may generate is lacking, but it most definitely is less than would be acceptable for a c-6 organization. C-3 organizations with UBI revenue streams should consult with expert advisors.

When assessing whether or not an organization has too much UBI, it is important to distinguish between non-dues revenues and UBI. Non-dues revenue is frequently “related” business income. There is no limit on the amount of non-dues revenue an association may make, provided the association operates in a manner consistent with its exempt status.

## Conclusion

Characterization of income of an association as either related business income (tax exempt) or unrelated business income (subject to UBIT) is critical. In some instances the characterization is relatively simple; in others it is appropriate to consult with expert tax and legal advisors.

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## About the Author

Mark Alcorn founded Alcorn Associates Law Offices in 1997 and is also a principal in Alcorn Associates Management Consulting. Mark is an experienced attorney and management consultant specializing in the non-profit association community. As part of the law practice, he counsels numerous associations and for-profit firms on business, tax, antitrust, management and related matters. As part of the management consulting practice he conducts visioning and strategic planning.

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