

## Unrelated Business Income

**What is unrelated business income and why is it important to my church?** Unrelated business income is income from a trade or business that is regularly carried on and 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. An example of this might be the establishment of a T-shirt shop by the church in order to raise additional money for the ministry. Unless each T-shirt carries a message specifically related to the church's exempt purpose, any income generated from the sale of the T-shirts would be unrelated business income and subject to the payment of unrelated business income taxes (UBIT).

Furthermore, if the income from the sale of the T-shirts was so significant that it became the substantial source of income for the church over its normal donations, the IRS could determine that the church was no longer a tax-exempt entity but had become a T-shirt business. This would result in the revocation of the church's tax-exempt status. It is critical that the church understands that the use of the income for ministry is unimportant to the IRS in the analysis of what is unrelated business income.

Within this initial definition, there are three requirements that must be met for this income to be classified as unrelated business income. An activity will be considered an unrelated business (and potentially subject to UBIT) if it meets the following three requirements: (1) it is a trade or business, (2) it is regularly carried on, and (3) it is not substantially related to the furtherance of the exempt purpose of the organization. However, there are a number of exclusions and modifications to this general rule.

The IRS Code contains a number of modifications, exclusions, and exceptions to unrelated business income. For example, dividends, interest, certain other investment income, royalties, certain rental income, certain income from research activities, and gains or losses from the disposition of property are excluded when computing unrelated business income. In addition, the following activities are specifically excluded from the definition of unrelated trade or business:

- **Volunteer Labor.** Any trade or business is excluded in which substantially all of the work is performed for the organization without compensation. Some fund-raising activities, such as volunteer-operated bake sales, may meet this exception.
- **Convenience of Members.** Any trade or business is excluded that is carried on by an organization described in 501(c)(3) or by a governmental college or university, primarily for the convenience of its members, students, patients, officers, or employees. A typical example of this would be a school cafeteria.
- **Selling Donated Merchandise.** Any trade or business is excluded that consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many church thrift shop operations run by exempt organizations would meet this exception.

Much of the above comes directly from the IRS web site. To read more, visit the following site:

[www.irs.gov/charities](http://www.irs.gov/charities)