

## Tax-Exempt Entities: The Unrelated Business Income Tax

Exempt organizations (other than U.S. corporate instrumentalities, charitable remainder trusts, homeowners associations, political organizations, and certain other exempt organizations) are subject to a tax on income from any “unrelated business.” An unrelated business is a trade or business (carried on for the production of income, whether or not profit results) regularly carried on by the organization, that is not substantially related to the exercise or performance of its exempt purpose or function. The term “regularly carried on” also includes a seasonal trade or business.

The deductions directly connected with the business income, as well as specified modifications, are taken into account in determining unrelated business taxable income. Although dividends, interest, royalties, and similar payments are normally excluded from taxation, such investment income is subject to tax if derived from controlled entities or debt-financed property.

**Exceptions.** The term “unrelated trade or business” is subject to several exceptions under which certain businesses (that may otherwise constitute unrelated businesses) are removed from the scope of the tax. These exceptions apply to: (1) businesses carried on largely by volunteers; (2) businesses conducted by charities primarily for the convenience of members, students, patients, and others; and (3) businesses consisting of the sale of donated merchandise. Other exceptions pertain to such diverse activities as entertainment events at fairs, trade shows, certain hospital services, bingo games, rental of telephone and electric poles, low-cost articles distributed incident to solicitation of charitable contributions, mailing lists, and sponsorship payments.

**Computing the Tax.** Computing the unrelated business income tax of an exempt organization depends on whether the organization is a trust or an organization “other than a trust.” The unrelated business income tax imposed upon non-trust exempt organizations is computed as follows:

- 15% of the unrelated business taxable income that does not exceed \$50,000;
- 25% of the unrelated business taxable income that exceeds \$50,000 but does not exceed \$75,000;
- 34% of the unrelated business taxable income that exceeds \$75,000 but does not exceed \$10 million; and

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- 35% of the unrelated business taxable income that exceeds \$10 million.

If an organization has unrelated business taxable income in excess of \$100,000 for any taxable year, the amount of the tax determined under the above rates is increased by the lesser of 5% of the excess or \$11,750. If the unrelated business taxable income exceeds \$15 million, the tax is increased by an additional amount equal to the lesser of 3% of the excess over \$15 million or \$100,000.

The unrelated business income tax imposed upon exempt trusts is computed as follows:

- 15% of the unrelated business taxable income that does not exceed \$2,300;
- \$345.00 plus 25% of the unrelated business taxable income that exceeds \$2,300 but does not exceed \$5,450;
- \$1,132.50 plus 28% of the unrelated business taxable income that exceeds \$5,450 but does not exceed \$8,300;
- \$1,930.50 plus 33% of the unrelated business taxable income that exceeds \$8,300 but does not exceed \$11,350; and
- \$2,937.00 plus 35% of the unrelated business taxable income that exceeds \$11,350.

**Tax Returns.** The unrelated business income tax is reported by an exempt organization on Form 990-T. An exempt organization subject to the unrelated business income tax must file a return if its gross income included in the computation of the tax equals or exceeds \$1,000. If an organization's unrelated trade or business gross income is \$10,000 or less, the instructions authorize an abbreviated return. If unrelated trade or business gross income exceeds \$10,000, the organization must file the entire Form 990-T. In all cases, except for qualified plans, the due date for filing the Form 990-T is May 15th. Qualified plans must file their Form 990-T by April 15th. An organization may request an automatic extension of time for filing Form 990-T, provided that any tax due is paid with the extension request.

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