

# WHAT IS UNRELATED BUSINESS INCOME?



Most PTAs are exempt from federal income tax under Section 501(c)(3) of the IRC and are further defined as public charities (not private foundations). Having tax-exempt status means that a PTA does not pay federal income tax on income from activities that are substantially related to the purpose for which the PTA was given tax-exempt status.

However, the PTA may be required to pay tax on other types of income, referred to as unrelated business income (UBI). The law requires nonprofits to

- Report unrelated business activities when gross receipts are at least \$1,000 by filing IRS Form 990-T.
- Pay taxes on net (after expenses) receipts. Nonprofits risk losing their tax-exempt status only if such activities become the primary focus and make the tax-exempt mission secondary.

## What Is Unrelated Business Income?

For an activity to be classified as yielding unrelated business income (UBI), three factors must be present: The activity must be (1) a trade or business, (2) regularly carried on, and (3) unrelated to the organization's tax-exempt purpose.

### 1. A trade or business

- For the activity to be considered a business, the nonprofit must take an active role in the generation of the income.
- The activity must provide income, but does not have to produce a profit.

### 2. Regularly carried on

- IRS regulations state that activities that are carried on only "discontinuously or periodically" will not be considered to be regularly carried on.
- If an activity is of short duration but follow-up or preparation is carried on over a long period, the income from that activity could be UBI.
- An activity occurring only once per year may yield UBI if a commercial company performing the same activity would also be active only once a year.

### 3. Unrelated to the organization's tax-exempt purpose

- If an activity is not substantially related to the PTA's mission, then it could be considered unrelated to fulfilling the tax-exempt purpose of the PTA.
- The substantial relation of the activity to the PTA's tax-exempt purpose cannot come solely from the PTA's need for money. The destination or use of the income has no bearing on whether it is unrelated business income. The determination is made by how the income is earned.

## Exceptions or Exemptions

The income from most PTA fundraising activities is exempt from federal income taxes because

- The activities are conducted only once per year, or
- At least 85 percent of the work of the activities is conducted by volunteers, or
- The activities consist of selling donated merchandise (e.g., a silent or live auction of donated merchandise).

## Judgment of whether an activity is related or unrelated is made on a case-by-case basis.

The federal, state, and local governments may have different standards for pursuing the charge of UBI, although most state and local governments follow the federal rules.