

UNRELATED BUSINESS INCOME

Q: Why should I be concerned about unrelated business income?

A: Even though the churches of the Iowa Conference are exempt organizations under the Internal Revenue Code, they are required to report and pay taxes on their unrelated business income.

Q: What is unrelated business income?

A: This is complicated. The place to start, at least for non-tax practitioners, is with a close review of IRS Publication 1828, *“Tax Guide for Churches and Religious Organizations”*. According to that publication, if a church or other religious organization earns income from activities unrelated to its tax-exempt purpose, the income may be considered unrelated business income and subject to income taxation:

Net Income Subject to the UBIT

Churches and religious organizations, like other tax exempt organizations, may engage in income-producing activities unrelated to their tax-exempt purposes, as long as the unrelated activities are not a substantial part of the organization’s activities. However, the net income from such activities will be subject to the UBIT [Unrelated Business Income Tax] if the following three conditions are met:

- *the activity constitutes a trade or business,*
- *the trade or business is regularly carried on, and*
- *the trade or business is not substantially related to the organization’s exempt purpose. (The fact that the organization uses the income to further its charitable or religious purposes does not make the activity substantially related to its exempt purposes.)*

Exceptions to UBIT

Even if an activity meets the above three criteria, the income may not be subject to tax if it meets one of the following exceptions: (a) substantially all of the work in operating the trade or business is performed by volunteers; (b) the activity is conducted by the organization primarily for the convenience of its members; or (c) the trade or business involves the selling of merchandise substantially all of which was donated.

In general, rents from real property, royalties, capital gains, and interest and dividends are not subject to the unrelated business income tax unless financed with borrowed money.

Q: If my church rents the parsonage is this rental income taxable?

A: A parsonage is real property. Because a church is an “exempt” organization, it does not pay income tax on the money it receives from the rental of the parsonage unless the parsonage is subject to a mortgage.

You may also wish to consult IRS Publication 598 *“Tax on Unrelated Business Income of Exempt Organizations”*. Both Publication 598 and Publication 1828 are available on line at www.irs.gov. At the end of the day, however, if you have serious questions about whether funds received by your church are “unrelated business income” there is no substitute for the advice of a qualified tax advisor.