

Form 990 and Accounting for Income from Unrelated Business Activities



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Form 990

Form 990 – What is it?



Form 990

Form 990, Return of Organizations Exempt From Income Tax

Tax-exempt organizations, nonexempt charitable trusts, and section 527 political organizations file this form to provide the IRS with the information required by section 6033.



Form 990

Form 990 – Which one do I file?



Form 990

Most tax-exempt organizations are required to file an [annual return](#). Which form an organization must file [generally](#) depends on its financial activity, as indicated in the chart below.

Status	Form to File	Instructions
Gross receipts normally \leq \$50,000 Note: Organizations eligible to file the <i>e-Postcard</i> may choose to file a full return	990-N	n/a
Gross receipts < \$200,000, and Total assets < \$500,000	990-EZ or 990	Instructions
Gross receipts \geq \$200,000, or Total assets \geq \$500,000	990	Instructions
Private foundation - regardless of financial status	990-PF	Instructions

Form 990 – Where do I find the forms?

- Form 990N: File ONLINE

<https://www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard>

- Form 990EZ/Form 990/Form 990PF/Schedules (all forms, all years):

https://apps.irs.gov/app/picklist/list/priorFormPublication.html?value=990&criteria=formNumber&submitSearch=Find&_ga=1.133359815.872769871.1475434130



Form 990 – Tips

Tips (when filing Form 990/Form 990EZ):

- The Form 990 and all Schedules (except for B) are public record – NO SSNs.
- It's the organization's chance to communicate with funders, the rest of Nonprofitland, the IRS/other government entities, and, potentially, the media. Use your opportunity wisely! This includes the statement of program service accomplishments, Schedule O.
- Be aware of governance, management, and disclosure. While no particular practices are generally “mandated” by federal law, there are certain policies and procedures that should be adopted. And, the Form 990 series asks questions to see if you've adopted those policies and procedures (i.e., Conflict of Interest, Whistleblower, Compensation, Document Retention, Joint Venture).



Form 990 – Tips

Tips (cont.):

- Include all required Schedules (as applicable):
 - **Schedule A: Public Charity Status and Public Support.** This Schedule requires the EO to report on how it qualifies as a public charity.
 - **Schedule B: Schedule of Contributors.** This is required for any EO required to file a Form 990, Form 990-PF, or Form 990-EZ and that received contributions totaling \$5,000 or more in money or property from any one contributor.
 - **Schedule C: Political Campaign and Lobbying Activities.**
 - **Schedule D: Supplemental Financial Statements.**
 - **Schedule E: Schools.** This schedule is focused on schools maintaining and executing policy of racial nondiscrimination.
 - **Schedule F: Statement of Activities Outside the United States.**
 - **Schedule G: Supplemental Information Regarding Fundraising or Gaming Activities.** This schedule seeks information about fundraising practices, all agreements with professional fundraisers, and states in which the EO is registered to solicit contributions. Organizations that earned more than \$15,000 from gaming activities must also complete Schedule G.
 - **Schedule H: Hospitals.** This schedule is required for any EO that operated a hospital facility and is virtually a separate return.
 - **Schedule I: Grants and Other Assistance to Organizations, Governments, and Individuals in the United States.** This is required if more than \$5,000 was distributed in any of those categories.
 - **Schedule J: Compensation Information.**
 - **Schedule K: Supplemental Information on Tax-Exempt Bonds**
 - **Schedule L: Transactions with Interested Persons**
 - **Schedule M: Noncash Contributions.** Required if the EO received non-cash contributions of more than \$25,000, or if the EO received art, historical treasures, similar assets, or qualified conservation contributions.
 - **Schedule N: Liquidation, Termination, Dissolution, or Significant Disposition of Assets**
 - **Schedule O: Supplemental Information to Form 990 or 990-EZ**
 - **Schedule R: Related Organizations and Unrelated Partnerships.** This Schedule must be included if the EO owns all of a disregarded entity – for example, a single member LLC.



Form 990 – Tips

Tips (cont.):

- Know what a “key employee” is:
 - NOT an Officer
 - Employees earning more than \$150,000
 - Meets “responsibility test”
 - » The employee has responsibilities or powers that on the whole are similar to those of an officer, director or trustee;
 - » The employee manages a segment or activity that represents 10% or more of the assets, income, or expenses of the organization; or
 - » The employee has or shares authority to control or determine 10% or more of the organizations capital expenditures, operating budget, or compensation for employees.

- Statement of Revenue – record revenues properly.
Contributions v. Program Services v. Membership Fees
v. other



Form 990 – Tips

Tips (cont.):

- Statement of Functional Expenses – 3 categories add up to the grand total: Program Service Expense, Management and General Expenses, and Fundraising Expenses
 - Allocation is a careful dance. See instructions. Errors in classifying functional expenses is a top error.
 - Example: If an organization applies for a grant or contract to enable it to carry out its exempt purposes or programs, the cost of that process is a program service expense (column (B)) if the activities are conducted to meet the contracting party's needs. In contrast, if the grant is for the EO's general purposes or to provide services to the general public, then the grant application process is a fundraising expense reportable under column (D).
 - Compensation can be allocated.



Form 990 – Tips

Tips (cont.):

- Improperly reporting compensation reported in a prior Form 990 on Schedule J.
- Reporting only unrestricted income.
- Reporting support payments to a related organization as “other expense.”
- Misidentifying the proper interested person on Schedule L.
- Showing details of related transactions with a 501(c)(3) parent organization on Schedule R.
- Failing to report UBIT, file the Form 990T, and publicly disclose the Form 990T filing.

Unrelated Business Income and Taxing it:

Definition. There are three pillars to identifying a business activity as generating unrelated business income. An “unrelated trade or business” is any activity that:

- (i) constitutes a trade or business or a facet of a trade or business,
- (ii) is regularly carried on, and
- (iii) is not substantially related to an organization’s exempt purposes.

Unrelated Business Income and Taxing it:

What is a “Trade or Business?”:

- Under Section 513, a “trade or business” includes any activity that is carried on for the production of income from the sale of goods or the performance of services.
- A trade or business activity must be operated for profit or at least have a profit motive.
- A trade or business activity does not lose that characterization simply because it is carried on as part of a larger activity or complex of activities that may be related to the EO’s exempt purpose.
- Policy of preventing unfair competition between exempt and non-exempt organizations carrying on the same business.



UBIT

Unrelated Business Income and Taxing it:

What is a “Regularly Carried On?”:

- Not surprisingly, this term refers to the frequency and continuity of an activity. Treas. Reg. § 1.513-1(c).
- If the activity is carried on with the frequency and continuity of a commercial enterprise, it will be considered “regularly carried on.” Again, the policy of preventing unfair competition is cited.
- The regulations also examine the time span in which activities are carried out. Treas. Reg. § 1.513-1(c)(1).
 - Year round?
 - Sporadic?
 - Compared to commercial business – is it also seasonal/intermittent?



UBIT

Unrelated Business Income and Taxing it:

What is “Substantially Related?”:

- A trade or business is related to an exempt purpose if it has a causal relationship with the accomplishment of the EO’s exempt purpose. To avoid UBIT treatment, the causal relationship must be substantial and “important.” Whether this relationship exists depends on the facts and circumstances of each case.
- If activities are inherently non-charitable, or if they are activities normally carried on by for-profit businesses, the activity may be considered as related if it is carried on at below-market costs and or is provided to other charities or individuals who are proper objects of charity.
- The scale of the activity can also matter. Assume that an EO carries out an activity that is seemingly related to the EO’s purpose. If the activity is conducted on a significantly larger scale than is necessary to accomplish the EO’s exempt purposes, then the portion the activity that is not necessary for accomplish those exempt purposes will generate UBTI. Treas. Reg. § 1.513-1(d)(3).



UBIT

Unrelated Business Income and Taxing it:

Statutory Exceptions. Some activities are statutorily excepted from the definition of an unrelated trade or business. Treas. Reg. § 1.513-1(e). A sample of these activities are (see IRS Publication 598 for a more detailed description):

- Volunteer workforce: A trade or business in which substantially all the work is performed for the organization without compensation.
- Convenience of members: As to 501(c)(3) organizations and state colleges and universities, an activity that is carried on primarily for the convenience of the organization's members.
- Selling donated merchandise: The selling of merchandise, substantially all of which was received by the EO as contributions or gifts.
- Certain bingo games.
- Qualified trade show activity.
- Qualified public entertainment activity (i.e., a fair or exposition promoting agriculture and education)
- Qualified sponsorship activities



UBIT

Unrelated Business Income and Taxing it:

Other Important Rules and Exceptions:

- S Corporation Income. All income from ownership of S corporation stock is UBIT, regardless if the S corporation business is related or unrelated. Code § 512(e).
- Section 512(b)(1): UBIT does not include dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued under a loan agreement, annuities, and deductions with respect to all such amounts.
- Section 512(b)(2): UBIT does not include royalties, however measured, and all deductions with respect to royalties.



UBIT

Unrelated Business Income and Taxing it:

Other Important Rules and Exceptions:

- Section 512(b)(3): UBIT does not include rents from real property or rents from personal property leased in connection with the real property if the rents attributable to the personal property are incidental to the total rents under the lease.
- Note: there are exceptions, and exceptions to the exceptions.
- Example: Debt Financed Income is NOT UBIT even though, by definition, debt financed income is a passive investment held to produce income. See materials, IRC Section 514, and IRS Publication 598.



UBIT

Unrelated Business Income and Taxing it: Why do we even care?

- Too much UBIT can jeopardize an EO's tax-exempt status.
- It can require tax-exempt organizations to pay tax. But, incurring UBIT liability isn't inherently bad:
 - If you generate "unrelated business income" per the IRS rules, you should report this income and directly connected expenses on IRS Form 990-T. Subsequently, you may owe some taxes on that income.
 - However, since you only pay taxes on the activity's net income after you subtract allowed expenses ("directly connected expenses") from the gross reported income, in many cases, generating unrelated business income results in no tax liability.
 - Many nonprofits that have been at this for a long time simply consider the tax liability on their UBI as a cost of doing business. If your nonprofit incurs unrelated business income, you're in good company. In 1995, more than 36,000 exempt organizations reported gross unrelated business income. This number has no doubt risen in the past five years.
- A nonprofit that expects to incur \$500 or more in UBIT liability must make estimated tax payments on a quarterly basis. Large nonprofits that generate substantial unrelated business income may be subject to the Electronic Federal Tax Payment System (EFTPS).

Thank you!!!



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