



Unrelated Business Taxable Income (UBTI) – Sec 512

There is no unrelated business taxable income unless: (1) there is a trade or business; (2) the trade or business is **regularly carried on**; and (3) the trade or business is not substantially related to the exercise or performance of an organization's exempt purposes. Therefore, in every case in which an exempt organization has unrelated trade or business income, a determination must be made whether the trade or business is regularly carried on before it can be concluded that the income derived therefrom is subject to tax.

Reg. 1.513-1(c)(1) provides that in determining whether trade or business from which a particular amount of gross income derives is "regularly carried on" within the meaning of IRC 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the nonexempt business endeavors with which they compete. It states that the business activities of an exempt organization will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

Reg. 1.513-1(c)(2)(i) provides that where income producing activities are of a kind normally conducted by nonexempt commercial organizations on a year-round basis, the conduct of such activities by an exempt organization over a period of only a few weeks does not constitute the regular carrying on of trade or business. The regulation states that the operation of a sandwich stand, for example, by a hospital auxiliary for only two weeks at a state fair would not be the regular conduct of trade or business, but that the conduct of year-round business activities for one day each week would constitute the regular carrying on of trade or business. According to this regulation, where income producing activities are of a kind normally undertaken by nonexempt commercial organizations only on a seasonal basis, the conduct of such activities by an exempt organization during a significant portion of the season ordinarily constitutes the regular conduct of trade or business. Citing this regulation provision, **Rev. Rul. 68-505, 1968-2 C.B. 248**, holds that a two-week horse racing meet featuring pari-mutuel betting conducted by an IRC 501(c)(3) county fair association is regularly carried on because it is usual to carry on such trade or business only during a particular season.

Reg. 1.513-1(c)(2)(ii) states:

"In determining whether or not intermittently conducted activities are regularly carried on, the manner of conduct of the activities must be compared with the manner in which commercial activities are normally pursued by nonexempt organizations. In general, exempt organization business activities which are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors. For example, the publication of advertising in programs for sports events or music or drama performances will not ordinarily be deemed to be the regular carrying on of business." Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business taxable income. An exempt organization that has \$1,000 or more gross income from an unrelated business must file **Form 990-T**, *Exempt Organization Business Income Tax Return*.

There is a commonly repeated view on Internet discussion groups, that "If your IRA invests in things that produce Unrelated Business Income (UBI), and the net income from these investments exceeds \$1,000, your IRA could be subject to the Unrelated Business Income Tax (UBIT)." (1). This is possibly a myth. The 2006 Tax Information info@LDSCO.com

packet for Hugoton Royalty Trust states, in page 9, "In the opinion of the trust's tax counsel, Winstead Sechrest & Minick P.C., the income of the trust will not be unrelated business taxable income so long as the trust units are not 'debt-financed property' within the meaning of section 514(b). In general, a trust unit would be debt-financed if the trust unit-holder incurs debt to acquire a trust unit [...]"

However, the IRS does unequivocally state in the first few paragraphs of Chapter 1 of the November 2007 revision of Publication 598 that IRAs are "subject to the tax on unrelated business income."

Types of Employee Benefit Plans That Are Subject To UBIT

1. Qualified Plans. A qualified pension, profit sharing, or stock bonus plan described in section 401(a) is subject to UBIT. §511(a)(2).

- With respect to qualified plans, "unrelated trade or business" is defined as *any* trade or business regularly carried on by the trust or by a partnership of which the trust is a member. §513(b).
- Thus, neither the "substantially related" test nor the exceptions of section 513(a) apply to section 401(a) trusts.

2. IRAs, SEPs, SIMPLE retirement accounts (§408(e)(1)), and education IRAs (§530(a)), are subject to UBIT.

3. Group Trusts. If certain requirements are satisfied, a trust holding pooled assets of qualified plans and IRAs is a tax-exempt trust under section 501(c) and therefore subject to UBIT. Rev. Rul. 81-100, 1981-1 C.B. 326, as clarified and modified by Rev. Rul. 2004-67, 2004-28 I.R.B. 28. UBTI applies as though the group trust were a qualified plan, meaning that individual section 401(a) trusts participating in the group trust do not receive flow-through UBTI.

4. Welfare Benefits Funds. Welfare benefits funds are subject to UBIT.

- **VEBAs—§501(c)(9).** AVEBA is an employees' association that provides for the payment of life, sick, accident, or certain other benefits to its members, their dependents, and their designated beneficiaries. Only "exempt function income" is excluded from the VEBA's UBTI. "Exempt function income" includes contributions or other payments from participants, or other income that is properly set aside, to provide for the payment of permissible benefits (and certain administrative expenses). §512(a)(3).
- **SUBs.** SUBs are described in section 501(c)(17). §513(b).
- **Group Legal Services Plan Organizations.** Group legal services plan organizations are described in section 501(c)(20).
- **Non-Exempt Welfare Benefit Trusts.** An employer sponsoring a welfare benefit fund not described in section 501(c)(9), (17), or (20) is taxed on the amount that would be UBTI if the fund were described in section 501(c)(9), (17), or (20). §419A(g).

5. Governmental Plans. The income of a governmental plan trust appears to be subject to UBIT. Treas. Reg. §1.511-2(a)(1)(i); §1.511-2(b). An argument can be made that governmental plans should be exempt under section 115(2), which provides that gross income does not include income derived from the exercise of any essential governmental function that accrues to a state or political subdivision. See Rev. Rul. 90-74, 1990-2 C.B. 34, which held that income of an organization formed by a political subdivision to pool risks arising from workers' compensation and employees' health is excluded from gross income under section 115.