



*This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.*

## **UBIT: Is Income Generated by Your Training Program Taxable?**

Have you ever shopped at a store or eaten at a restaurant that was operated by a nonprofit? Many organizations that have 501(c)(3) tax-exempt status conduct such commercial business activities in order to provide training opportunities for clients and make money for their ongoing programming. Such organizations do not have to pay any Federal income taxes, right? Not necessarily.

While nonprofits with 501(c)(3) status typically do not pay Federal tax on their income, there is an exception for income that is not substantially related to the organization's exempt purpose, known as "unrelated business income" or UBI. An organization that receives UBI will have to pay tax on that income unless it qualifies for one of the exceptions, exclusions or deductions. This tax is called "unrelated business income tax," or UBIT. If the organization receives a substantial amount of UBI in relation to its exempt income, it may jeopardize the organization's 501(c)(3) status.

Organizations that conduct commercial business activities, such as running a restaurant, must consider whether the income from such activities constitutes UBI requiring the payment of UBIT. When determining whether your organization has to pay UBIT, the first question is whether the income is UBI. In order for income to be considered UBI, it must result from:

1. A trade or business,
2. Regularly carried on, and
3. Not substantially related to the organization's exempt purposes.

All three of the elements must be in place in order for income to be considered UBI.

If the organization is operating a commercial business, it is almost certainly meeting #1 and #2 above, so the key factor is #3 – whether the activity is substantially related to the organization's exempt purposes. Providing training opportunities to clients seems like it should be related to an organization's mission, but that depends. The question to ask is *"Does the commercial business activity contribute importantly to accomplishing the organization's exempt purpose (its mission) other than through raising funds?"*

The Internal Revenue Service has provided some guidance on this topic. For an organization's training program to be considered substantially related to the organization's mission, there must be a "clear and distinct causal relationship" between the work activity and the training of the individuals. Further, the scale of the training

Dated: 6/17/2013

[www.pbpatl.org](http://www.pbpatl.org)

© 2013 Pro Bono Partnership of Atlanta, Inc.

program must not be larger than what is reasonably necessary to accomplish the organization's charitable purpose.

For example, consider a nonprofit whose mission is to empower homeless individuals to achieve economic self-sufficiency. In order to provide transitional employment and training opportunities for homeless individuals, the nonprofit operates a janitorial service that is hired by businesses to do regular cleaning. Income from the janitorial service supports the nonprofit's programs. In order for the income to be considered substantially related to the nonprofit's mission, and therefore not subject to tax, there must be a direct link between the commercial business activity (the janitorial service) and the training of the homeless individuals served by the organization. In addition, the scale of the janitorial service operation must not be larger than what is necessary to provide training to the homeless individuals. If the janitorial service becomes so successful that the nonprofit cannot operate it with just the individuals in the program (in addition to a few supervisors) and must hire outside workers, then the income may become taxable.

Training programs that have been determined to be related to the mission of the organization, and thus not generating UBI, exhibited a combination of the following characteristics in addition to those stated above:

- Program clients/trainees are the primary employees, except for individuals providing training and supervision of the program participants/trainees
- All of the work involved in the business activity is performed by the program clients/trainees and those who provide training and supervision
- The work or employment in the program is transitional employment to gain certain skills or competencies in accordance with the program objectives
- The program clients/trainees may only work in the program's employment for a limited period of time (i.e., if the organization provides rehabilitation and temporary housing for recovering alcoholics, the employment in the training program may only last the length of time the particular participant receives temporary housing)
- Any net profits gained from the commercial business activity training program operations are applied toward the organization and its mission

Dated: 6/17/2013

[www.pbpatl.org](http://www.pbpatl.org)

© 2013 Pro Bono Partnership of Atlanta, Inc.

- The training program may sell products to the public as long as the products resulted from the performance of exempt functions (e.g., products made by handicapped individuals as part of a rehabilitation program) and are sold in substantially the same state as they existed when the client/trainee made or prepared the product
- The program client/trainee will learn new occupational skills as part of his or her training and may be required by the organization to set learning goals

For assistance in determining whether your nonprofit's commercial business activity could generate taxable income or could jeopardize your tax exempt status, consult with an attorney.

For more information on UBIT, see:

- [UBIT: Four Letters Your Nonprofits Need to Know](#)
- [Webcast: Unrelated Business Income](#)

Dated: 6/17/2013

[www.pbpatl.org](http://www.pbpatl.org)

© 2013 Pro Bono Partnership of Atlanta, Inc.