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UNRELATED BUSINESS INCOME TAX

Please note that this is only an overview. For questions pertaining to your organization, please consult the IRS tax code and your tax preparer.

If your organization earns unrelated business income and if the gross amount of that income is $1000 or more, you must report that income and, perhaps, pay tax on it even if the organization has 501(c)(3) tax-exempt status. Following are a few brief words on the topic in order to make you aware of your group's obligation in this area.

From the 990-T tax form instructions: Unrelated trade or business income is defined as the gross income derived from any trade or business that is regularly carried on, and not substantially related to the organization's exempt purpose or function (aside from the organization's need for income or funds or the use it makes of the profits). A trade or a business is any activity carried on for the production of income from selling goods or performing services. Not substantially related means that the activity that produces the income does not contribute importantly to the exempt purposes of the organization, other than the need for funds, etc.

For NCTE groups, unrelated trade or business income includes paid advertising in the periodical published by the group. Report advertising income on tax forms 990-T (item 11) accompanied by Schedule J. There are also other sources of unrelated trade or business income. See the 990-T form for other types of unrelated business income that must be reported.

In general, if the advertising income is more than direct advertising costs and circulation income equals or exceeds readership costs, then unrelated business income is the excess of advertising income over direct advertising costs. If advertising income is more than direct advertising costs, and readership costs are more than circulation income, then unrelated business taxable income is the excess of total income (advertising income plus circulation income) over total periodical costs (direct advertising costs plus readership costs). If the amounts arrived at after following these formulas are less than $1000, the organization does not need to file form 990-T with the IRS. However, if that income figure is $1000 or more, the organization must file form 990-T.

Figuring gross income from unrelated trade or business is a rather complicated process and the following explanation is a way too simplified version, but it does illustrate the basic idea. Find the precise explanations in the instructions for Schedule J of the 990-T form. First, figure your costs on a per issue basis for the time period of the fiscal year in question.

Advertising income is the total amount paid for advertising in the issue. Direct advertising costs are the amount it cost to print the advertising per issue of the publication. To figure the cost of advertising per issue, figure the cost to produce and mail each publication during that fiscal year (include any editorial costs); divide the number of advertising pages in that issue by the total number of pages in the issue, including covers; and multiply the resultant figure by the total cost of the issue. This gives you the proportional cost of the advertising for each issue of each publication. The sum of the cost for each issue that fiscal year is known as direct advertising costs.

Circulation income is the percentage of the total membership dues collected that fiscal year which pays for the publication. To figure circulation income, add up all the exempt activity expenses for the organization (e.g., convention expenses, publication expenses, professional development expenses) and divide the yearly expenses for producing the publication by the total of the organizational expenses. Multiply the result by the total amount of membership dues collected that fiscal year. This is the circulation.

Readership costs are the yearly costs to produce the publication (as figured above).