

LAW COMMITTEE REPORT – SPRING CONVENTION 2015

Unrelated Business Income Tax – Issues of Concern For Lodges

One of the “hot” topics being discussed in Elkdom these days is what obligations our lodges may have to pay income taxes for Unrelated Business Income derived by the lodges. I will try to provide what I hope will be a useful overview of the topic herein. Please keep in mind the inquiry can be fact intensive and can lead to stiff tax penalties if unrelated business income is derived but taxes on such income is not paid. This Report is intended to help identify the issues for you. More intense analysis with a legal or accounting professional with expertise in this area may be needed for a more detailed analysis of the risk of any individual lodge. Also please keep in mind not only the general definition of *unrelated business income*, but also the exclusions to such definition that will apply to many of our lodges.

What is Unrelated Business Income?

For most organizations, an activity is an unrelated business (and subject to unrelated business income tax) if it meets three requirements:

1. It is a trade or business,
2. It is regularly carried on, and
3. It is not substantially related to furthering the exempt purpose of the organization.

There are, however, a number of modifications, exclusions, and exceptions to the general definition of unrelated business income.

"Trade or Business" Defined

The term *trade or business* generally includes any activity carried on for the production of income from selling goods or performing services. Activities of producing or distributing goods or performing services from which gross income is derived do not lose their identity as trades or businesses merely because they are carried on within a larger framework of other activities that may, or may not, be related to the organization's exempt purposes.

"Regularly Carried On"

Business activities of an exempt organization ordinarily are considered *regularly carried on* if they show a frequency and continuity, and are pursued in a manner similar to comparable commercial activities of nonexempt organizations. The activity need not be performed daily or even weekly to qualify as *regularly carried on*, they must however be something more than sporadic activity. A one time event certainly will not qualify for tax application. However, a monthly dinner open to the public may.

"Substantially related"

To determine if a business activity is *substantially related* to the exempt (charitable) purpose of the lodge requires examining the relationship between the activities that generate income and the accomplishment of the organization's exempt purpose. Trade or business is related to exempt

purposes, in the statutory sense, only when the conduct of the business activities has causal relationship to achieving exempt purposes (other than through the production of income). The causal relationship must be *substantial*. The activities that generate the income must contribute importantly to accomplishing the organization's exempt purposes to be substantially related. Thus, profits made at charitable golf outings to support 365 or Gold Key would be exempt as being substantially related to our charitable purposes.

Unrelated Business Income Tax Exceptions and Exclusions¹

The Internal Revenue Code contains a number of modifications, exclusions, and exceptions to unrelated business income. The exclusions and exceptions that are mostly to apply to our lodges are as follows:

- **Volunteer Labor:** Any trade or business is excluded in which substantially all the work is performed for the organization without compensation. Fundraising activities, such as volunteer operated bake sales, would likely meet this exception as would dinners prepared by volunteers. Thus, if a lodge has a dinner that is open to the public, such as a Friday Fish Fry, and the cooks, servers and bartenders are all volunteers, the income generated that evening is not subject to taxation. If they are paid by the lodge, the income is taxable.
- **Convenience of Members:** Any trade or business is excluded that is carried on for the convenience of its members. Under this exclusion, income generated by meals served in the Member's Lounge, primarily to members, is likely to be excluded from taxation, regardless of whether the person preparing such meals is a volunteer or paid.
- **Selling Donated Merchandise:** Any trade or business is excluded that consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many rummage sales of exempt organizations would meet this exception.
- **Bingo:** Profits derived from bingo games are not subject to taxation as unrelated business income provided the bingo games are properly licensed and authorized under State Law.

If there are any further questions please feel free to contact me at pr@sullivanleavitt.com

Respectfully Submitted

Paul E. Robinson – Law Committee Chairperson

¹ These exceptions and exclusions are limited to how the IRS will review a set of facts for Federal Income Tax Purpose, it is not a safeguard that the State of Michigan would not claim an entitlement to sales tax on such events. This is a separate issue that would have to be separately considered by a lodge with the assistance of its tax professional.