

## Potential Income Tax Implications from use of Church Property

Churches often rely on receipts beyond contributions to sustain operations. This information sheet is to alert churches to the possible income tax implications of certain methods of generating income for your church.

**UNRELATED BUSINESS INCOME (UBI)** is income received by a church that is deemed to be commercial and therefore subject to tax even if the proceeds are used in the church's mission and ministry. Generally, if a church engages in an ongoing activity that is similar to that of a for-profit business, the resulting income will be UBI.

**INVESTMENTS:** Income (interest, dividends, gain on sale) from marketable securities is not UBI.

**RENTS:** Generally, if a church leases property to a third party and is not involved in the activities of that third party, the rent will not be UBI. Merely collecting rent is not a commercial activity.

- If a lease includes both real property and personal property (such as tables and chairs), none of the rent will be UBI if no more than 10% of the rent is attributable to the personal property. If personal property is included in a lease and is not a significant part of the value of the lease, it would be prudent to specify the amount of rent allocable to the personal property in the lease to support that the personal property accounts for no more than 10% of the rent.
- If a lease includes services provided by the church, the rent allocable to the services will be UBI. If a tenant will have exclusive use of the rented premises, it is prudent to have the tenant provide all services (e.g., janitorial). It is OK if the tenant hires the church's janitor for this purpose.

**OCCASIONAL SALES:** Occasional bake sales of homemade items and occasional rummage sales of donated merchandise does not generate UBI. Note that the activity must be occasional and not regularly conducted. A one-shot bake sale that is wildly successful and generates a profit of \$1,000 does not result in UBI.

**PARKING:** Occasional rentals of parking spaces in the church parking lot that involve no active operation by the church is not UBI. However, if the church uses its parking lot in competition with for-profit parking operations, there is a risk of UBI. The church can lease the parking lot for a set rent to a parking operator who manages all aspects of the business (setting rates, hiring on-site managers, collecting revenue, advertising) without risking UBI. This would most commonly arise when the parking lot is near a facility that generates crowds for events and the need for parking during events.

**SPECIAL RULES FOR DEBT-FINANCED PROPERTY:** Income such as rent that would otherwise not be UBI but is generated by property that has a mortgage or similar debt for acquisition or improvement is UBI. This exception applies to income from renting the debt-financed property or from the sale of the debt-financed property.

## FILING RETURNS FOR UBI

If a church has gross (receipts less cost of goods sold) UBI of \$1,000 or more must file Form 990-T with the IRS and Form 109 with the California Franchise Tax Board. The amount subject to tax is the net income – gross income less related expenses).

The Federal form must be filed electronically through some entity that has an EFIN, an Electronic Filing Identification Number. Many CPAs will have an EFIN as do online filing providers such as Tax990. However, it is suggested that you first download Form 990-T and its instructions from IRS.gov, fill out the hard copy of the form and then transfer the results to the online form. Note that the IRS software may reject your submission if the name of your church on the electronic form does not match exactly the name on file with the IRS, e.g., Saint Matthew versus St. Matthew. The official name of your church can be checked on the California Secretary of State's website: <https://bizfileonline.sos.ca.gov/seach/business> by using the Search option on the left-hand side of the webpage.

The California return can be downloaded from the Franchise Tax Board website, filled out, and mailed in.

For more information, see IRS Publication 598 (available online).