

2019 Mid Year Auditing and Accounting Seminar

Unrelated Business Income and Rental Income



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Unrelated Business Income

What is It?

How to Account for It



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Unrelated Business Income (UBI)

...is the income from a **trade** or **business** **regularly** conducted by an exempt organization and **not** substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity.



Source: IRS Publication 598

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Three Key Factors

1. A Trade or Business



Source: IRS Publication 598

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Trade or Business

Defined by the IRS as “any activity which is carried on for the production of income from the sale of goods or the performance of services.”



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Three Key Factors

1. A Trade or Business
2. Regularly Carried On



Source: IRS Publication 598

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Regularly Carried On

Business Activities ordinarily are considered regularly conducted if they show a frequency and continuity, and are pursued in a manner similar to comparable commercial activities of nonexempt organizations.



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Regularly Carried On

Examples:

Seasonal sales of holiday cards	YES
Operation of sandwich stand at a State Fair	NO
Operation of parking lot once a week	YES

There are Exceptions – more on this later



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Three Key Factors

1. A Trade or Business
2. Regularly Carried On
3. Not Substantially Related



Source: IRS Publication 598

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Not Substantially Related

A business activity is ***NOT*** substantially related to an organization's exempt purpose if it does not contribute ***importantly*** to accomplishing that purpose (other than through the production of funds).

The IRS regulations emphasize that “the size and extent of the activity must be considered in relation to the nature and extent of the exempt function that they intend to serve.”



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General Rules to Avoid UBI

An exemption applies to “exempt function income.”

Defined as “the gross income from dues, fees, charges or similar amounts paid by members or their dependents or guests to further the organization’s exempt purposes.”



Source: IRS Publication 598

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General Rules to Avoid UBI

Sales to members

Not UBI

Sales to non-members

Presumed UBI

IRS point of view is that the nature of the sales is determined mainly by who makes payment for the sale. If member pays it will not be considered UBI.



Source: IRS Publication 598

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General Rules to Avoid UBI

Guests of members are considered non-members.

IRS defines guest as “an individual invited to participate in an activity, ***accompanied by a member***, and for whom ***all expenses*** are paid by the member.”



Source: Auditing and Accounting Manual

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General Rules to Avoid UBI

Imperative therefore that to avoid being classified as UBI the Lodge member must pay for all expenses of their guests.

With the advent of POS systems, simply posting a sign to this effect is no longer effective. Debit and Credit Card transactions can be traced.

Note: a member's spouse is treated as a member if provision is made in the Lodge's By-laws .



Source: Auditing and Accounting Manual

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General Rules to Avoid UBI

The “General Public” are “persons other than members of a club or their dependents or guests.”

Exemption does not apply to sales to the “general public.”

Solicitation by advertisement or otherwise for public patronage of it’s facilities is prima facie evidence of an organization engaging in an Unrelated Trade or Business.



Source: Auditing and Accounting Manual

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General Rules to Avoid UBI

Sales to visiting BPOE members

Grand Lodge position that these sales are not UBI

1. All Lodges operate under same Group Exemption
2. All members pay a uniform national per capita
3. All Lodges operate by uniform national rules
4. Supported by IRS pronouncements



Source: Auditing and Accounting Manual

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General Rules to Avoid UBI

Sales to visiting BPOE members

1. Record Income as Member Income in Lodge Records
2. Use separate Visiting Elks Register, not guest register
3. If the Lodge is under examination and the IRS takes a contrary position contact the State Sponsor and Area Committeeman for further guidance



Source: Auditing and Accounting Manual

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Excluded Trade or Business Activities

Bingo Games



Source: IRS Publication 598

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Excluded Trade or Business Activities

Bingo Games are excluded provided that:

1. Game meets the legal definition of Bingo
2. Is legal where played
3. Played in a jurisdiction where Bingo Games are not regularly conducted by ***for-profit*** organizations



Source: IRS Publication 598

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Excluded Trade or Business Activities

Bingo Games legal definition:

A game of chance played with cards generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the card in an attempt to form a preselected pattern. The first participant to form the preselected pattern wins the game.



Source: IRS Publication 3079

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Excluded Trade or Business Activities

Bingo Games legal definition:

In addition, for a game to meet the legal definition of bingo, wagers must be placed, winners must be determined, and prizes or other property must be distributed in the presence of all persons placing wagers in that game.

This eliminates instant “Bingo” games from qualifying for the exemption.



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Excluded Trade or Business Activities

Bingo Games

Volunteer Workforce



Source: IRS Publication 598

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Excluded Trade or Business Activities

Volunteer Workforce

1. Substantially all the work is performed without compensation
2. Substantially all is 85% or greater
3. Any reasonable allocation method
4. Applies to all Lodge fundraising activities
5. Should be documented in the event report.



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Income Exclusions

- Dividends, interest, annuities and other investment income
- Gains and losses from disposition of property
- Revenues from membership drives
- Rents



Source: IRS Publication 598

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Income Exclusions

- Dividends, interest, annuities and other investment income
- Gains and losses from disposition of property
- Membership Drives
- Rents

These two Exclusions are unique to a 501(c)(8) organization and why the Grand Lodge vigorously defends this status with the IRS. They are not available to any other non profit fraternal or social club type.



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Income Exclusions – Membership Drives

1. Can apply to any Lodge event if advertised as such
2. Must be able to document applications received as a result of the drive
3. All revenues collected will not be UBI



Source: IRS Publication 598

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Income Exclusions – Rents

Quick Test

Are Real Property Rentals considered
Unrelated Business Income?

Answer: It Depends



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Income Exclusions – Rents

- Rental of Personal Property (tables, chairs, etc.) is always Unrelated Business Income
- Rental of Real Property (land, room or banquet hall, apartments, etc.) is generally excluded subject to conditions



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Income Exclusions – Rents

1. Applies to Real Property Rents only
2. If Mixed Lease then exclusion is based on the personal property component
 - a) < 10% personal property then 100% of rents excluded
 - b) > 10% and < 50% then only Real Property component excluded
 - c) > 50% then none of the rents are excluded
3. Special Rules for Debt-Financed Property



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Debt-Financed Property

Any property held to produce income for which there is an acquisition indebtedness at any time during the tax year. It includes rental real estate, tangible personal property and corporate stock.

The debt can be a mortgage or any other type of loan or borrowing that is related to the acquisition of the property (including member bonds).

Can occur before, during or after acquiring the property



Source: IRS Publication 598 and
Auditing and Accounting Manual

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Debt-Financed Property

If 85% or more of the use of any property is substantially related to an organization's exempt purpose then the property is not treated as debt-financed property.

1. Related use does not include a use solely to the organization's need for income, or its use of the profits.
2. Use based on comparison of time or portion or both
3. If < 85% only the portion not related to the exempt purpose is considered debt-financed property
4. Rentals to or by members are related to the Lodge's exempt purpose and therefore excluded



Source: IRS Publication 598 and
Auditing and Accounting Manual

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Debt-Financed Property

If property is debt-financed then both Income from the property and Expenses related to the property are allocated based on the average amount of the debt divided by the average basis of the property during the tax year.

The average calculation can be selected by the Lodge (annual, quarterly, monthly, etc.)



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Income Inclusions

- All Lodge Bulletin Advertising Revenues are UBI
- Bulletin Booster Revenues are not UBI
(simple list of members donating to offset bulletin costs)



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Accounting Procedures – Revenues

Begin classification of income at source

1. Lounge Area – Have separate register keys set up for member versus non-member receipts
2. Rental Agreements – Have rental type included in the agreement; specify personal property rent separately
3. Catering Agreements – specify member versus non-member in agreement
4. Other Activities – segregate as required.



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Accounting Procedures – Expenses

Directly Related or Attributable Expenses

1. Record in appropriate General Ledger Account
 - Use sub accounts for accounts in 30000 – 50000 series
 - Use Classes in Quickbooks to segregate
 - Create series in the 60000 – 90000 series



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Accounting Procedures – Expenses

Indirectly Related or Allocable Expenses

1. Record as any other expense
2. Develop a reasonable and consistent method(s) for allocation between non-UBI and UBI
3. Document the method(s) in the Governing Body minutes



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Unrelated Business Income Tax (UBIT)



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Unrelated Business Income Tax (UBIT)

1. Assessed on the Unrelated Business Taxable Income of an exempt organization (UBTI)
2. Calculated on Form 990-T at corporate tax rates
3. Form 990-T is required to be filed by any tax exempt organization with UBI of \$1,000 or more
4. There is a Specific Deduction against UBTI of \$1,000 allowable



Source: IRS Form 990-T Instructions

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The Top 5 Lists



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Top 5 Annual Financial Report Issues

1. Issues with Transmittal Letter



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**THIS PAGE TO BE COMPLETED BY THE
AUDIT COMMITTEE OR LODGE SECRETARY**

TRANSMITTAL LETTER

Grand Lodge Auditing and Accounting Committee

Dear Committee Member:

In Accordance with Section 13.040, Laws of the Order, enclosed are the results of the examination of the books and records for the fiscal year ended March 31, 2019 of Lodge Danbury 120 1680

NAME		NUMBER	DISTRICT	
Mailing address		CT	STATE	ZIP
STREET	CITY			

E-mail address _____

The upload file(s) consist of the following (enter an "X" in each box):

- 1. Transmittal Letter and page 1 through 10 of Grand Lodge Annual Financial Report
- 2. Copies of all of Independent Accountant's Reports and Financial Statements if Prepared
- 3. Copy of Federal and State Information and Income Tax Returns (Form 990 and Form 990T as applicable)

Are all Entities of the Lodge included in this report? _____
 (Enter "Yes" or "No") _____ If "No" Explain in Page 7 Notes.
 Enter In House or Accountant's Name in cell below.

Accountant's Phone # _____ E-mail _____

The report was presented to the Lodge membership on : _____

Lodge Auditing and Accounting Committee (For the 2018 - 2019 Lodge Year)

	Name	E-mail	Telephone No.
1			
2			
3			

Please PRINT/TYPE Names, Addresses and E-mail Addresses of the CURRENT (2019 - 2020) Exalted Ruler and Secretary:

	Current Exalted Ruler	Current Secretary
Name		
Street		
City, State, Zip		
E-mail Address		

- Retain Copies as follows:
- 1. Retain for Lodge File
 - 2. Lodge Auditing Committee

By completing this page and typing my name below I acknowledge that I am electronically signing this transmittal letter.

Fraternally,

 Chairman, Lodge Auditing & Accounting Committee
 E-mail Address: _____
 Year Ending: March 31, 2019

DO NOT MAIL ANY HARD COPIES - ALL SUBMISSIONS MUST BE UPLOADED TO ELKS.ORG

Upload pdf files to: <http://www.elks.org/grandlodge/auditing/submitAudit.cfm>

"FOR INTERNAL USE ONLY"



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Top 5 Annual Financial Report Issues

1. Issues with Transmittal Letter
2. Restricted Funds Reporting including ENF Grants
3. Page 8 COGS percentages (the 35% issue)
4. Page 9 reporting (missing/inconsistent data)
5. Failure to implement the Accountant's Recommendations



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Top 5 Form 990 Issues

- Definitions of Governing Body
- Listing of Officers
- Part VIII allocation to Substantially Related (Col B), Unrelated Business Income (Col C) and excludable from Unrelated Business Income (Col D)
- Schedule G Part III reporting (gambling and games of chance)
- Filing of Form 1099 and Form W-2



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Top ~~5~~ 7 Form 990 –T Issues

1. Not filing a Form 990-T
2. Reporting 100% of Revenues and Cost of Goods from Lounge, Gaming, Catering, etc. as UBI
3. Real Property Rent Reporting
4. Failure to allocate indirect expenses against UBI
5. Failure to use the Specific Deduction of \$1,000
6. Not including all information for questions A thru J including leaving out Group Exemption Number
7. Inconsistent amounts for UBI on Form 990 and 990-T



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Questions and Answers

