

# Unrelated Business Taxable Income (UBTI) for Private Foundations



When a tax-exempt organization realizes income from a business activity that is not regularly carried on and is not substantially related to its charitable purpose, that income is known as unrelated business taxable income (UBTI), which is subject to taxation at the higher, for-profit corporate or trust tax rates, rather than the usual 1.39% excise tax that typically applies to a foundation's net investment income. Generally, the tax on UBTI prevents tax-exempt entities from having an unfair competitive advantage over commercial enterprises, which are subject to taxation. UBTI must be reported on a separate IRS tax form (Form 990-T), and sometimes, if applicable, an additional state tax form as well, both of which Foundation Source routinely handles for its clients.

UBTI can also be generated by investments or assets that were purchased using borrowed funds (i.e., acquisition indebtedness). Such indebtedness may partially or wholly “taint” the purchased assets, in the sense that a portion of passive income (e.g., interest, dividends, rent) that would otherwise be subject to the nominal excise tax, as well as capital gains realized upon their sale, may give rise to UBTI.

A common source of UBTI is investments in companies taxed as partnerships, as any business income generated by a downstream investment held by the partnership will “flow through” to the foundation. Of course, acquisition indebtedness can also play a role in this context if the partnership itself borrows money to finance the acquisition of investment assets. A foundation must be sure to make each of its partnership investments aware that it is a Section 501(c)(3) private foundation so that the partnership will indicate the foundation’s share of UBTI, if any, on the Schedule K-1 issued to the foundation each year. Additionally, S corporation income (including any capital gain realized on the sale of S corporation stock) is treated as UBTI.

Private foundations are largely precluded from directly engaging in business activities or owning a substantial interest in a business enterprise, so they must be wary of generating excessive UBTI. In fact, if a *substantial* portion of an organization’s income consists of UBTI, the IRS may revoke its tax-exempt status. Unfortunately, the IRS hasn’t provided a bright-line threshold for the loss of tax-exemption due to excess UBTI. Because the rules and regulations regarding UBTI are complex and the amount of UBTI generated by an investment can impact the foundation’s net return on an investment, it is advisable to consult with a tax advisor who is well versed on private foundations when considering a foundation investment that may generate UBTI.

## ABOUT FOUNDATION SOURCE

**Foundation Source empowers people and companies to create a better world through philanthropy.**

We support more than 4,000 charitable organizations with innovative technology backed by philanthropic expertise.

## HAVE A QUESTION?

Call 800.839.0054 or send us an email at [info@foundationsource.com](mailto:info@foundationsource.com).

[www.foundationsource.com](http://www.foundationsource.com)

©2025 Foundation Source Philanthropic Services Inc.  
All rights reserved. v0325

The information provided in this document is for general information purposes only, and does not constitute legal, tax or investment advice.

**FOUNDATIONSOURCE**