

Unrelated Business Income Tax

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Tax Exempt or Not?

Isn't the University exempt from Federal
Income Tax?

Yes and No

Tax-Exempt Activities

- The University is [exempt from federal tax on related income] ... under Section 115 of Internal Revenue Code.
- The University is exempt from federal income tax for engaging in activities which include charitable, scientific, testing for public safety, literary, educational, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Taxable Activities

- However, the University is not exempt from income tax imposed on activities which are substantially unrelated to those exempt purposes, even though these activities may bring in funds to support the University's exempt operations.

Definition: Unrelated Business

An unrelated business activity must meet all three of the following conditions:

- A trade or business
- Regularly carried on
- Not substantially related to the exempt purpose

Trade or Business?

- The term “trade or business” generally includes any activities carried on for the production of income from selling goods or performing services.
- If the University is selling goods or services to generate income, even if it is conducting the activity within a larger group of activities related to its exempt purpose, the activity is a trade or business. So, while the University is carrying on its daily exempt function, it could also be carrying on activities that are taxable.

Trade or Business?

- A trade or business must exhibit intent to profit from the activity
- Where an activity carried on for profit is unrelated trade or business, not part of the trade or business is excluded merely because it does not result in profit
- However, sustained, significant and repeated losses generated by unrelated activities may not be considered “trade or business” for lacking of profit motive

Trade or Business: Examples

- The University solicits, sells, and publishes advertisements for commercial vendors in its publication
- The Parking and Transportation Services sells parking permits to Marriot Hotel
- The Student Union provides catering services to public

Regularly Carried On?

- In most cases, if the activity shows frequency and continuity and is conducted the same way that a non-exempt organization would run a similar business, it is regularly carried on.

Regularly Carried On?

An activity should not be considered as regularly carried on if it is

- On a very infrequent basis;
- For a short period of time during the year;
or
- Without competitive and promotional efforts.

Regularly Carried On?

More you need to know...

- Year round activities are regular even if they are conducted only one day a week.
- Seasonal activities may be considered regularly carried on, even though they are conducted only for a short period each year

Regularly Carried On: Example

- The Student Union operates a food stand for one week at a conference held on campus. Because the activity is a one-time occurrence and is unlikely to compete with for-profit food stores that operate year-round, the activity is not “regularly carried on.”
- However, the daily sales of food at the Student Union is **regular** conduct of a trade or business.

Substantially Unrelated ?

- Any income-producing activity that does not directly further the University's exempt purpose could generate UBI.
- Sometimes, activities that ARE related to exempt purposes can still generate UBI if they are conducted on a larger scale than is reasonably necessary to perform an exempt function. In this instance, the portion that is more than needed is considered an unrelated trade or business.

Substantially Unrelated: Example

- The University solicits, sells, and publishes advertisements for commercial vendors in its publication. Even though the publication contains content related to the organization's exempt purpose, the publishing of advertising is still unrelated.

Review: Unrelated Business Tests

- Is the activity a trade or business?
- Is the activity regularly carried on?
- Is the activity not substantially related to the University's exempt purpose?

Exceptions

- Volunteer workforce
- Convenience of members
- Sale of donated merchandise
- Qualified Sponsorship

Exception: Volunteer Workforce

If the activity conducted by volunteers 85 percent or more of the time, the activity is not unrelated business.

Exception: Sales of Donated Merchants

The activity constitutes the sale of donated merchants is not unrelated business.

Exception: Convenience of Members

- Trades or businesses operated primarily for the convenience of members of the University are also exempt.
- University members include students, faculty, employees, officers, and patients. Alumni and family of the University members are considered general public for UBIT purpose.
- For example, a college laundry facility used to launder dormitory linens and students' clothes is not an unrelated trade or business and therefore not subject to UBI tax.

Exception: Qualified Sponsorship

- A payment made by a corporation or business to the University in return for which the company receives no substantial benefits other than use or acknowledgement of its products or services
- Substantial benefits: benefits other than (1) use or acknowledgement of sponsor's products or services; (2) goods and services with aggregate fair market value (FMV) of less than 2% of the total payments
- The "use or acknowledgment" does not include advertising the sponsor's products or services

Exception: Qualified Sponsorship

Samples of Substantial Return of Benefits

- Advertising
- Exclusive provider arrangement
- Goods, facilities, services or other privileges
- Exclusive or non-exclusive right to use the University's intangible assets, such as trademark, patent, logo or designation.

Exception: Qualified Sponsorship

Acknowledgment

- Exclusive Sponsor Agreement
- Logos and slogans that do not contain qualitative or comparative descriptions of the payor's products, services, facilities or company
- A list of the payor's locations, telephone numbers, or internet address
- Value-neutral descriptions, including displays or visual depictions, of the payor's product-line or services
- The payor's brand or trade names, and product/service listings.

Exception: Qualified Sponsorship

Acknowledgment

More you need to know....

- Logos and slogans that are an established part of a sponsor's identity are not considered to contain qualitative or comparative description;
- Mere display or distribution, whether for free or remuneration, of a sponsor's product (by either the sponsor or the University) at the sponsored event is not considered an inducement to purchase, sell, or use the sponsor's product
- Use or acknowledgment of sponsor's business name, logo, or product/service lines in the University's periodical is NOT qualified sponsorship. However, a program or brochure distributed at a sponsored event is not considered periodicals for this purpose.

Exception: Qualified Sponsorship

Advertising

- Messages containing qualitative or comparative language (unless such language is an established part of the sponsor's identity)
- Price information or other indications of savings or value
- An endorsement
- An inducement to purchase, sell, or use any company, service, facility or product.

A single message that contains both advertising and an acknowledgment is advertising.

Exclusions

- Investment income
- Rents from real property
- Royalty income
- Gains or losses from the sale of property
- Research income

Exclusion: Investment Income

- Interest from bank accounts
- Annuities
- Payments with respect to securities loans, and
- Any other incomes from routine investments, including notional principal contracts, which the IRS determines are largely similar to these types of income.

Exclusion: Rents

You can also exclude rents from real property, including elevators and escalators, when calculating UBI.

However, the exclusion does not apply to:

- Rents from personal property*
- Rents from real property based on net profit
- Rents from real property when personal services are provided, or
- Rents from debt-financed real property (if 85% or more of the real property is used for exempt purpose, the real property is not considered debt-financed)

Exclusion: Rents

Rents from a mixed lease of personal property and real property:

- If 10% or less from personal property – incidental and excludable under rents from real property rule
- If 11-50% from personal property – taxable in proportion to the percent of personal property rents to the total rents
- 51% or more from personal property – 100% taxable

Exclusion: Royalty Income

- A royalty is the money paid for the use of a right like a trademark, trade name, or copyright. Similarly, payments for the use of an athlete's name, photo, likeness, or facsimile signature are also considered royalties.
- Typically, royalties are paid or received when one of these rights is used by someone other than the owner of that right. For example, a publisher of educational books, videos, or computer programs would pay the original author or producer royalties on all sales.
- Be careful not to confuse royalties with payments for services. For example, payments for interviews or personal appearances with an athlete cannot be excluded from the UBI tax calculation.

Exclusion: Gains or losses from the sale of property

- This include gains and losses from the disposition of property, other than inventory or property held primarily for sales to customers.

Exclusion: Research Income

- Revenues generated by research performed by the University is excluded from Unrelated Business Income
- However, the term “research” for this purpose does not include activities ordinarily carried on as an incident to industrial operations, such as ordinary testing or inspection of products

Exclusion: Research Income

- IRS has defined “ordinary testing” as those activities where "a standard procedure is used, no intellectual questions are posed, the work is routine and repetitive and the procedure is merely a matter of quality control."
- IRS also rules that a project is "ordinary testing" if the work is performed to satisfy a federal or state regulation requiring such an evaluation before a product may be marketed.