Unrelated Business Income Tax (UBIT)

Unrelated business income (UBI) is the gross income from any trade or business that is regularly carried on by the University and that is not substantially related to the University’s exempt mission and purpose (teaching, research, and public service). The tax is based on the unrelated business income received by the university.

The activity/event that produces revenue must meet all three criteria:

- **Trade/Business**: activity for the production of income from selling goods or performing services, conducted with a profit motive
- **Regularly Carried On**: throughout the year or the season; and based on the frequency and continuity with which the activities are conducted; activity is NOT regularly carried on when conducted on an annual recurrent basis
- **Substantially Related**: activity that produces the income does not contribute importantly to the exempt purposes of the university

The University only needs to meet one of these tests to exclude the activity from UBIT.

If revenue is determined to be UBI, expenses may be deducted from the taxable amount. Deductible expenses must be directly connected with the carrying on of unrelated trade or business activity; and must bear a proximate and primary relationship to the conduct of the activity.

**Revenue Exemptions**

1. Passive Income: interest, dividends, royalties
2. Rent from real property: classrooms, parking lots, athletic facilities
   - Services such as custodial (cleaning/collection of trash) and furnishing of utilities are acceptable (Note: Additional services may change revenue from exempt to subject to taxation)
3. Rental revenue from wireless/telecommunications vendors, as long as their dishes and antennas are located on ground space or roofs (NOT attached to university broadcast towers)
4. Use of excess broadband capacity
5. Police Services for reimbursement of added costs incurred by university to protect property and people (Note: Police Services for the interest and benefit of the vendor is UBIT)
6. Work substantially performed by volunteers
7. Activity for the convenience of faculty, staff, and students
8. Items that are normally sold through vending machines
9. Gains and losses from the sale, exchange, or disposition of property
   - Corporate Sponsorships for Intercollegiate Athletics as long as sponsor only receives acknowledgement of name, logo, product lines (Note: If value of tickets and advertising exceeds 2% of sponsorship amount, then ticket and advertising value is UBIT; up to the amount of the sponsorship payment)
Additional Information (IRS Publication 598)

“Unrelated trade or business” means any trade or business that is not related to the exercise or performance by the university carrying on the business activity of its exempt purpose. Three factors must be present for the university’s gross income to be subject to the tax on UBI:
1. The income is from a trade or business.
2. The trade or business is regularly carried on by the organization.
3. The conduct of the trade or business is not substantially related to the performance by the institution of its tax-exempt functions.

There are certain types of income and activities that are exempt from unrelated business income taxation (UBIT).

Basic Principles
The UBI rules are among the most revered of tax-exempt organizations law, having been a feature of the federal tax law since 1950. These laws were created to avoid unfair competition between exempt nonprofit organizations and taxable for-profit entities.

Rationale for Unrelated Business Law
UBIT applies only to active business income that arises from activities that are unrelated to the university’s tax-exempt purposes. In other words, income generated by the university from the conduct of activities that are undertaken for reasons other than the furtherance of the university’s exempt purpose is taxed in the same manner as the income would have been if received by a taxable entity.

Basic Definition
Trade or Business
1. “any activity which is carried on for the production of income from the sale of goods or the performance of services”
2. “an activity that otherwise possesses the characteristics of a trade or business”

Profit Motive Requirement
Profit motive is the most important standard as to whether an activity is a trade or business for the purposes of the business expense deduction. The Supreme Court stated, “taxpayer’s primary purpose for engaging in the activity must be for income or profit.” The Court wrote that the primary purpose for engaging in the activity “was entered into with the dominant hope and intent of realizing a profit.” An appellate court stated that the “existence of a genuine profit motive is the most important criterion for...a trade or business.”
The appellate court wrote that,” for an activity of a tax-exempt organization to be a trade or business, it must be conducted with a profit objective.”

Regularly Carried On Rule
Gross income of a university may be includable in the computation of UBI where the trade or business that produced the income is regularly carried on by the organization. Therefore, specific business activities of a college or university organization ordinarily will be deemed to be “regularly carried on” if they manifest a frequency and continuity and are pursued in a manner generally similar to comparable commercial activities of nonexempt organizations.

Determining Regularity
The conduct of activities over a period of only a few weeks does not constitute the regular carrying on of a business. However, the conduct of year-round business activities for one day each week constitutes the regular carrying on of a business.
In general, business activities that are engaged in only intermittently or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors.
Fund-Raising and Similar Activities by Colleges and Universities
Fund-raising can constitute unrelated business activities. Regularity is often the only basis on which the income from these activities is not taxed as UBI.
Certain intermittent income-producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as trades or businesses that are regularly carried on. For example, fundraising activities lasting only a short time are not ordinarily treated as being regularly carried on if they recur only occasionally or sporadically. Furthermore, activities will not be regarded as regularly carried on merely because they are conducted on an annual basis.
Even if fund-raising activities are deemed to be regularly carried on, advertising in connection with them is likely to be taxable.

The Substantial Relationship Test
Gross income derived from charges for the performance of a university function does not constitute gross income from the conduct of an unrelated business. Thus, income is not taxed when it is generated by functions such as performances by students enrolled in a school for training children in the performing arts, the conduct of refresher courses to improve the trade skills of members of a union, and the presentation of a trade show for exhibiting industry products by a trade association to stimulate demand for the products.

Dual Use
An asset or facility may be used for commercial purposes. In these dual use instances, you must determine whether the activities productive of the income contribute to the accomplishment of exempt purposes.

Example
The IRS ruled that the operation of an exempt school of a ski facility for the general public was the conduct of an unrelated business, while use of the facility by students of the school for recreational purposes and in its physical education program were related activities.
Likewise, a college that made available its facilities and personnel to an individual not associated with the institution for the conduct of a summer tennis camp was ruled to be engaged in the conduct of an unrelated business.

Supplying athletic or other activities to outsiders may be a tax-exempt function to the extent that the instruction of individuals on the subject of a sport can be an educational activity. The IRS held that the following were exempt educational activities:
• The conduct of a summer hockey camp for youths by a college
• The conduct of four summer sports camps by a university; and
• The operation of a summer sports camp by a university-affiliated athletic association.

The IRS also determined that a college may operate a professional repertory theater on its campus that is open to the general public and that a college may make its facilities available to outside organizations for the conduct of conferences – both activities being in furtherance of exempt purposes.

There is an exclusion from unrelated income taxation for rent received. A college may lease its facilities to a professional sports team for the conduct of a summer camp and receive nontaxable lease income, as long as the college does not provide food or cleaning services to the team. By contrast, where the institution provides services, such as cleaning, food, laundry, security, and grounds maintenance, the exclusion for rent is defeated.

Exceptions for Activities
In spite of the fact that an activity may represent an unrelated trade or business that is regularly carried on, the activity may escape federal income taxation under one or more specific statutory exceptions.
Convenience Businesses - Income from a business that is carried on primarily for the convenience of its students or employees is excluded from UBI. An example is a laundry operated by a college for the purpose of laundering dormitory linens and the clothing of students. (A laundry operated by a college apart from its campus primarily for the purpose of making a profit from laundering the clothing of the general public would be an unrelated business and outside the scope of this limitation.)

Research - Income derived from research for government, tax-exempt, college, university, and “of fundamental research” units is excluded.

Corporate Sponsorships - Qualified sponsorship payments received are exempt from the UBIT. These payments are reported as charitable contributions on IRS Form 990.

Qualified Sponsorship Payment - Any payment made by a trade or business with which there is no arrangement or expectation that they will receive any substantial benefit other than the use or acknowledgment of the name or logo in connection with the activities of the organization that receives such payment. It is irrelevant whether the sponsored activity is temporary, permanent or related to the recipient organization’s exempt purpose. Payment means money, transfer of property, or performance of services.

Exclusions

Any sponsorship payment dependent upon the level, amount, or other factors indicating the degree of public exposure to one or more events is not a qualified sponsorship payment. The statute also excludes any amounts received in return for the display of the company’s name or logo in regularly scheduled publications and at trade shows.

Substantial Return Benefit

A substantial return benefit is any benefit other than a “use or acknowledgment” or a “disregarded benefit.” A benefit includes:

- Advertising and exclusive provider arrangements, as defined in the regulations;
- Goods, facilities, services, or other privileges; and
- Exclusive or nonexclusive rights to use an intangible asset, such as a trademark, patent or logo.

Other examples may include complimentary tickets, pro-am playing spots, receptions for donors, and a licensing arrangement for use of the university’s name and logo. A payment for a right to use an intangible asset may be exempt from the UBIT as a royalty.

Use or Acknowledgment

Listing a sponsor’s name or displaying its logo constitutes a use or acknowledgment that is not treated as a substantial return benefit. Use or acknowledgment may include:

- Exclusive sponsorship arrangements;
- Logos and slogans that do not contain qualitative or comparative descriptions of the sponsor's products, services, facilities, or company (logos or slogans that are an established part of a sponsor’s identity are not considered to contain qualitative or comparative descriptions);
- A list of the sponsor’s locations, telephone numbers, or Internet address;
- Value-neutral descriptions, including displays or visual depictions, of the sponsor’s product line or services; and
- The sponsor’s brand or trade names and product or service listings.

Merely displaying or distributing a sponsor’s product at an event is considered to be a use or acknowledgment, not advertising.

Advertising

Advertising includes “messages containing qualitative or comparative language, price information or other indications of savings or value, an endorsement or an inducement to purchase, sell, or use the products or services.” For example, in return for receiving a
sponsoring payment, the university promises to use the sponsor’s name or logo. The organization publishes the sponsor’s name, logo and a list of products in the fundraising event program. This is an acknowledgment and the payment is protected from UBIT. However, if the fundraising program included a favorable description of the sponsor’s products that would “induce” purchase and price information, the sponsor has received advertising, and the sponsor’s payment would not be qualified sponsorship payment. Distribution or display of a sponsor’s products to the general public at a sponsored event is considered a use or acknowledgment and not advertising. If a sponsor wanted to place a product sample at each person’s plate, this action would not disqualify the sponsorship payment.

**Exclusive Arrangements**

There are two types of exclusive arrangements:

1. Exclusive sponsorship and
2. Exclusive provider of goods and services.

An exclusive sponsor of an activity or exclusive representative of a trade, business or industry does not result in a substantial benefit unless the exclusive sponsorship limits the sale, distribution, availability, or use of products, services, or facilities that compete with sponsor’s products. Income from an exclusive provider is not exempt from UBIT. Only if the organization agrees to limit distribution of competing products would the sponsorship become an exclusive provider arrangement.

**Internet Sponsorships**

The hyperlink, without more, is an acknowledgment protected by the safe harbor. However, upon linking to the sponsor’s Web site, a viewer would see an authorized endorsement of the sponsor product. This constitutes advertising and is not a qualified sponsorship payment.

**Periodicals**

IRS rules do not apply to an acknowledgment of a sponsor or the sponsor’s name or logo (or product line) in an exempt organization’s periodical. Printed materials also include electronically published material. Safe harbor does not apply to payments that lead to acknowledgments in a monthly journal, but does apply if a sponsor receives an acknowledgment in a program or brochure, printed or electronic, distributed for a sponsored event.

**Exceptions for Income**

**Investment Income**

- **Dividends** – Dividends paid to colleges and universities generally are not taxable.
- **Interest** - Interest paid to a tax-exempt organization is not taxable.
- **Annuity Income** - Income received by a tax-exempt organization as an annuity generally is not taxable.

**Other Forms of Investment Income**

**Rent**

The principal exclusion is for rental income from real property. Not all income labeled “rent” qualifies for the exclusion. Where a college or university carries on activities that constitute an activity carried on for trade or business, even though the activities involve the leasing of real estate, the exclusion will not be available. For example, a tax-exempt organization may own a building and lease space in it, and the income from this activity will constitute excludable rent even where the organization performs normal maintenance services, such as the furnishing of heat, air conditioning, and light, the cleaning of public entrances, exits, stairways, and lobbies, and the collection of trash. Where the organization undertakes functions beyond these maintenance services, such as services rendered primarily for the convenience of the occupants (for example, supplying office cleaning services), the payments will not be considered as being from a passive source but,
instead, from an unrelated trade or business (assuming that the activity is regularly carried on
and is not substantially related to the organization’s tax-exempt purposes.
The contractual relationship between the parties from which the apparent rental income is
derived must be reflected in a lease, for the exclusion for rental income to be available.

**Personal Property Leased with Real Property**
The exclusion from UBI for rents of property applies to rents of personal property leased with
real property only where the rent attributable to the personal property is incidental (no more
than 10%).
The exclusion is not available where
- The total rent attributable to the property is tied to the user’s income or profits or
- If more that 50% of the total rent is attributable to the personal property leased.
The IRS has classified that income received, i.e. a university radio station tower; from the
rental of space on its antenna tower and transmission facility does not qualify for the
exclusion for rental income because the tower and attachments are personal property.

**The Business of Education**
The principal purpose of colleges and universities is the education of students. Income
gathered in the form of tuition, other fees, assessments, dormitory rent, food service revenue,
and the like, is not taxable.

**Research**
Research is an exempt function at colleges and universities. Research is generally not
taxable.

**Bookstore Operations**
Operation of the bookstore yields opportunities for unrelated business issues. Some
institutions lease the bookstore to unrelated parties, with the resulting rent nontaxable. The
bookstore operation is a tax-exempt function; however, there are some sales that can attract
the tax on UBI. There are three categories of business activities in this context:
1. Related business
2. Business activities that are protected from taxation by a statutory exception
3. Unrelated business

Related business activities include the sale of course books, supplies, tapes, CDs, athletic
wear necessary for participation in athletic and PE programs, computer hardware and
software, and items that induce school spirit, including T-shirts, tote bags, pennants, and
mugs.
Other items protected from taxation include sundry articles, film, cards, health and beauty
aids, and novelty items.
All other sales are unrelated business transactions. The IRS views times that have a useful
life of more than one year are not convenience items. Articles such as wearing apparel,
appliances, stuffed animals, wall posters, wristwatches, and plants are subject to taxes.
Sales of items to the general public can be unrelated business activity.

**Athletic Events**
Athletic events are a major function of today’s educational institutions. The revenue for
admissions to athletic events is income from a related business.
Revenue generated by the telecasting and radio broadcasting of these events is not taxable.

**Rental of Facilities**
Income derived from providing facilities for seminars or the training of professional athletes is
likely UBI where the institution is providing collateral services such as meals or maintenance.
Simply leasing facilities would likely generate passive rental income excluded from taxation.

**Travel Tours**
In 1977, the IRS ruled that a travel tour program conducted by an alumni association of a
university was an unrelated trade or business.
• The activities of the alumni association in working with commercial travel agencies in the planning and preparation of the tours, mailing out the tour announcements, and receiving reservations constituted a trade or business.
• Travel tours were inherently recreational, not educational.
• The unrelated business was regularly carried on.

An alumni association travel tour program that is structured as an authentic educational activity is not an unrelated trade or business. Tours that devote a significant amount of time to endeavors such as sightseeing are not usually exempt functions. Tours that are “not significantly different from commercially sponsored” tours are probably unrelated business, as are extension tours.

Fitness Facilities
If the fees for use of the facility are sufficiently high so as to restrict use of the facility to a limited segment of the community, the fitness facility will be an unrelated business. By contrast, where the facility provides a community-wide benefit for the community which the organization serves, the operation of the facility is a related business.
If the facility is operated directly by the educational institution, promotion of health may be the rational or, if the facility’s programs include instruction and counseling on diet, nutrition, weight loss, conditioning, and the like, the exempt purpose may be advancement of education.

Advertising
Generally, the net income derived by a tax-exempt organization from the sale of advertising is taxable as UBI.
Income from the sale of advertising in publications of tax-exempt organizations generally constitutes UBI, taxable to the extent it exceeds the expenses directly related to the advertising. If the editorial aspect of the publication is carried on at a loss, however, the editorial loss may offset against the advertising income from the publications.

Other UBIT Issues for Higher Education
• Participation as a general partner in partnerships
• Involvement in joint ventures
• Unrelated debt-financed income issues
• Taxation of income from the lending of securities
• Use of subsidiaries
• Generation of royalty income
• Share-crop leasing
• Calculation of allowable deductible expenses