

**BASIC:
UNRELATED BUSINESS
INCOME TAX (UBIT)**

Overview

- ① UBIT background
- ② Definition of Unrelated Business Income
- ③ Exclusions from UBIT
- ④ Potential UBI-Generating activities

UBIT Background

- First enacted by Congress in 1950 to eliminate **unfair competition** between tax-exempt and for-profit organizations.
- Revenue Act of 1951 expanded scope of UBIT to include **public** colleges and universities.

UBIT Background

- Tax Reform Act of 1969 extended UBIT to all tax-exempt organizations (including churches), except government entities.
- IRS Compliance Project in 2008 – focusing on higher education. Final report was completed in April this year.

Definition of UBIT

Unrelated business income is defined as gross income derived by an exempt organization from any unrelated trade or business that is regularly carried on.

- ⦿ Trade or Business
- ⦿ Regularly Carried On
- ⦿ Not Substantially Related to Exempt Purpose

Trade or Business

IRC Sec 513 (c)

- ⦿ Trade or business includes any activity which is carried on for the **production of income** from the sale of goods or the performance of services.

Regularly Carried On

Reg. Sec. 1-513-1 (c)

- ⦿ Trade or business must be regularly carried on. IRS generally compares time span of **comparable commercial activity** to time span of activity conducted by exempt organization.

Regularly Carried On

- ⦿ Activities engaged in only **discontinuously or periodically** will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors.
- ⦿ Income producing or fundraising activities lasting only a **short** period of time on an annual basis would not be considered regularly carried on.

Not Substantially Related

IRC Sec. 513(a)

- ⦿ Any trade or business, the conduct of which is **not** substantially related to the performance of the organization's charitable, educational, or other purpose that constitutes basis for exemption under Sec. 501 (c)(3).

Not Substantially Related

- ⦿ Whether a trade or business is substantially related to an organization's purpose depends on the facts and circumstances.
- ⦿ Activity must contribute importantly to the accomplishment of the exempt purpose.

Exclusions from UBI

- ⦿ Interest, dividends, and annuities
- ⦿ Capital gains
- ⦿ Royalties
- ⦿ Rent from real property
- ⦿ Research
- ⦿ Business conducted by volunteers
- ⦿ Convenience exception
- ⦿ Sale of donated merchandise
- ⦿ Qualified sponsorship payments

Interest and Dividends

IRC Sec. 512(b)(1)

- Interest, dividends, and payments connected with loans and annuities are **exempt** from UBIT

Interest and Dividends

- Securities purchased on margin are considered **debt-financed** property and subject to UBIT.

Capital Gains

IRC Sec. 512(b)

- ⦿ All gains and losses from the sale, exchange, or other disposition of property are **excluded** from the computation of an organization's UBTI.
- ⦿ Exclusion does not apply to property that is treated as **inventory** in the hands of the institution, or property that is held primarily for **sale to customers** in the ordinary course of trade or business.

Royalties

IRC Sec. 512(b)(1)

- ⦿ All royalties excluded whether measured by production or by gross or taxable income from the property.
- ⦿ Royalties are defined as payments for the use of the payee's intangible property--trademarks, patents, and copyrights.

Royalties

Exceptions to the exclusion for royalties:

- ① **Debt-financed property** - Property held to produce income that has acquisition related indebtedness.
- ② **Substantial services** - Active involvement in enterprise generating the revenue.

Rent from Real Property

IRC Sec. 512(b)(3)

- Rent from real property and certain personal property leased with real property is excluded from UBIT.

Rendering of Services with Rents

- ⦿ Amounts paid for occupancy of space are not excludable rents if owner provides **services** for convenience of occupant.
- ⦿ Services are considered rendered to occupant if primarily for his/her **convenience**, and go beyond usual services rendered in connection with rental of rooms or other space.

Rendering of Services with Rents

- ⦿ Maid or linen services go beyond usual services; furnishing heat and light and cleaning of public entrances do not.
- ⦿ IRS has determined **rental of parking spaces** to general public is not rent from real property, regardless of whether any services are provided.

Rents from Personal Property

- ⦿ Rents from personal property must be an incidental part of the total rents received to be excludable. Rules on personal property rent
 - ⦿ 10% or less is incidental and not taxable
 - ⦿ 11-50% taxable in proportion to total rents
 - ⦿ 51% or more is 100% taxable

Research

IRC 512(b)(7-9) - Excludable research:

- ⦿ Research done for the United States or any of its agencies or instrumentalities.
- ⦿ Research done by a college, university, or hospital.

Research

Excludable research (continued):

- ⦿ Research done by organizations operated primarily for the purpose of carrying on **fundamental** research the results of which are freely available to the public.
- ⦿ Research does not include **testing**, e.g. clinical trials.

Business Conducted by Volunteers

IRC Sec. 513(a)(1)

- ⦿ If substantially all the work in carrying on the business is performed by volunteers, the activity is not an unrelated trade or business.

Sale of Donated Merchandise

IRC Sec 513(a)(3)

- Sale of merchandise that has been received as a gift or contribution does not constitute unrelated business income.
- Auctions and similar sales of donated items can be conducted without creating UBTI.

Convenience Exception

IRC Sec. 513(a)(2)

- ⦿ An activity carried on for the **convenience** of members, students, patients, officers, or employees is not an unrelated trade or business.
- ⦿ Sales to **alumni** do not qualify for the convenience exception (TAM 9645004).

Qualified Sponsorship Payments (QSP)

IRC Sec. 513(i) - Exclusion for QSPs

- ⦿ Payment from a person engaged in a trade or business, with **no expectation** of any **substantial benefit** other than use or acknowledgement of the name or logo of person's trade or business.
- ⦿ Use may be in connection with activities of organization, but may not include **advertising** products or services.

Taxable Advertising

- Messages or other program materials broadcast or otherwise displayed in connection with a specific sponsored event to **promote a company** in exchange for corporate sponsorship payment is considered taxable advertising.

Taxable Advertising

Following **factors** would indicate that an organization is engaged in advertising:

- ⦿ Qualitative of comparative language,
- ⦿ Price of savings information,
- ⦿ A call to action,
- ⦿ An endorsement, or
- ⦿ An inducement to buy, sell, rent, or lease sponsor's product or service.

Potential UBI-Generating Activities

- ◉ **Advertising** - Sale of commercial advertising space
- ◉ **Alumni Affairs** - Sale of travel tours
- ◉ **Bookstore** - Sales to the general public
- ◉ **Computer Center** - Sale of surplus computer time
- ◉ **Parking** - Rental of parking spaces to the general public
- ◉ **Printing** - Sale of printing services
- ◉ **Recreation** - Sale of memberships to the general public
- ◉ **Rent** - Rental of space including personal property or services

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Questions

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