Finding and Managing UBI on Campus

Anne Jetmundsen, University of South Florida
Dale Larson, Dallas Theological Seminary

Renaissance Orlando at SeaWorld
4:15 p.m. to 5:15 p.m.
Wednesday, February 20th
Tax Reform

“Tax reform is taking the taxes off things that have been taxed in the past and putting taxes on things that haven’t been taxed.”

- Art Buchwald
Use of Checklists to Find UBI

- Internal Documentation for Tax Department
  - UBI Survey of revenue generating accounts
  - Departmental Communication

- Identify Need to Contact Tax Department Re: Possible Reporting
  - Parking Revenue
  - Research vs. Testing
Process for Developing

• Identify area that needs to be analyzed
  – Topic of interest to IRS
  – Frequent questions from departments

• Research tax treatment

• Develop questions to ask and incorporate in checklist
  – Conclude UBI/not UBI
  – Contact Tax Department to discuss
• **Article II, Compliance**
  - The IRS will analyze the Form 990-T data to develop risk models that will help identify organizations that consistently report significant gross receipts from UBIT but declare no taxes due.
  - EO will use this work in connection with an upcoming UBIT project.

• **Article IV, General Work - Colleges and Universities**
  - To date, the IRS sent compliance checks to 400 colleges and universities, released an ‘interim report’ and conducted subsequent audits.
  - Findings of the interim report include:
    - Apparent gaps between the information included with the compliance checks and the tax information reported on the Forms 990-T for the year in question.
    - The reporting of cost allocation practices across activities and related organizations; and
    - The reporting of losses from exempt and unrelated activities.
  - IRS was scheduled to release its final report in 2012
Process for Developing

• IRS College and University Compliance Project May 7, 2010 IRS Interim Report
  – 47 potential UBI Activities from Questionnaire (pages 22-26)
    • Advertising
    • Corporate Sponsorship
    • Rentals
    • Other
  – Review list for activities at your institution
2010 IRS Interim Report

- Advertising Activities (p. 23)
- Corporate Sponsorship (p. 23)
- Rental Activities (p. 24)
• Other Listed Activities (p. 25)
  – Catalog Sales
  – Internet Sales
  – Travel Tours
  – Broadcast Rights
  – Royalties from Oil and Gas Interests
  – Affinity Cards
  – Mailing List Rentals
  – Logo Usage
• Other Listed Activities (cont.)
  – Working Interest in Oil, Gas, etc.
  – Other Royalties
  – Exclusive Use Contracts
  – Commercial Research
  – Patents
  – Copyrights and Trade Names or Secrets
  – Operation of Hotel
  – Operation of Conference Center
  – Operation of Restaurant
• Other Listed Activities (cont.)
  – Catering Services
  – Food Services
  – Credit Card Promotions
  – Computer Services
  – Exploited Exempt Activity Income (non-advertising)
  – Bartering
  – Parking Lots Operations
  – Power Generation
• Other Listed Activities (cont.)
  – Bookstore
  – Golf Course
  – Partnership Allocations
  – S-Corporation Allocations
  – Income from Controlled Entities
  – Other Activities that Generated More than $50,000 in Annual Gross Revenue
Recent Pronouncement

- **Compliance Check** – The interim report found that of the activities listed, rental activities was the highest reported activity amongst colleges and universities.

- **Reversed Position on Rentals**
  - In PLR 201106019, the IRS reverses an earlier private letter ruling when it concludes that revenues derived from hotel rentals to persons other than students may constitute UBIT.
  - Previously, in PLR 200625035, the IRS concluded that providing living quarters in buildings owned by the school to the following was not UBIT:
    - Students and faculty,
    - Family members of student and faculty,
    - Potential students and their family members,
    - Guests who are speakers at the institution and those who are guests of other non-affiliated non-profit organizations in the immediate geographic area.
  - Operation similar to a boutique hotel.
Real property rental income is **not** subject to unrelated business income tax except when:

1) **Personal Property is Leased**

To the extent personal property is leased (i.e., computer equipment, etc.) together with the real property, the rental exclusion will apply, but only if the amount of rent attributable to the personal property is incidental. If the rent attributable to personal property is:

- Less than 10% of the total rent, the amount is treated as incidental and none of the rental payment is treated as UBI.

- Between 10-50%, the amount of the rent attributable to the real property still qualifies for the rental exclusion but the personal property rental portion of the payment must be treated as UBI.

- Exceeds 50% of the total rent, then none of the rent is eligible for the rental exclusion and all of the rental income must be treated as UBI.

2. **Services are Provided**

The lessor must not provide significant services for the convenience of the occupant. The regulations define such services as maid service in the case of hotel occupancy. Other potential disqualifying services include: providing an IT Coordinator for computer problems, training users on how to use equipment, providing administrative support such as copying maps, answering phones, coordinating/providing catering and setting up tables. Services such as the provision of heat, light, cleaning of public space and collection of trash are not disqualifying services.

3. **Rent Based on Earnings or Profit**

The rent payment cannot depend in whole or in part on the income or profits of any person operating the property being rented. If it does, the rental income exclusion will not apply and the income earned will be subject to UBIT. It is permissible to base the rental payments on a fixed percentage of receipts or sales and still have the arrangement qualify for the rental exclusion.
Reference Sources

Tax Materials
IRS Publications
Final Examination Guidelines for Colleges and Universities, IRS Announcement 94-112 (1994) and other IRS publications on particular tax issues.
Publication 598 - Tax on Unrelated Business Income of Exempt Organizations

Textbooks
Nonprofit Law for Colleges and Universities, Hopkins, Gross, Schenkelberg, John Wiley & Sons,
Guidelines for Filing IRS Forms 990 and 990-T, Richard J. Locastro, CPA

Monthly Publications
The Exempt Organization Tax Review published monthly by Tax Analysts
Taxation of Exempts published by Warren, Gorham and Lamont of RIA

Research Software
Packages includes Bureau of National Affairs, Inc. (BNA) and Clearing Commerce House, Inc. (CCH)
Other Sources of Information

IRS Resources

- Exempt Organization Update, irs@service.govdelivery.com
- IRS Priority Guidance Plan for 2010-2011
- IRS Strategic Plan 2009-2013
- Exempt Organization Update, irs@service.govdelivery.com
- IRS Statistics of Information (SOI) Tax Stats - Historical Table 16
  http://www.irs.gov/taxstats/article/0,,id=175876,00.html

Community Resources

- Participate in NACUBO UBIT conferences and web casts.
- Subscribe to NACUBO list serve and mailing lists from professional firms that specialize in non-profit tax law.
- Join peer groups of schools similar in size or by region to address UBIT concerns, including the sharing of tax returns and recent issues.
- Surf websites for UBIT policies and procedure statements published by similar schools.
General UBI Survey

- Exhibit 1 – Small Private
- Exhibit 2 – Large Public
- Who to Survey?
  - All departments
  - Only departments generating outside revenue
- How often to Survey?
  - Annual (small institution)
  - Other (large institution)
## General UBI Survey

<table>
<thead>
<tr>
<th>Type of Income Generating Activity</th>
<th>YES</th>
<th>NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising or sponsorship income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bookstore and gift shop sales to the Public</td>
<td></td>
<td></td>
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<tr>
<td>Catering and food service sales to the Public</td>
<td></td>
<td></td>
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<tr>
<td>Apartment rentals to the Public</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entertainment events (i.e. concerts, movies, etc…)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leasing and rental activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licensing agreements where services are provided to the licensee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merchandising operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other sales and services provided to the Public</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participation or ownership in a partnership or joint venture with a non-(your institution) entity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exclusive provider and sponsor agreements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parking revenue from private companies or contract arrangements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hotel and restaurant services provided to the Public</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other activities that are not directly related to the tax-exempt purposes of the institution (i.e., other than religious or educational activities)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## General UBI Survey

### Is the activity:

<table>
<thead>
<tr>
<th>YES</th>
<th>NO</th>
<th>N/A</th>
</tr>
</thead>
</table>

- Conducted for the purpose of generating income?
- Conducted on a regular basis?
- Related to the institution’s exempt purpose?
- Performed by volunteers?
- Conducted via the internet or mail order?
- Conducted for the convenience of Institution’s students, faculty or staff?

### Does the activity:

<table>
<thead>
<tr>
<th>YES</th>
<th>NO</th>
<th>N/A</th>
</tr>
</thead>
</table>

- Involve the sale of donated merchandise?
- Generate revenue from royalties?
Advertising & Sponsorship Income: [YES] [NO] [N/A]

Does your department publish, sell or distribute the following:

- Phone directories, journals, newsletters, other publications?
- Do any of these publications contain paid advertising?
- Does your department receive gifts or revenue directly from corporations, and in exchange, provide special promotions of the corporation’s product or service?
General UBI Survey

Rental of Property:  

YES  NO  N/A

• Is space (land, buildings, rooms) rented to the Public or outside entities?
• Does the lease include personal property (e.g., computers, equipment, furnishings)?
• Are personal services provided (e.g., security, food, maid, or linen service, operating microphone and/or lights)?
• Is the leasing organization non-profit?
• Is the space leased for educational or religious purpose?
• Is (your institution) actively involved in the presentation of programs conducted in the rented space?
• Is the rental rate lower than commercial rates?
General UBI Survey

• Include Controller/VP name on survey
  – Encourages departments to take seriously
  – Improves compliance

• What to do with completed surveys?
  – Review for possible UBI activities
  – Ask More Questions
  – Research if needed
  – Set up filing system to document conclusions
Annual UBI Certification

• Exhibit 3
  – Completed annually by departments reporting UBI (large public)
  – Reminder for departments accustomed to reporting a particular activity that they may have other reportable activities
  – Reminder of consequences for not reporting
    • Tax
    • Interest/Penalties
  – Reminder to consider tax in pricing
## Annual UBI Certification

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
<th>UBI Reporting Consideration</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td><strong>1.</strong> I have examined revenue from all sources outside the university and discussed those revenues with UTD. I am aware all revenue from sources outside the university is potentially reportable as UBI.</td>
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<td><strong>2.</strong> I have categorized what is and is not considered a UBI customer appropriately.</td>
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<td><strong>3.</strong> I have a documented tax position for all revenue earned the past fiscal year and reported to UTD all UBI activities for inclusion on the university’s IRS Form 990-T.</td>
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<tr>
<td></td>
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<td><strong>4.</strong> I have considered UBI taxes my department may need to pay in developing the rates I am charging external customers for products and services. Currently the highest combined federal and state UBI tax rate is 38.575%.</td>
</tr>
<tr>
<td></td>
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<td><strong>5.</strong> I have reconciled UBI revenue/expenses to the official university records.</td>
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<tr>
<td></td>
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<td><strong>6.</strong> I have identified all costs associated with generating UBI (including indirect costs such as utilities &amp; depreciation)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>a. I have documented the allocation of costs between related (non-UBI) activities and UBI activities and the UBI costs are reasonable and supportable.</td>
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<tr>
<td></td>
<td></td>
<td>b. I have reviewed all costs including E&amp;G, auxiliary, and Foundation funds and have offset taxable income by expensing those connected to the UBI activity.</td>
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<tr>
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<td><strong>7.</strong> I have prepared the tax return work papers on an accrual basis making sure income and/or expenses have not been included on prior year tax work papers.</td>
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<tr>
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<td><strong>8.</strong> I have disclosed all transactions with Direct Support Organizations or another university related entity, including interest, annuity, royalty, and rent payments.</td>
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<td></td>
<td><strong>9.</strong> I am not deducting any internal charge for interest.</td>
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<td><strong>10.</strong> I have accurately and completely filled out the revenue generating activity sheet.</td>
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</tbody>
</table>
Checklist for Target Concerns

• Exhibit 4 – Research Project Questionnaire
  – Assist in determining if research (not UBI) or testing (UBI)
  – Complex issue results in complicated checklist that may be difficult for departments to use
    • Create online “process” simplifying checklist and directing individuals to contact Tax Department
    • Use when talking to PI about a particular project in order to cover all questions
Research Project Questionnaire

SECTION ONE (“Yes” indicates research, “No” indicates testing)

Does the work/research performed by university:

1. Include designing and testing a hypothesis versus use of a standard protocol with very few intellectual questions asked by university?

2. Involve designing and testing a hypothesis versus primarily testing or inspection of a product for another party?

3. Involve designing and testing a hypothesis rather than determining whether an item meets certain specifications?

4. Involve scientific analysis of an activity versus primarily analyzing the performance of a commercial or industrial application for another party?

5. Involve scientific analysis versus work that is repetitive and merely a matter of quality control?

6. Require involvement of sophisticated/trained individuals versus unsophisticated/untrained individuals?

7. Not involve the clinical testing of drugs performed for a pharmaceutical company in conjunction with the company’s submission of an application to the FDA for approval?
SECTION TWO ("Yes" indicates research, "No" indicates testing)
Complete Section Two only if all of the questions in Section One are answered “yes”

8. Is there appropriate project supervision and design by professionals, i.e. development of a new assay?

9. Is there development of a design to solve a problem through the use of the scientific method,

10. Is there analysis of the data for the effect on the truth or falsity of a hypothesis, or

11. Is there a research goal of discovering a demonstrable truth, involving the use of observation or experimentation to formulate or verify facts or natural laws?

12. Is all of the work being performed by university and not sub-contracted to any university related parties or direct support organizations (such as research foundation or medical support organization)?
SECTION THREE ("Yes" indicates testing may be for a special class and possible exclusion from UBIT)

Is the testing/research:
13) Performed for the benefit of patients (i.e., serving patient medical care purposes, adding to the body of scientific knowledge through the testing of the use of particular drugs to treat disease, search for a cure for disease, etc.?)

14) Performed to benefit the scientific education of university students? If answering yes, it must be because it is part of the students’ core curriculum and incorporated into their coursework such as labs, lectures, exams, and not just simply a job the students perform separate from their required coursework (like an hourly paid lab job).

15) Carried on “in the public interest” (including helping people in an indirect way by publishing results), i.e., testing for public safety, assists with regional economic development (including overall helping local small businesses succeed) or lessening the burden of government?

16) Related to established doctor/patient relationship?
Checklist for Target Concerns

• Exhibit 5 – Entertainment Events
  – Assist in determining if event activities are commercial (UBI)
  – Arena
  – Theatre
  – Campus Activities with student selected events
Questionnaires may be distributed annually to determine any changes in those UBIT or potentially UBIT activities.

- **Questionnaire Example: Taxation of Entertainment Events**
  - Does Student Union (SU) hire professional entertainers? [ ] YES [ ] NO
  - Does the Director have experience as a promoter of commercial events? [ ] YES [ ] NO
  - Are the average number of tickets sold off-campus for the produced events in excess of 25%? [ ] YES [ ] NO
  - Are tickets sold at the same price as sold by retailers in the local community? [ ] YES [ ] NO
  - Does the SU schedule popular events within the community for weekends, holidays, or other special occasions? [ ] YES [ ] NO

If you answered ‘yes’ to two or more of these questions, please contact the designated compliance office for your department.
Checklist for Target Concerns

• Exhibit 6 – University Press
  – Assist in determining if publishing activities are commercial (UBI)
  – Rev. Rul. 67-4
University Press

• Does the University Press (UP) publish material or content that is considered to be other than educational and scholarly?  □  □

• Does the UP have a marketing department to promote sales?  □  □

• Do key individuals at the UP receive compensation similar to remuneration paid to such individuals in the for-profit sector?  □  □

• Do the sales representatives receive commissions for sales made?  □  □

• Are contributing authors paid fees similar to commercial rates?  □  □

• Does the University journal board or committee permit a broad or cross representation from members of the publishing community?  □  □

• Are the events indistinguishable from commercial publishers by price or type of publication?  □  □
Small Institution Concerns

- Contract Review for tax issues
  - Rental of personal; purpose of agreement; royalty?

- Assign responsibility to Accounting Staff (implies training required)
  - Analysis of General Ledger Accounts and new accts
  - Income account evaluation – what is “other” income

- Auxiliary & athletic budget managers

- Entrepreneurial-minded folks

- Investment office – search for K-1s
Examples of UBIT Tools

• University of Tennessee
  – UBIT Determination and Reporting Guide
    http://controller.tennessee.edu/tax/Default.htm
  – UBIT Decision Tree Diagram http://controller.tennessee.edu/tax/Flowchart.pdf
  – Questionnaire
    http://controller.tennessee.edu/tax/Tax%20Questionnaire%20Form.pdf

• University of Georgia
  – UBIT overview, questionnaire, examples, training video, advertising cost allocation template www.busfin.uga.edu/accounting/unrelated_bus_income.html

• Texas A&M University System
  – UBIT overview, examples of potential UBI activities, expanded discussion on mailing lists & affinity cards, hospitals and research http://www.tamus.edu/offices/budget-acct/tax/taxmanual/unrelatedtax/

• University of California
  – Tax Status and Determination Guide (see handout)
### Tax Status and Determination Guide

<table>
<thead>
<tr>
<th>ACTIVITY TYPE</th>
<th>DESCRIPTION</th>
<th>TAX STATUS</th>
<th>AUTHORITY</th>
<th>DETERMINATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADVERTISING</td>
<td>Sale of commercial advertising space in campus newspapers, journals, magazines, or other periodicals.</td>
<td>R</td>
<td>IRC 513(c)</td>
<td>The sale of general consumer advertising in an exempt organization's publication is an unrelated trade or business since it does not contribute importantly to the organization's exempt purpose.</td>
</tr>
<tr>
<td></td>
<td>Sale of commercial advertising and underwriting time on a campus radio station. Students assist in subscription drives and underwriting and advertising sales programs.</td>
<td>E</td>
<td>Reg. 1.513-1 (d)(4)(iv)</td>
<td>The sale of general consumer advertising and underwriting by students contributes importantly to the University's educational purpose through the training of students.</td>
</tr>
<tr>
<td></td>
<td>Sale of advertising space in souvenir programs for sports events (or music or drama performances).</td>
<td>E</td>
<td>Reg. 1.513-1 (c)(2)(ii)</td>
<td>The sale of advertising in programs for sports events (or music or drama performances) is not considered to be regularly carried on.</td>
</tr>
<tr>
<td></td>
<td>Sale of commercial advertising in sports media guides. Sales are made by a full-time person throughout the year.</td>
<td>R</td>
<td>TAM 9147007 PLR 9137002</td>
<td>The advertising activity is a sophisticated promotion effort which is rendered over a relatively significant period of time. Moreover, the advertising solicitation is conducted in the same manner as a typical commercial enterprise.</td>
</tr>
</tbody>
</table>

**Attachment** - Hand-outs include the full excerpt of this Guide.