Unrelated Business Income Tax (UBIT) Fundamentals

Presented by: Financial Services, Tax Compliance
TAX EXEMPT OR NOT?

Isn’t the University exempt from Federal Income Tax?

Yes and No
EXEMPT ACTIVITY

Why is UA partially income tax exempt?

• UA is income tax exempt as an integral part of the State of Arizona

Which activities are tax exempt?
• Those that are related to the exempt purposes of colleges and universities:
  • Research and Discovery (with restrictions)
  • Teaching and Learning
  • Outreach and Public Service
  • Fostering national or international amateur sports competition

BUT...
UA is not tax exempt under § 513 of the Internal Revenue Code for activities which are:

- Substantially unrelated to the exempt purposes of colleges and universities, even if the funds produced are used to support the University’s exempt functions.
UBIT DEFINED: 3 PRONG TEST

In order to be subject to UBIT, an activity must meet all three designations:

• Conducted like a trade or business, AND

• Regularly carried on, AND

• Not substantially related to UA’s tax exempt purpose
TRADE OR BUSINESS

• In general, a trade or business is an activity conducted for the production of income from:
  • The sale of goods, or
  • The performance of services

• In order to be a trade or business, an activity must be:
  • Conducted with an intent to profit
  • Not resulting in profit in the short term does not exclude the activity from being a trade or business
  • Prolonged losses could signify a lack of intent to profit and disqualify the activity as UBIT
REGULARLY CARRIED ON

• In general, an activity is regularly carried on if:
  • It shows frequency and continuity
  • Is conducted in a manner similar to a non-exempt organization running a similar business

• An activity should not be considered regularly carried on if it is:
  • Conducted only on an infrequent basis
  • Conducted without competitive or promotional effort

• More 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 annually
SUBSTANTIALLY UNRELATED TO EXEMPT PURPOSE

• In general, an activity is unrelated if:
  • It does not contribute importantly to the exempt purposes of the University other than through the production of income
  • Is conducted to a size or extent larger than necessary for the exempt function
EXCEPTIONS

• Volunteer workforce
  • 85% or more of the activity is conducted by volunteers

• Convenience of members
  • Trade or business provided for the convenience of members
  • UA members include students, faculty, employees, officers and patients
  • Alumni and members of the general public are not members for UBIT purposes

• Sale of donated merchandise

• Qualified sponsorship
  • Payment to UA by a corporation or business for which the company receives no substantial return of benefit other than the use or acknowledgement of its products or services
SUBSTANTIAL RETURN OF BENEFITS: EXAMPLES

- Non-qualified Sponsorships are potentially subject to UBIT and might include such return of benefits as:
  - Advertising
    - Contains comparative or qualitative language
    - Contains price or savings information
    - Includes a call to action
    - Includes an endorsement or inducement to purchase sponsor’s product or service
  - Exclusive provider arrangements
  - Goods, facilities, services or other privileges
  - Exclusive or non-exclusive right to use the University’s intangible assets
    - Trademark
    - Logo
EXCLUSIONS

• Investment income, such as:
  • Interest
  • Annuities

• Royalty income

• Gains or losses from the sale of property (other than inventory or property held primarily for sales)

• Rents from real property, if:
  • Does not include personal property rental
    • Graduated taxability based on inclusion of personal property of <10%, 11-50%, or 51%
  • Rents are not based on net profit
  • Personal services are not provided
  • Property is not debt financed
    • If used 85% or more for exempt purposes, property is not considered debt financed

• Research, except...
RESEARCH: FOR UBIT PURPOSES

• In general, any fundamental or applied research performed by the University for any person is excludable from UBIT as substantially related to UA’s exempt purposes. However:

• For the purposes of UBIT, research does NOT include activities normally conducted incident to:
  • Commercial application
  • Industrial application

• For example:
  • Ordinary testing or inspection of products
  • Testing with standard procedures and pre-developed protocols
### TAX CUTS & JOBS ACT: SOME UBIT IMPACTS

<table>
<thead>
<tr>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tax Rate(s)</strong></td>
<td>Graduated; up to 39%</td>
</tr>
<tr>
<td><strong>Qualified Transportation Fringes</strong></td>
<td>Costs not included in UBTI</td>
</tr>
<tr>
<td><strong>Activity Bucketing</strong></td>
<td>Gains and losses of all UBI activity consolidated</td>
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</tbody>
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UBIT ESTIMATED PAYMENT AND RETURN

• Tax Services annually makes an estimate of UBIT liability
  • Estimated payment is due October 15th

• Tax Services annually prepares IRS Form 990-T
  • Return is due November 15th and covers the FY ending June 30th
UBIT CASE STUDIES

- **PLR 201630009:**
  - Tax Exempt Organization rented real property with personal property equaling 5% of FMV of the rental price. Rental price was not based on net income or profits of the activity.
  - Rent from real property held nontaxable; rental from personal property held incidental and nontaxable

- **PLR 201710002:**
  - Tax Exempt Organization specialized in data analysis on community issues, the results of which were made freely available to the general public. The organization offered the same technical assistance services to other organizations and provided them based on a sliding scale.
  - Income from the sale of the services was held to be substantially related to the organizations tax exempt purposes
UBIT CASE STUDIES

• PLR 201645017:
  • Tax Exempt Organization operated a coffee shop in connection to their facilities. The shop was advertised widely and operated in a commercial manner. The profits were used to support the organizations exempt functions.
  • The coffee shop was deemed substantially unrelated to the organization’s exempt purposes and held subject to UBIT.

• PLR 201710005:
  • Tax Exempt Organization (Cultural Center) operated coffee shop housed inside the center. There were no exterior doors to the coffee shop nor any external advertising of any kind.
  • As there was no call to non-visitors of the Cultural Center to purchase coffee in any other circumstance than while they happened to be visiting the Center, the activity was held not unrelated to the organizations exempt purpose.
RESOURCES AND CONTACT INFORMATION

• Tax Services webpage: http://www.fso.arizona.edu/tax-services

• Contact information:
  Email: taxservices@fso.arizona.edu
  Direct Line: 520-621-1957

• FSM 20.10: https://policy.fso.arizona.edu/fsm/2000/2010

• Research Gateway: https://research.arizona.edu/administration/home/forms-and-templates

• Internal Revenue Code including but not limited to §§ 511, 512, 513: https://www.irs.gov/privacy-disclosure/tax-code-regulations-and-official-guidance

• Title 26 of the Code of Federal Regulations including but not limited to §§ 1.511, 1.512, and 1.513: https://www.law.cornell.edu/cfr/text

• Internal Revenue Service Publication 598: https://www.irs.gov/forms-instructions