FI0330 – Unrelated Business Taxable Income (UBTI)

Topics:

Objective:

To ensure proper reporting of Unrelated Business Taxable Income (UBTI)

Policy:

Definition

1. Under Internal Revenue Code Section 115, The University of Tennessee is tax-exempt as an instrumentality of the State of Tennessee (IRS Determination Letter dated March 27, 1998). The Internal Revenue Code provides the exempt purposes of state colleges and universities include charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competition, or preventing cruelty to children or animals. The University is not, however, exempt from tax imposed by Code Sections 511, 512 and 513 on activities which are unrelated to those exempt purposes and must file Form 990-T annually on gross income from an unrelated trade or business of $1,000 or more per fiscal year.

Policy

2. Three elements must be present in order for an activity conducted by the University to generate unrelated business income (UBI):

a. Trade or Business – the term "trade or business" generally includes any activity carried on for the production of income. The IRS and the courts have long held that for any entity to classify an activity as a trade or business, it must conduct the activity with the intent to earn profit. Treas. Reg. §1.183-2(b) sets forth nine (9) different factors taken into account in making this profit motive determination, one of which is "history of income or losses with respect to the activity". The IRS often disallows losses on Form 990-T if an activity incurs two or three consecutive years of losses. For example, a 4-H camp earns a net profit in 2014 but incurs net losses in years 2015, 2016 and 2017. The IRS would likely disallow the University from taking a loss on its 2018 990-T and would continue to disallow future losses until the 4-H camp earns a net profit again. If a department is unsure of whether or not an activity meets the profit motive test but is otherwise considered UBI, please proceed with reporting the activity to the Controller's Office for final determination.

b. Regularly Carried On – activities ordinarily are considered regularly carried on if they show frequency and continuity of sales, and are pursued in a manner similar to comparable commercial activities of nonexempt organizations.

c. Substantially Unrelated to the Exempt Purpose of the University – see Paragraph 1 for definition of exempt purpose for state colleges and universities.

3. Statutorily excepted, activities that meet one of the following criteria will not be subject to the unrelated business income tax (UBIT):

   a. Performed substantially (85% or more) by volunteer labor

   b. Conducted primarily for convenience of University students, faculty, staff or patients

   c. Sales of donated merchandise

d. Qualified sponsorship payments – a payment for which the sponsor receives no substantial return benefit* other than mere acknowledgement** by the university.

*See under "Examples of UBTI" below, Paragraph 19.

**Acknowledgement may include the following:

1. The sponsor's name and logo
2. Contact information and locations
3. General description of the sponsor's products or services
4. Slogans that do NOT contain qualitative or comparative descriptions of the sponsor's products or services.
5. A "click through" logo on a university website that takes users onto the sponsor's website, as long as no endorsement by the university is present on the university's website or the sponsor's website.

e. Distribution of low cost articles

f. Exchange or rental of member lists between tax-exempt organizations

4. Additionally, the following types of income are excluded from UBI:

a. Passive investment income

b. Gains or losses from sale of property (not inventory)

c. Rents from real property (however, see "Sales or Rentals to the General Public" below – rental of real property becomes taxable when the University provides services to the general public with the rental)

d. Royalty income

e. Research income (not ordinary testing or inspection of products)

5. UBTI means the gross income derived from any unrelated trade or business regularly carried on by the University, less the deductions "directly connected" with carrying on

the trade or business.

6. To be directly connected with the conduct of an unrelated business, deductions must have a proximate and primary relationship to carrying on that business.

7. For purposes of computing UBTI, expenses attributable solely to the operation of an unrelated business may be deducted in full. An example of this for the Consolidated Investment Pool (CIP) would be the cost of the software purchased solely to track and report UBTI from the various partnership investments.

8. Expenses incurred in connection with both an exempt purpose and the conduct of an unrelated trade or business (e.g., facilities or personnel) must be allocated between the two purposes using a reasonable basis of allocation. An example of this for the CIP would be allocating the cost of the Investment Office's staff (because only a portion of total income from the CIP is considered UBTI).

9. If a particular cost has been allocated, the department, school or center must specify the basis of allocation. Reasonable methods include hours of use, revenue generated, type of activity, or number of pages (for publications). The Controller's Office may also allocate a reasonable amount of overhead expenses to each activity.

10. Federal income tax must be paid on the amount of UBTI generated by an activity. Total tax due will vary, based on losses from other University activities, losses from the CIP and net operating losses (NOLs) carried forward from previous years.

11. Those schools/departments whose activities generate UBTI will be charged their proportionate share of the tax expense which will be allocated at the time of the IRS payment and reported in April/May of the following year.

Examples of UBTI

12. Sales of commercial advertising in University publications.

13. Revenues from summer camps administered by third parties and 4-H camps hosted on University property.
14. UBTI passed through from partnership investments within the University's CIP.
15. Sales or rentals to the general public, including, but not limited to, rooms in dormitories and residence halls, and access to recreation facilities. Providing services, except for landlord general services – heat and light, trash pick-up, indoor cleaning, security services, etc. - makes rentals to the general public subject to tax.
16. Sales of non-excluded items at the University bookstore
17. Parking revenues generated from general public attendance at non-University sponsored events.
18. Routine analytical or testing services to non-University users.
19. Substantial Return Benefit - value of items given to corporate sponsors, if the value of those items exceeds 2% of the sponsorship payment.
    a. Departments that receive qualified sponsorship payments (e.g., athletics, etc.) must track the value of any items given to the sponsor, such as tickets, goods, ads, facilities use, services, rights to intangible assets, etc., and determine if the total value of those items exceeds 2% of the sponsorship payment.
    b. Do NOT include the value received from mere acknowledgement of the sponsor (see examples of acknowledgement in Paragraph 3d above) in this calculation.
    c. If the value of the items given exceeds 2% of the sponsorship payment, the sponsor has received a "substantial return benefit", and the value of those items must be included in UBTI. Only the portion of the sponsorship payment that exceeds the fair market value of the substantial return benefit will be deemed a qualified sponsorship payment.
    d. Departments are strongly encouraged to keep good records of these calculations, even if no "substantial return benefit" is received. The IRS can tax an entire sponsorship payment if a department cannot prove the value of items given to the sponsor were less than 2% of the sponsorship payment for "substantial return benefit" purposes.
    e. Please see IRC Reg. §1.513-4 for several good examples of a variety of sponsorship issues.

Responsibility

20. The Controller is responsible for ensuring schools and centers comply with federal tax law and regulations regarding the reporting and taxation of UBTI. The Controller also is

responsible for the timely preparation and submission of the Exempt Organization Business Income Tax Return (IRS Form 990-T).

21. Each department has the primary responsibility for monitoring and reporting to the Controller any external revenue generating activity to ensure such activity is properly reported for possible inclusion on IRS Form 990-T. This includes, but is not limited to, implementation of monitoring procedures by the department to:
    a. Ensure timely notification and consultation with the Controller prior to the commencement of such activity for guidance and potential mitigation of tax exposure.
    b. Ensure revenue and expenses of each activity are accurately captured and reported.
    c. Ensure allocation methods associated with the costs of each activity are reasonable and consistent.
22. Each department, school or center that makes external sales (non-departmental sales) is required to complete an Unrelated Business Income Questionnaire for each activity generating UBTI, regardless of the amount of revenue generated. Thereafter, a questionnaire should be completed only when new activities are initiated or a change occurs in an existing activity previously determined to be exempt.
    a. In an effort to capture all UBI activities across all campuses, the Controller's Office sends an annual memo to all Campus Business Officers (CBO's) on June 15th (just prior to year-end close). This memo asks that all CBO's review revenue-generating activities for UBI, including new activities and changes to previously reported activities. A list of all "sales and service" and "other" I accounts for each campus/unit is attached to this memo for review.
    b. Questionnaires must be submitted to the Controller's Office no later than August 15th of each year, when applicable.
    c. The completed questionnaire will be used to determine if the activity should be included in the University's Consolidated Exempt Organization Business Income Tax Return (Form 990-T) submitted to the IRS.

d. Annually, the Unrelated Business Income Worksheet must be submitted by September 10th of each year to report unrelated activity related to the prior fiscal year. (i.e. September 10, 2018 for fiscal year June 30, 2018 activity). The worksheet can be used for reporting the revenue and expenses associated with UBI.

23. The Chief Business Officer should certify to the accuracy of the activity being reported on the questionnaire returned to the Controller's Office from their respective departments and that it encompasses all business activities that must be reported as UBTI. (CBO Transmittal Letter)

PROCEDURES:

Knoxville:	http://web.utk.edu/~dfinance/fiscal-policy.shtml
Health Science Center:	https://uthsc.policymedical.net/policymed/home/index?ID=de47aa28-16aa-408b-9c96-cb04f232964f&
Institute of Agriculture:	https://ag.tennessee.edu/Pages/UTIApolicies.aspx
Martin:	http://www.utm.edu/departments/finadmin/procedures.php
Chattanooga:	http://www.utc.edu/business-financial-affairs/fiscalpolicies.php

FOR MORE INFORMATION:

Megan Talley (865) 974-2493 mmtalley@tennessee.edu

Controller's Office webpage: https://controller.tennessee.edu/tax/unrelated-business-income/