

# Unrelated Business Taxable Income (UBTI)

Definitions, Exceptions and Examples



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## Trade or Business

The term "trade or business" generally includes any activity carried on for the production of income from selling goods or performing services. An activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities that may, or may not, be related to the exempt purposes of the organization.

## Regularly Carried On



EXAMPLE: Organizers of an annual student picnic receive a payment from a local car dealership in exchange for inclusion of the G H D O H U · V O R J R R Q D V L J Q D W W K H H Q W U \ R I W K H payment is a QSP and is not subject to unrelated business income tax.

2. Providing facilities, services, complimentary tickets or other privileges to the sponsor in connection with a QSP does not affect whether the payment is a QSP. Instead, the provision of such privileges is treated as a separate transaction in determining whether the university would have unrelated business income from the payment. If such additional privileges are not of substantial benefit, the payment will not be subject to tax.
3. A payment is not a qualified sponsorship payment if, in return, the organization advertises the sponsor's products or services. Advertising includes:
  - x Messages containing qualitative or comparative language, price information or other indications of savings or value
  - x Endorsements
  - x Inducements to purchase, sell or use the products or services.
4. The use of promotional logos or slogans that are an established part of the sponsor's identity is not, by itself, advertising. Mere distribution or display of a sponsor's product by a university to the public at a sponsored event, whether free or for remuneration, is considered use for acknowledgement of the product rather than advertising.

EXAMPLE: The organizers of the picnic described above have put together a commemorative program for the event. In exchange for the dealer's sponsorship payment, the dealer is able to place a full color advertisement in the program and display an automobile on the picnic grounds in addition to placing its logo on the sign at the entry to the picnic grounds. In this case, the value of the advertisement would be considered unrelated business income and the value of the logo placement and the right to display would be exempt.





their promotion of Apparel Company X products). Excluded from UBTI as a royalty and sponsorship.

- x Mercury, an upstart in sports apparel, pays a university a fixed percentage of its sales of its sportswear line, which features the appearances by several of the university coaches at the unveiling of the product line. The coaches also have committed (in whole or in part) to endorse the apparel line. The inclusion of personal services in the royalty arrangement causes the loss of the royalty income tax exclusion and this would be subject to UBTI.
- x Unrelated business income does not include royalty income from licensees of patents owned by a university that were assigned to it



received or accrued under the lease is attributable to personal property, the entire lease is subject to UBI tax.

- x If the lease involves the provision of services, such services must be limited to the type of services rendered in connection with the rental of rooms or other space of occupancy only (Treas. Regs. Section 1.512(b)-1(c)(5)).

EXAMPLES:

- x A university lease of a blacktop along with an office building to another entity that will use it as a parking lot for patrons of the leased building, is the lease of real property. In contrast, operation of a parking lot) is considered the provision of services, not the lease of real property, and income from such leases would be UBI, unless such leases contribute importantly to the convenience exception (for example, the lease of parking spaces to employees). (See Private Letter Ruling (PLR) 9835001 and Revenue Ruling 69-269.) discuss this example in detail.
- x Venture, an exciting new restaurant, leases space from the university. The university provides furnishing of heat and light, cleaning of public entrances, exits, stairways, lobbies, the collection of trash, etc. Under IRC section 512(b)(3), these services provided would be in connection with the lease of property for the protection of the property rather than for the convenience of the lessee (Venture), and income from such a lease will qualify as an exception and exempt from UBI.
- x Similar facts as the previous example with Venture, except that the university provides the following services: maid service, linen/laundry services, and catering. These services would be deemed rendered for the convenience of the occupant (Venture), rather than services rendered in connection with

x

- x Stock in trade or other property of a kind that would properly be included in inventory;
- x Property held primarily for sale to customers in the ordinary course of a trade or business, or
- x Cutting of timber that an organization has elected to consider as a sale of timber.

Gain or loss from the sale of S -corporation stock is subject to tax as UBTI. Also this exclusion does not apply to debt -financed property under IRC Section 514.

### Options or Securities

Any gain from the lapse or termination of options to buy or sell securities is excluded from unrelated business income, but only if written in the course of the organization's investment activities.

## Other Sources of Unrelated Business Income

### Partnership Income (IRC Section 512(c))

Each item of income received from an entity treated as a partnership for tax purposes (general partnership, limited partnership, limited liability partnership, limited liability company, or income from a joint operating agreement) retains its character in the hands of the recipient organization in determining whether such item is subject to the UBI tax. Thus, if the



- x Real property debts of an educational institution are generally exempt from the acquisition indebtedness rules.

If substantially all (85% or more) of the use of any property is substantially related to the organization's exempt purposes, the property is not treated as debt-financed property. Related use does not include the generation of income.

If an organization acquires real property with the intention of using the land for exempt purposes within 10 years, it will not be treated as debt-financed property if it is in the neighborhood of other property the organization uses for exempt purposes. Neighborhood property is that which is contiguous to the owned property or within one mile if it is not practical to acquire contiguous property.

After 5 years, the organization must satisfy the IRS that exempt use will occur with the next 5 years.