# CU-Boulder Accounting & Budget Services (ABS) Policy and Procedure

Title: Unrelated Business Income Tax

Date: April 1, 2002

Original:

Revised: x (Date of Original Policy - September 1, 1993)

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# Background Information

The university's primary purpose is the fulfillment of the institution's instructional, research or public service missions. Most university activities are either directly or indirectly related to these primary purposes. Any university activity not substantially related can be categorized as unrelated to the primary purpose. Categorizing the numerous operations of the campus to these rather nebulous descriptions can be very difficult. The importance of doing so has income tax ramifications since the institution is tax exempt for it's non-profit primary purpose and taxable at state and federal levels for business activities that are not substantially related to the tax-exempt purpose.

Recent IRS audits of institutions of higher education have challenged long-standing traditions of activities previously thought to be related to our primary mission. The jury is still out on exactly which activities are tax exempt and which are taxable. We can, however, look at some broad guidelines and be cognizant of our business activities in relation to this dynamic tax issue to ensure that those activities conform or that proper reporting to governmental agencies is taking place.

A related, and equally important, issue, is the question of the tax exempt institution becoming more involved in activities that compete with the private sector. For-profit businesses are claiming unfair competition due to lower retail prices because of the exclusion of income taxes in the pricing structure as mentioned above. Confrontations are resulting, and governing bodies have been slow to issue concrete rulings on this issue. Again, we must deal with changing conditions and a very "gray" topic.

# 2. Policy Statement

Program managers of proposed and existing campus activities shall review their particular operations for possible exposure to Unrelated Business Income Tax (UBIT). Unrelated business income is defined as gross income from any regularly conducted trade or business that is not substantially related to the university's educational and other exempt purposes. Passive income sources such as dividends, interest, annuities, royalties, real property rent, do not represent a trade or business activity and are therefore exempt. Operations should not be

terminated simply to avoid paying taxes. These programs must have proper pricing structures to allow for the cost of operations and the additional burdens of the tax.

If a program manager determines that a tax reportable activity is being conducted, they must immediately contact the Boulder Campus Cost Accountant (303-492-2428). The cost accountant is responsible for reporting the net taxable unrelated income or loss to the System Office, which files a consolidated Unrelated Business Income Tax Return for the University. In order to determine if there is net taxable income or loss, the cost accountant - with the assistance of the program staff - will conduct a cost study to determine the share of the direct program expenses, as well as indirect costs of the program, that can be attributed to the unrelated revenues. The program will be charged for tax deposits made on their behalf. Net losses from other *related* programs of the University will be used to offset taxes owed by income producing programs. The program will receive credit if a refund is issued by the IRS. Note: The IRS does not permit offsetting net gains and losses using *unrelated* activities of the University. Individual departments are responsible for taxes, interest and penalties for failure to identify and report taxable activity.

## 3. Procedure

Determination of whether an activity produces unrelated business taxable income can be made by answering the questions shown below. If difficulty is encountered in making determinations on activities, assistance is available from the Cost Accountant, Area Accountant, Assistant Controller, or the Controller.

#### 1. Is the activity regularly carried on?

A specific business activity is regularly carried on if it is conducted with a frequency, continuity, and manner of pursuit comparable to the conduct of the same or similar activity by a taxable organization.

- An activity is regularly carried on if it is conducted:
  - intermittently the year round;
  - during a significant portion of the season for a seasonal type of business.
- But, an activity is not regularly carried on if it is conducted:
  - on a very infrequent basis (once or twice a year);
  - for only a short period of the year;
  - without competitive or promotional efforts.

#### 2. Is the activity substantially related to the exempt purposes of the university?

To be substantially related, the business activity must contribute importantly to the accomplishment of a purpose for which the university was granted tax exemption, other than the mere production of income to support such purpose. The primary exempt purpose of a college or university is education and research. The IRS regulations define "educational" as including:

- the instruction or training of the individual for the purpose of improving or developing his/her capabilities; or,
- the instruction of the public on subjects useful to the individual and beneficial to the community.

## 3. Is the activity conducted with volunteer services?

Any business activity in which substantially all (85% or more) of the work is performed by volunteers is specifically exempted from unrelated business income tax.

#### 4. Is the activity primarily for the convenience of faculty, staff or students?

The activities are exempt regardless of their nature. Examples are food service, bookstores, laundry, telephone service and vending machines. (This particular exemption is currently under heavy scrutiny by the IRS and may change shortly)

#### 5. Is the income derived from debt financed property?

Examples are dividends, interest, rents, etc. earned from stocks, bonds and rental property.

This particular directive is quite complex and each activity must be examined on a caseby-case basis.

## 6. Is the income received from a controlled (owned-80% or more) corporation?

All but dividend income may be subject to the tax. Again, due to complexities, each must be examined individually.

## 7. Is income from the rental of real property?

Rental income is tax-exempt, but if significant services, such as set-up, cleaning and laundry service, are also provided, then the income is usually taxable.

#### 8. Is the income from advertising?

The activity is probably taxable if the operation is profitable.

#### 9. Is the income derived from research?

The income is tax exempt except for testing or inspection of materials, products, design or construction of buildings, etc. The nature of the entity (commercial, governmental, non-profit) for which the research is performed is irrelevant.

In addition to reviewing activities based upon the above guidelines, managers should make certain that adequate records are in place to account for revenues and allocable expenditures of exempt and non-exempt activities. FOPPS must clearly delineate tax exempt and taxable operations.

(Excerpts have been taken from "Managing Unrelated Business Income - Colleges and Universities", Peat Marwick Main & Co.)

# 4. Examples

Some examples of activities that **may** generate UBIT are provided below. It is necessary to analyze each activity, on a case-by-case basis, to determine if it results in UBIT.

- External sales of advertising such as print advertisements, scoreboard advertisements, and revenue received from advertisements run during radio and television shows
- Catering and food service activities
- Entertainment events
- Travel-study tours

Merchandising services

# 5. Resources

Questions pertaining to Unrelated Business Income Tax can be directed to the <u>Boulder Campus Cost Accountant</u> at 303-492-2428, or to the University System's tax contact at 303-860-4210.