

Unrelated Business Income

The University of Georgia

December 8, 2010

Recap of UBI

Tax Exempt Activities

- The University is tax-exempt as an instrumentality of the State of Georgia under Section 115 of Internal Revenue Code. [The Foundations are exempt under Section 501(c)(3)].
- The University is exempt from federal income tax for engaging in activities which further its educational purpose.

Recap of UBI

Taxable Activities

- However, the University is not exempt from income tax imposed on activities which are substantially *unrelated* to those exempt purposes, even though these activities may bring in funds to support the University's exempt operations

Recap of UBI

What is Unrelated Business Income?

3-Prong Test

- Trade or business – any activity carried on for the production of income from selling goods or performing services;
- Regularly carried on – any activity that shows a frequency and continuity and is pursued in a manner similar to comparable commercial activities of nonexempt organizations; and

Recap of UBI

What is Unrelated Business Income?

3 prong test (cont'd)

- Not substantially related to organization's exempt purpose – the activity does not contribute importantly to accomplishing the University's exempt purpose.

Note: There are exceptions to these requirements and in some situations; determination of whether or not the activity generates unrelated business income will be case specific.

Types of Activities Deemed Unrelated

- If an activity generates revenue and is unrelated to the University's mission of instruction, research and public service, it could be UBI.
- Activities generating revenue from customers other than students, faculty or staff are also considered to be UBI unless the activities are considered to be related to the University's mission.
- Advertising Revenue is almost always considered UBI.

Types of Activities Deemed Unrelated

- Advertising Definition:
 - Messages containing qualitative or comparative language
 - Price information or other indications of savings or value
 - An endorsement
 - An inducement to purchase, sell, or use any company, service, facility or product.

Examples Include: Advertising included in Georgia Review, Georgia Magazine, The Georgia Pharmacist Magazine

Possible exception: Are students involved? Is the purpose of their involvement to educate them about creating publications?

Types of Activities Deemed Unrelated

- Sales of Goods and Services

Examples Include:

- A unit provides a service of duplication and media format transfers among a variety of audio and videotape, CD, and DVD formats to members of the University (faculty, staff, and students) as well as customers external to the University. The service is the same for both customers, however revenue generated from external customers is considered UBI.
- If students are involved in these processes from a training perspective – it would be considered related.

Types of Activities Deemed Unrelated

- Sales of Goods and Services (cont'd)
 - University Golf Course – revenue generated from golfers that are not faculty, staff or students
 - Ramsey Center – membership dues received from individuals that are not faculty, staff or students (i.e. dependents, spouses, retirees, or guests)
 - Campus Transit – revenue generated from charter bus activity from those customers external to the University (i.e. charter bus services provided to the Chamber of Commerce)

Types of Activities Deemed Unrelated

- Sales of Goods and Services (cont'd)
 - Bioexpression & Fermentation Facility – fermentation services are provided to external customers only. This activity is not specifically providing instruction or conducting research. No students are involved.
 - Travel and Vision Clinic – the University Health Center provides services through the Travel and Vision Clinic. Revenue generated from customers other than students, faculty or staff is unrelated.

NOTE: The Travel Clinic is open to the general public; the Vision Clinic is open to UGA students, faculty and staff, and their spouses, domestic partners and dependent children as young as four years of age.

Types of Activities Deemed Unrelated

- Rental of Facilities and Services
 - Conference Centers - Georgia Center for Continuing Education, Tifton, Griffin and 4-H Centers – activities that are not a conference or continuing education event, such as revenue from weddings and other reception functions provided to the general public.

Lessons Learned

- UBI is **NOT** “bad” and departments should not be afraid to offer activities that may generate UBI. The key is to analyze and report UBI activity on the 990-T and to maintain good records on the activities.
- Regardless of the annual financial surplus or deficit, the UBI activity should be reported on the 990-T tax return.

Lessons Learned

- Advertising is almost always unrelated unless the ad is included in a publication where students are getting instruction/training on publication, composition, and development. Generally, when students are involved in the revenue generating activity, the activity is considered related. However, this is not always the case.
 - For example, the Georgia Pharmacist Magazine is put together by two pharmacist students who volunteer their time. However, advertising contained in the Georgia Pharmacist Magazine is considered to be UBI.

Lessons Learned

Expense allocations

- Expense allocations for unrelated activities should not be based on percentages of revenue (between related and unrelated). To qualify as allowable deductions in computing UBI taxable income, the expenses, depreciation, and similar items generally must be allowable income tax deductions that are “directly connected” with carrying on the unrelated trade or business.

Lessons Learned

Expense allocations

- **Expenses attributable solely to unrelated business.**

Expenses, depreciation, and similar items attributable solely to the conduct of an unrelated business are proximately and primarily related to that business and qualify for deduction to the extent that they are otherwise allowable income tax deductions

- For example, salaries of personnel employed full-time to carry on the unrelated business would qualify as well as depreciation of the building used entirely in the conduct of that activity.

Lessons Learned

Expense allocations

- **Expenses attributable to dual use of facilities or personnel.** When facilities or personnel are used both to carry on related functions and to conduct an unrelated trade or business, expenses, depreciation, and similar items attributable to the facilities or personnel must be allocated between the two uses on a reasonable basis.

Lessons Learned

Expense allocations

- For example, a University with income from an unrelated trade or business pays an administrator \$70,000 a year. The administrator devotes approximately 10% of his time to the unrelated activity. To figure the organization's unrelated business taxable income, a deduction of \$7,000 ($\$70,000 \times 10\%$) is allowed for the salary paid to the administrator.

Lessons Learned

Expense Allocations

- A cost perspective should be utilized for expense allocations.
 - Ask the question: What costs are incurred during the process of generating this unrelated business income?

Lessons Learned

- Rental of a facility is generally excluded, however, if in conjunction with the facility rental, rental of personal property (such as furniture, equipment, machinery, linens, table settings, dance floor or AV equipment) or services are provided, the rental income may be considered unrelated and is subject to the following rules:
 - If 10% or less from personal property – considered incidental and not UBI in accordance with real property rental income exclusion
 - 11-50% from personal – taxable in proportion to the percentage of personal property rent to the total rents
 - 51% or more from personal property – 100% taxable

Lessons Learned

- Services in addition to rental of a facility will generally result in unrelated revenue.
 - Example: Revenue generated from facility rental and provision of food or catering services will be unrelated revenue.
 - Services such as pest control or waste disposal are normal landlord provided services and should not make any part of rent UBI. Other such landlord provided services could include: grounds keeping, indoor cleaning, and security services.

Lessons Learned

- Research income is generally exempt from UBI:
 - “Substantially Related” Research: If the research project is substantially related to the educational mission of the institution, it is exempt from UBI.
 - For example, if students are involved, the activity may be considered education.
 - Research conducted for the federal or state government
 - Scientific research in the public interest is also considered “substantially related” to a university

Lessons Learned

Research Activity (cont'd)

- 3 criteria:

- Must be “scientific research” – supervised by professionals; designed to solve a problem
- Must not be conducted incidentally to commercial or industrial operations
 - Example: Testing for pharmaceutical companies which is purely testing services and does not contribute to research efforts is usually unrelated. However, if students worked in the lab to learn about the testing process, it could be exempt due to the educational exemption.
- Research must be conducted in public interest – results made available to the general public. If results are “proprietary”, the income could be UBI.

Accounting Best Practices

- All accounting transactions recorded in the University's Financial Accounting system (general ledger) are the official data records used for reporting by the University
 - If departmental sub-systems are used, balances should be reconciled to the general ledger on a monthly basis
- Matching of revenues and expenses within the fiscal year is critical
- Unearned revenues should be deferred and recorded in the University's Financial Accounting system

Accounting Best Practices

- At fiscal year end, if services have been performed but revenue has not been collected, the department should record an accounts receivable on the University's Financial Accounting system
- Detailed record keeping is the key to successful reporting and is key to the successful completion of any audit
- Accounting records should be retained for at least 7 years
- Copies of any publications (magazines) produced should also be retained along with accounting records
- Any UBI supporting documentation requested and provided to the Accounting Department should agree to the University's general ledger

Reporting for FY2010 and FY2011

- Questionnaires were due to Accounting November 15.
- Accounting will review and request revenue and expenditure activity from departments based on information provided on the questionnaire. Information will be due to Accounting by Feb 1 and should reconcile to the University's general ledger.

Reporting for FY2010 and FY2011

- If you are unable to identify expenses associated with the unrelated revenue, an expense allocation will need to be provided. Contact the Accounting Department if you need guidance on expense allocations.
- UGA will file the 990-T tax return May 15

Recommendations for FY2012

- The Accounting Department recommends during budget development for FY2012, departments establish a specific account number to record each UBI activity. From a tax preparation standpoint, this is the most accurate way to identify revenue and expenses associated with UBI activity.
- Record all revenue and expenditure transactions related to the activity in this account.

Recommendations for FY2012

- The account name should include UBI in the description in an effort to simplify extracting data for 990-T Reporting.
- Provide the UBI account numbers on the UBI questionnaire distributed by Accounting each year
- Contact the Accounting Department for guidance on setting up new accounts for UBI activities

QUESTIONS?