

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 1 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

PURPOSE

To list and define Unrelated Business Income.

SOURCE

IRS Policy

POLICY

The University is exempt from federal income tax for engaging in activities which include charitable, scientific, testing for public safety, literary, educational, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. However, section 511 and corresponding Treasury Regulations place a tax on income that is not related to the organization’s exempt purposes.

CMP 309 Unrelated Business Income

Procedure

For income to be unrelated business income and taxable (UBIT) the activity generating the income must be:

1. A trade or business -- Conducted with intent to generate profit.
2. That is regularly carried on – Determined by looking to frequency, continuity, and whether manner conducted is consistent with the manner of a commercial taxable organization.
3. And not substantially related to the exempt purpose of the organization – Does not contribute importantly to furthering the university's purposes; motivated primarily for the production of income.

There are possible exceptions and modifications for each of these prongs depending on the activity in question. Possible activities that might generate UBIT are as follows:

Advertising Income

The University sells advertising in multiple ways, including commercial ads in the student newspaper, professional journals, and athletic programs, and sponsorship agreements for using and displaying the company's product. As a general rule, advertising income is UBIT. Advertising is given a fairly broad definition as slogans, trademarks, logos, and other information similar to listings in professional journals, newspapers, and the yellow pages. Income from ads on an organization's facility wall space was also held

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 2 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

to be UBIT from advertising.

To be advertising, a trade or business must exist, and is present when the advertising activity or the sale of the publication is generally profitable. When one or both activities are operated at a loss year after year, it can be argued there is no profit motive and no trade or business. In addition, such business must be regularly carried on, meaning the ad is part of a journal, newspaper, or similar periodical published on a regular basis.

The following are a few exceptions to the usual UBIT determination. In *Reg. § 1.513-1(d)(4)(iv), Ex 5* – An exempt university provides facilities, instruction, and faculty supervision for the student-operated campus newspaper. The newspaper also contains paid advertising, which is solicited, sold and published by students. However, there is no UBIT as this advertising contributes importantly to the university's educational program through student training. The same would be true if the newspaper were published by a separate section 501(c)(3) organization, if qualified under university rules for recognition of student activities, even if the organization uses its own facilities and is not under faculty supervision. It would have to perform its function by means of student instruction and participation in editorial and advertising activities. Under *TAM 199914035*, a 501(c)(3) organization that was separately incorporated but had a close working relationship with the university published a university's daily student newspaper. The university had donated office space where the department of journalism was located. Students and faculty members comprised the board of directors, and students conducted the reporting and writing functions of the paper. The business functions were conducted by 17 students and 10 non-students. It was held the ad income was still substantially related, but this is a "safe-harbor" and not a bright line test.

Activities with a History of Consistent Losses

Under the test for UBIT, one prong is whether the activity is conducted for the primary purpose of generating income/profit. The IRS and Tax Courts have adopted a facts-and-circumstances test to answer this question. It should be noted that while many universities have used the argument of an activity with a history of consistent losses not being conducted for the primary purpose of generating income or profit, and hence not being an unrelated business activity, the IRS has used this to disallow claimed loss deductions for allegedly unrelated business activities. Such history should be determined on an activity by activity basis.

In *National Water Well Association v. IRS*, the court held a contractual right to receive commissions or fees is not necessary to find a profit motive; such can be inferred from the objective facts that the petitioner was extensively involved in endorsing and administering a program that proved highly profitable for the petitioner. In *PLR 8846002*, a 501(c)(3) organization's primary activity consisted of providing public television broadcasting to a particular region of the US. It rented certain facilities to the general public, including studio space and equipment. It reported a large loss from this activity, due to accelerated depreciation and administrative costs, and argued its losses have substantially decreased over the years and it has always had a profit motive in this activity. The IRS held a series of consistent losses is relative, but not the only factor. The loss this year could be attributable to factors such as the

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 3 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

depreciation, which will not be present in future years. Its pricing was competitive, and it conducted this activity in a businesslike manner. The rentals are more than incidental and there is repeat business. The organization was subject to UBIT. In *PLR 8428008*, a 501(c)(5) organization provided qualified officer personnel and maintained an office for the provision of insurance to union members. For three years the organization sustained a loss and in the fourth year the agreement was changed, giving the organization its first profit. The IRS found a profit motive based upon the following reasons: the organization was not independently negotiating contracts that produced losses, increasing volume was a factor in reaching a break-even point, the organization made a profit in the last year, and the losses under the contracts were decreasing every year. Finally, in *TAM 8508004*, X operated a clubhouse for its members and guests. It consistently suffered substantial losses from all of its activities with nonmembers and sales to nonmembers were at prices insufficient to recover the cost of sales. There was not a profit motive and X may not use these sales to deduct against other income.

Athletic Events/Television and Broadcast Rights

This occurs when a university earns income from admissions to athletic events or from the sale of television and broadcast rights. *HR Report No. 2319* states income from admission charges is not UBIT because athletic activities are substantially related to a university's educational purpose. In the following PLR and Rev. Ruling, the IRS held income from the sale of radio or television rights are likewise not UBIT because these are other methods of exhibiting the game to the public. In *PLR 7948113*, the IRS ruled the gift of the rights, title, and interest in the operation, production and exhibition of an all-star college football game played by a university to an exempt organization which supported the university would not endanger the organization's exempt status. In addition, an agreement with another entity to broadcast the game for profit would not generate UBIT. In *Rev. Ruling 80-296*, the sale of broadcasting rights to a national radio and television network by an organization created by a regional collegiate athletic conference made up of universities to hold an athletic event was not UBIT. Finally, in *PLR 200151047*, the IRS ruled income from video production and satellite uplink services provided by a exempt public broadcasting corporation to a noncommercial television network, and income from educational programming services provided to a commercial television station, was not UBIT.

Bookstore Operations

The IRS breaks down this area into two categories:

Situation 1 -- University leases bookstore facilities to a for-profit company and receives rental income. A question is raised as to whether the relationship is a bona fide lease, with payments received qualifying for rental income exclusion, or the for-profit company is simply acting as an agent in return for a management fee.

Situation 2 -- University retains a for-profit company to manage under a management contract, or

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 4 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

University operates the bookstore itself or arranges for operation by a separate, nonprofit entity controlled by the University. Under this category, all bookstore sales are UBIT, unless the sale is either

- i. A sale to students, faculty and staff of items directly related to the school's educational purposes (i.e. books, general supplies) and athletic wear used in the athletic and physical education programs or
- ii. A sale of non-educational items for the convenience of students and faculty, and other employees (not alumni). This is determined by a convenience test with two requirements – the item should be of recurrent demand because of day-to-day campus living, like toiletries, and the item should not have a useful life of more than one year. The IRS goes by a general rule that any non-educational item with a useful life of more than one year does not fall within the exception, except for clothing, and novelty and other items embossed with the school's logo.

There are a few additional considerations. The sale terms might affect the convenience test. For example, if a refrigerator or television set is leased on a short-term basis, it is considered for convenience. In addition, while the sale of one computer to a student/faculty member may be considered exempt, the sale of multiple computers to a single student or the sale of a computer to someone not enrolled may be UBIT.

Catering Activities

This arises when an university provides its own catering services for the following: (1) university or affiliated group sponsored events; (2) university department invitation to a nonaffiliated group; (3) university permission for a nonaffiliated group to use the dining facilities in connection with a meeting; (4) university caters wedding receptions, graduation and birthday parties, or private parties for senior officials; (5) catering department of university advertises to the general public for catering services. Under *Rev. Ruling 81-69*, a social club that sells food and beverages to non-members at prices insufficient to recover the costs may not deduct losses from its other UBIT because the activity is not profit motivated. Under *PLR 8020010* university-held functions requiring the use of the facilities, including alumni dinners and class reunions, are not UBIT because these activities kept the alumni abreast of current development on campus and as such, the catering for these events was a related activity.

Concession Sales

This occurs when university makes sales of food, novelty items, t-shirts and other such items. If the university makes concession sales to students, faculty, and staff, the activity falls within the convenience exception and is not treated as UBIT. If the concessions are sold to anyone at a related event, such as a football game or a student play, the sales are treated as an integral part of the event and not subject to UBIT. If the concessions are sold to members of the general public or to anyone else in connection with an unrelated event, the concession activity will not be treated as related and will be subject to UBIT.

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 5 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

Conferences, Meetings, and Training Programs

This arises in one of three instances: (1) university has conference center/facilities at which institution related meetings and conferences are conducted; (2) university rents such facilities to other entities, both non-profit and profit; (3) university enters into a contract with another entity to provide special training programs and classes for its employees.

There is no UBIT in the first situation. If under the other two UBIT is determined, it might be excluded under the rental income exclusion, depending on the degree and extent of the university-provided services. In *TAM 9137002*, a state university entered into contracts with an operating company to provide instruction in support of certain courses. The contract provided all material which became an integral part of the contract, as well as information prepared by the university, or as a result of work done for the course, should be the exclusive property of the operating company. The university and the operating company both provided computing resources, and the university provided two instructors, teaching assistants, and a secretary. The operating company provided instructional materials and classroom space. The teaching was part of the instructors' regular load and undergraduate credit if desired. The IRS held it was demonstrated the courses were educational and furthered the mission of the university. Therefore the income was not taxable. In *TAM 7840072*, a state college leased its facilities to various non-profit and commercial entities to conduct various conferences, seminars, and training programs and who used the college's dormitories, cafeterias, meeting halls, and other facilities. The college also conducted conferences and seminars open to the general public. The IRS held the college's direct conduct of conferences and seminars is substantially related to its exempt function. The leasing activities do not contribute importantly to the exempt purposes and are included in UBIT. Finally, in *PLR 9824048*, income from a conference center and lodging facility constructed and operated by an organization affiliated with a university, which was used primarily for executive education and continuing professional education types of training, was not subject to UBIT.

Corporate Sponsorship Payments

A corporation or a business makes a payment to the University in return for some mention or acknowledgement of the business's products or services. The issue is whether this is fundraising and acknowledgement, or the sale of advertisements. Under *Reg 1.513* a qualified sponsorship payment is not UBIT. A qualified sponsorship payment occurs when a payment is made to an organization by a person engaged in a trade/business and there is no expectation the person will receive a "substantial return benefit" in exchange. It does not matter whether the sponsored activity is related or unrelated to the exempt purposes of the organization or whether the activity is temporary or permanent. The regulations apply to ongoing events like annual fundraisers.

A substantial return benefit is any benefit other than a use or acknowledgement of the payer's name or

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 6 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

logo in connection with the organization's activities, or certain goods/services with an insubstantial value. A use or acknowledgement can include logos or slogans that do not contain qualitative or comparative descriptions of the payor's products, services, facilities or company. Such logos/slogans need to be an established part of the payor's identity. A good/service has an insubstantial value when the aggregate fair market value of all the benefits provided to the payor/persons designated by the payor in connection with the payment during the organization's taxable year is not more than 2% of the payment amount. The existence of a written sponsorship agreement does not prevent the qualified classification –the agreement terms determine the classification. If payment is based on the degree of public exposure to a message the payment will be classified as nonqualified; however, a contingent event will not have the same effect.

On the Internet, an exempt organization can provide links on its website and notices of certain benefits provided to the organization's members by certain providers. If the organization does not charge a fee for the listings or the links, the IRS has held the links are not advertising – they were acknowledgments and not subject to UBIT. In addition, banner advertising featured on the website is not advertising if it appears on the website generally, and not part of an online periodical. If a corporate sponsorship payment were for both periodical advertising and advertising that appeared on the website generally, then the payment would have to be allocated.

Residence Hall Rentals

Residence hall space is rented to other organizations or individuals, usually in the summer. A question arises as to whether this rental activity is substantially related to the school's education purposes. A 1990 IRS ruling analyzed the following summer rental programs at a college:

a. *Summer internship rental program* – Students from schools around the country stayed in dorms while taking part in summer internship programs at local corporations and law firms. The college also conducted career counseling sessions for the students and a biweekly seminar program focusing on law and business, and allowed the use of the library and other education facilities.

b. *Organizational education* – Organizations (both profit and non-profit) rented space to conduct educational classes, seminars, and workshops. Some classes used the college's facilities. For profit-organization classes, the college required the following: classes be educational in nature and not directed at enhancing the sponsor's commercial objectives, the sponsor use the school's facilities, and the company submit a course description to allow the college to monitor the classes to ensure the educational nature.

The IRS held both programs did not generate UBIT for three reasons: the school established requirements and criteria to ensure activities were educational in nature, the school provided other educational benefits, such as career counseling, and it made it non-dormitory facilities available to the individuals.

Two other IRS rulings are also instructive. In the first, a state college could allow a non-profit professional theatre group to use its facilities each summer, as well as various non-profit and commercial

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 7 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

entities which conduct conferences, seminars, and training programs. However, the lease of facilities and dormitories to a NFL football team as a pre-season training camp did not contribute importantly to its exempt purpose and was UBIT. In the second, a college held two summer sessions of hockey camp for boys ages 8 to 14, as well as a summer camp run by a professional football team and outside organizations' educational conferences. The hockey camps were considered in furtherance of exempt educational purposes, as were the educational conferences. The leasing of the facilities to the professional football team did not further the educational purposes, but was exempt under the rental exclusion.

Exclusivity Contracts

These contracts are divided into two subcategories, and examples are in the Regulations:

- a. Exclusive sponsor arrangements – a company sponsors an event and the organization agrees the company will be the exclusive sponsor; then in most cases states such in its event publicity. The IRS holds this arrangement, in and of itself, is not regarded as a substantial return benefit that generates UBIT.

- b. Exclusive provider arrangements – "an arrangement that limits the sale, distribution, availability, or use of competing products, services, or facilities in connection with an exempt organization's activity." *Treasury Reg 1.513-4*. Such an arrangement is held by the IRS to be a substantial return benefit and taxable as UBIT.

Internet

This occurs when non-profit organization utilizes the Internet for fundraising or advertising purposes. The rulings in this area are not as developed as other areas concerning UBIT. The *2002 Tax Exempt Organizations and World Wide Web Fundraising and Advertising on the Internet, Training Manual for Field Agents* states that use of the Internet to accomplish a particular task does not change how the tax laws apply to that task, but it can change the manner in which the tasks are accomplished, affecting the resulting tax treatment. Use of a hypertext link in a message that otherwise meets the corporate sponsorship guidelines will retain the passive character of a corporate sponsorship while a moving banner is more likely to be considered advertising. A distinction is drawn between periodicals and most online content except where the organization has online editions and print publications that are sufficiently segregated from other traditional Website materials.

In *PLR 200225046*, a 501(c)(3) educational incorporated N as a for-profit corporation with the same mailing address as a wholly owned subsidiary of the organization. The organization entered into licensing agreements with N, and N delivered products and services to business professionals through an Internet vertical portal. The license granted was non-exclusive, non-transferable, and non-sublicensable, except N had an exclusive North American license to use the organization's trademarks, logos, trade dress, and domain name for the purpose of hosting or sponsoring a website on the Internet. The organization

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 8 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

established standards and guidelines relating to permitted use, depiction, and display or licensed marks and content and quality control procedures. The two parties also entered into an advertising agreement whereby N agreed to give the organization banner advertising space on the website and in consideration for such, the organization would provide N advertising in its periodicals and publications. The organization would report any additional revenue from N as UBIT. The IRS held income from the licensing agreement was to be considered royalties and income from the ads should be UBIT. Similarly, in *PLR 200303062* a 501(c)(5) organization was committed to the advancement and prosperity of agriculture. It regularly published news publications, and accepted advertising, treating it as UBIT. M had membership benefits through other service providers, and provided information in brochures and on its website about these companies. It simply listed the service provider on its webpage and provides benefit information. It did not encourage the use of such benefits nor provide a link to the service provider's website. The organization did not accept advertising from the service providers for its website, although it did for other periodicals. Some of these service providers also sponsored activities, and the organization asked for permission to acknowledge the sponsors on the website with links to the main corporate page of the sponsors' websites without recognition of UBIT. The IRS held the information listing of service providers does not generate UBIT. Any website advertising that is offered in addition to periodical advertising has some separate value and may or may not have to be included in the computation of periodical advertising. As long as the corporate sponsorship listings and links can be categorized as an acknowledgement, rather than an advertisement, such would not generate UBIT.

Finally, in *Rev. Ruling 2004-112* – Two examples are given and a distinction is drawn:

- a. A trade association exempt under 501(c)(6) maintains an information website about its trade shows. In conjunction with its semi-annual trade show, it adds a section enhancing the trade show by allowing members and the public to access information. This section is available during the 10 day trade show, and during a 3 day period prior to and a 3 day period after the trade show. The IRS held the activities conducted on the supplementary website section during the 16 day period that coincides with the trade show meet the requirements of a qualified convention and trade show activity and therefore do not generate UBIT.
- b. A similar trade association establishes an Internet site available to the general public 24 hours a day, 7 days a week for a 2 week period. The 2 week period does not overlap or coincide with any international, national, state, regional, or local convention, annual meeting or show. The IRS held the Internet activities are not carried on in conjunction with or enhancing any convention, meeting, or trade show. Therefore the operation of the website, even for a short period of time, is an unrelated trade or business.

Operation of Parking Lots

This issue arises when a school has excess parking spaces available and leases these spaces to local businesses or members of the general public. Such operations were a key concern, shown by legislative history, and the resulting Regulations hold a strong position in favor of treating revenue from such leases

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 9 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

as UBIT. Because of inconsistent previous rulings a 1990 GCM was issued to make the IRS's position clear, and it stated the following:

- a. A tax-exempt organization that engages in the operation of a parking lot for unrelated use will never qualify for the rental income exclusion because of the Regulation's strong statements tracking the legislative history.
- b. A tax-exempt organization that "net leases" the parking lot to a third party lot operator can qualify for the rental income exclusion, if the organization provides only minimal services as part of the arrangement.

The IRS has also held parking lot income is exempt under the convenience exception, but only in the context of income generated from students, faculty, and staff, not outside public or visitors.

Participation in Partnerships

IRS §512 requires an exempt organization to include in its UBIT its share of the gross income from any activity conducted by a partnership that would not be a related activity if the organization conducted the activity itself. Any income included under this section is still subject to the other UBIT modifications. In addition, the Tax Court has held there is no distinction drawn by the status between a general and a limited partnership interest. Finally, the IRS issued a major ruling in 1998 that set forth guidelines on the extent to which a tax-exempt organization can enter into a partnership with a for-profit entity. In such the IRS requires the tax-exempt organization to be in control of the partnership, and failure to meet this requirement can result in loss of 501(c)(3) status. In public presentations IRS officials have stated if the partnership arrangement violates the control requirement, but the facts are insufficient to support loss of the status, partnership distributions will be treated as UBIT.

Professional Entertainment Events

This situation arises when a university sponsors a professional performance involving paid entertainers, not students. Such events are related to a school's educational purposes only if "operated primarily as an integral part of the educational program of the university, but unrelated if operated in substantially the same manner as a commercial operation." In a 1991 TAM and GCM, the IRS set forth factors used to distinguish between related and unrelated events. In these, a state university owned and operated an auditorium at which many related activities were conducted, including registration, athletic events, and commencement. The university also held 45 different "ticket events" in the facility, including performances by rock bands, contemporary professional entertainers, and professional boxing matches and basketball games. In its analysis, the IRS listed the following nonexempt factors:

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 10 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

- a. General public fees are comparable to those charged by commercial facilities.
- b. Only those who purchase the goods/services benefit from the activity in direct proportion to the fees charged.
- c. The organization's own employees perform substantial services and the organization furnishes the facilities.
- d. The organization's reputation as an educational institution is secondary, if even a factor, in attracting attendees.
- e. The predominant motivation underlying the organization's conduct of the activities is revenue maximization.

The following was of great importance in the IRS concluding the ticket events generated UBIT:

- a. A director with more than 30 years' experience in promoting commercial events managed the facility.
- b. The fine arts department of the university had no involvement in the selection of events or their presentation.
- c. During the year, more than 25% of the tickets were sold off-campus.
- d. No pricing discrimination existed between students and the general public, and students received discounts on only 3 occasions. No records were maintained distinguishing between student sales and general public sales.
- e. The events were indistinguishable from similar commercial events in price or type of performance.
- f. Entertainers received the same pay as they would have at a for-profit facility, under university negotiations.
- g. The university and the entertainer jointly negotiated the ticket price.
- h. Tickets were sold through a commercial ticket service.
- i. The university included in its standard contract a non-compete clause forbidding artists from performing within a 75-mile radius of the university 60 days before or after the performance.

The IRS further stated the focus is on the manner in which a university decides to secure performers and the business considerations used as the decision foundations. The emphasis on revenue maximization to the exclusion of other factors indicates the trade or business is not operated as an integral part of

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 11 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

educational programs.

This issue also involves the fragmentation rule. Although all 45 events were grouped together in this analysis, the question is unanswered whether the IRS would do the same in the future or instead view each activity as separate. The concern here is events that are unprofitable will be viewed as related and events that generate a profit will be classified as unrelated, thus leaving no losses to offsets the gains of unrelated business income.

Publishing Activities

This issue usually arises where an organization's sole or primary activity is publication. Colleges and universities usually do not have to worry about this area because they meet the four part test below. The four part test to determine whether an organization's publication activities are educational based on the facts and circumstances is as follows:

- a. The publication content is educational in nature.
- b. The material preparation follows methods generally thought to be educational in character.
- c. The material distribution is necessary or valuable in achieving the organization's educational purpose.
- d. The distribution manner is distinguishable from ordinary commercial publishing practices.

In example, the IRS has held the publication and sale of foreign-language books and a scholarly magazine by a university were substantially related to its exempt purpose, and the publication of a bimonthly journal containing scholarly business articles by the business administration department of a university was substantially related.

However, the *1999 IRS Training Manual Textbook* stated a university press may generate UBIT if it publishes a large number of different books each year, has more than a nominal per-book press run, and pay normal commercial royalties to authors.

Research

This is an area of concern when a university enters into research contracts with governmental agencies and commercial entities. Such a research contract will almost always be treated as a trade or business activity, and usually the test is applied to the sum total of all the university's research projects. This also holds true for the regularly carried on prong of the UBIT test. The most difficult is the third prong, whether the activity is substantially related to the university's exempt purposes. Certain types of activities are clearly related such as those educational in nature if significant involvement by students in the activity

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 12 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

or scientific research in the public interest under 501(c)(3) status.

Under the second type, scientific research in the public interest, a three prong test has developed. Each prong will be discussed in the paragraphs following. The activity must be (1) scientific research; (2) not conducted incident to commercial or industrial operations; and (3) conducted in the public interest. Scientific research is defined under *Reg. §1.501(c)(3)-1(d)(5)* as including practical and applied, fundamental, or theoretical research, even social sciences research. *GCM 39,883* stated scientific research is present if the activity has three elements: project supervision and design by professionals, a specific design to solve a problem through use of a scientific method and a research goal that consists of discovering a demonstrable truth. Under *Reg §1.501(c)(3)-1(d)(5)(ii)* examples of commercial or industrial operations include the ordinary testing or inspecting of materials or products, and the designing or constructing of equipment and buildings. Two subsequent cases have held research can encompass a wider range of activities than those listed in the regulations.

Testing was defined as when "a standard procedure is used, no intellectual questions are posed, the work is routine and repetitive, and the procedure is merely a matter of quality control." under *GCM 39883*. Research is conducted in the public interest when it meets the following factors listed in *Reg. §1.501(c)(3)-1(d)(5)(iii)* –

- a. the results of research are made available to the public on a nondiscriminatory basis, or
- b. the research is performed for a governmental entity, or
- c. the research is directed towards benefiting the general public. Ex -- aiding in the scientific education of college and university students; obtaining scientific information published in a form that is available to the interested public; discovering the cure for a disease; aiding a community by attracting new industry to the community or encouraging the development or the retention of an industry in that location.

It should be noted that an university can also use one of two other statutory provisions to avoid UBIT treatment for the research activity. Under *IRC §512(b)(7)*, income derived from research for the U.S. government or any of its agencies/instrumentalities, or for any state/political subdivision is exempt from UBIT. Under *IRC §512(b)(8)*, "In the case of a college/university/hospital, income derived from research performed for any person" is not UBIT. The only restriction here is the word research, meaning the activity cannot be carried on for commercial or industrial operations, and the same "testing" rules will apply.

Restaurant Operations

This issue arises when a university operates a restaurant on or near campus for students, faculty, visitors, and the general public. If a school can demonstrate a restaurant is used as an integral part of its

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 13 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

educational activities, such as cooking school, then it will be judged as substantially related to the school's exempt purposes. It is very difficult to show restaurant operation is a substantially related activity. For example, in *GSC 38,060*, the Chief Counsel proposed the following situation: a college operates a restaurant located adjacent to the school's campus year round and general public patronage is gained through magazine advertisements, brochures and meeting guides. Prices charged are comparable to area commercial establishments. The restaurant is not operated for providing practical, on-the-job training as part of a course of instruction. No substantial causal connection between the restaurant operation and the college's exempt purposes was found, particularly where other commercial facilities were available. However, the IRS also stated if a school is isolated and lacking in reasonably available food facilities, a restaurant's income from persons have a demonstrable connection to students, faculty or staff could escape taxation under the convenience exception.

As another example, *PLR 9720002* held a museum which operated a restaurant, café, and cafeteria on its premises was partially subject to UBIT. The restaurant was located on the museum's second floor and only accessible through its front entrance. However, patrons were allowed to enter without paying the museum's general admission. The museum contracted with a commercial enterprise to operate the restaurant, and the prices charged were comparable with area finer dining establishments. In addition, the museum advertised the restaurant in a local magazine, its own advertisements, and the yellow pages. At least one of the ads noted admissions was waived for patrons. Under the fragmentation rule, the IRS held sales to museum's visitors and employees were substantially related and not subject to UBIT. However, sales to the public (who did not visit the museum) were subject to UBIT.

Finally, *PLR 8248074* featured an exempt organization that oversaw certain universities and established a hotel, conference center, administration building, and a restaurant and lounge. The restaurant and lounge were open to the general public and during normal business days was frequented primarily by conference members and faculty. In the evenings and during Sunday brunch, the general public primarily comprised the diners. Use for in-house training and conferences, board meetings, and other college sponsored events promoted the exempt purposes of the university and did not qualify for UBIT. However, use for sponsored conferences with contracted clients, commercial business conferences with or without university instructors, social activities, and other organizations for their private purposes was not substantially related and was subject to UBIT. This included banquets, weddings, and anniversaries.

Summer Sports Camps

There are two categories under which this issue arises: (1) camp is conducted by the university using its own facilities and employees, or (2) camp is conducted by third party leasing facilities from University. In *Rev. Ruling 80-297*, the IRS analyzed the following two situations for a university:

- a. School used its tennis facilities, including locker rooms, for 10 weeks during the summer to conduct a tennis camp for the general public. Attendees were charged a fee. Two school employees operated the camp, collecting fees and scheduling court time. The IRS held any

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 14 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

income generated was UBIT because the school provided more than just facilities; the two employees provided substantial services to the camp members.

b. Same facts as above except the school made its facilities available to an unrelated individual for a fixed fee not dependent on the profit from the camp's operation. The individual and two others operated the camp. The IRS held income generated was UBIT, but was exempt under the rental income exclusion, because it was not dependent upon the camp profit, and the school did not provide any services to the third party individual.

The IRS has also found the following to be related to a school's exempt purpose: a university who operated a summer sports camp featuring tennis, swimming, and basketball lessons and instruction for disadvantaged youth; a university who operated a summer hockey camp for children up to high school age; a university sponsoring several athletic summer camps for boys and girls supervised by employees of the university because they provided instruction in sports skill; and an association formed by a parent university for promoting, managing, and conducting all forms of athletics at the university sponsoring a sports camp for the purposes of improving the athletic ability of the participants, encouraging them to attend the university in the future and providing experience for the camp counselors who were primarily college students.

However, when a university allowed a corporation wholly owned by the college's nationally recognized coach to conduct a summer sports camp using the college's athletic facilities, UBIT was generated because the camp was not part of the educational program offered by the school. In addition, when a school (operating primary and secondary) rented its facilities in the summer to various sports-related camps it generated UBIT because it negotiated between the camps and the food service, essentially providing a substantial service.

Treatment of Alumni

This occurs when the university makes a sale of some item to a former student. This needs to be viewed in conjunction with the area of the item sold. For example, many affinity card programs use university alumni as their primary targets. IRS holdings regarding alumni have been conflicting and depend on the circumstances involved. In example, under *PLR 8340102*, the IRS held golf course operation for the student golf team and students, faculty, staff and alumni did not generate UBIT. The IRS made a distinction between the alumni and the general public, stating providing the golf course to the alumni and sustaining university contributors was an inducement for them to provide continuing support. Therefore the activity contributed importantly to the university's exempt purposes. However, under *PLR 9645004*, the IRS held income received from alumni usage of a university held golf course was UBIT. These individuals were held not to be sufficiently distinguishable from the public and the IRS rejected the argument the university was providing an inducement for financial contributions or other involvement.

Three different scenarios were presented in *TAM 8020010*. The university offered memberships to alumni

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 15 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

for its recreational facility during the months of June, July, and August when the university was not in session. The IRS grouped alumni with the general public and held the membership sales provided the alumni the opportunity to engage in personal recreational activities, unrelated to the university's exempt purpose of education. The same was held for a university sponsored ice skating rink. However, the IRS held catering and the renting of university facilities for alumni dinners and class reunions were traditional and commonplace functions universities nationwide and facilitated the university's interactions with other schools. These were activities which kept the alumni abreast of current developments on the campus and as such were related to the exempt purposes of the university.

Use of Facilities by the General Public

A university might have facilities it allows students and faculty and staff to use for free or for a reduced fee and allows the general public to use without the fee reduction. Facility usage by students, faculty and staff is related to a university's exempt purpose, although the discount value provided to an employee may be treated as additional compensation. *Rev. Ruling 78-98* provides the example of a university operating a ski facility located several miles from campus. The university's physical education program used the facility, as well as students and general public for recreational purposes. Operation and fees were substantially similar to commercial ski facilities. It was held providing a recreational facility to the general public was not an exempt purpose of the school, and so generated UBIT. The IRS has reached identical conclusions with respect to: health club operation for the general public with comparable fees to commercial establishments; recreational facility memberships to the general public and alumni including use of a golf course; and ice time rental in a school's hockey rink to the general public. However, *TAM 8020010* states activities such as wedding receptions, receptions for faculty or students from other schools, and alumni dinners and class reunions are substantially related and do not generate UBIT. These activities allowed alumni to stay abreast of current developments on campus and further the educational purpose.

It should be noted this depends greatly on the entity's exempt purposes. In *PLR 200051049*, the IRS held a hospital's operation of a fitness center was related because it served the community's health care needs. The health care center members consisted of the general public, hospital employees and former cardiac rehabilitation patients. The joiner fee paid was set, the IRS held, so that an "economic cross-section" of the community could join. In *PLR 9732032* the IRS held a university which operated a health and fitness facility open to students, faculty, and staff (both active and retired), trustees, alumni, a fundraising group on campus and family members of each of these groups generated related business income as regards to the "wellness" programs offered. The IRS did not offer an opinion as to the other activities available because the question was not raised.

COMPTROLLER POLICY MANUAL

	POLICY: CMP 309
	Section: 300 Revenue
	Page 16 of 16
	Responsible office: Comptroller
	Origination date: 01/01/2015
Subject: Unrelated Business Income	Effective date: 01/01/2015
	Revision date: 02/01/2016

CROSS-REFERENCE

Internal Revenue Service – Unrelated Business Income Tax

www.irs.gov/Charities-&-Non-Profits/Unrelated-Business-Income-Tax

[CMP 122 Unrelated Business Income Tax](#)