Unrelated Business Income (UBI) is the income from a trade or business that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt function, except that the organization uses the profits derived from the activity. Such income may be taxable because the activities may unfairly compete with those of non-exempt (i.e. taxed) businesses. Since the mission for which the University of Maine System (UMS) was granted tax-exempt status is education, profits derived from University activities not directly related to education may be subject to Unrelated Business Income Tax (UBIT). There are however certain trade or business activities that are not treated as an unrelated trade or business.

The Internal Revenue Service (IRS) examines three points in deciding whether income is unrelated to the primary purpose of an exempt organization.

1. **Trade or business.** The income must be derived from a trade or business. For IRS purposes, "the term trade or business generally includes any activity carried on for the production of income".\(^1\)

2. **Regularly carried on.** The income-producing activity must be "regularly carried on". The IRS considers the frequency and continuity of applicable transactions in determining whether an activity meets this criteria.

3. **Not substantially related.** And the activity must **not be** "substantially related to the performance of the exempt function".\(^2\) For the associated income to be nontaxable, an activity must "contribute importantly to the accomplishment of the organization's exempt purpose".\(^3\) Also, according to the IRS, producing income for later use in achieving the exempt purpose does not constitute a substantial relationship.

The following examples of unrelated businesses are taken from IRS Publication 598, "Tax on Unrelated Business Income of Exempt Organizations".

1. **Membership list sales.** The regular sale of membership mailing lists to business firms by an educational organization does not contribute importantly to the education objective, and is therefore an unrelated trade or business.

2. **Services provided with lease.** The lease of an exempt university's football stadium to a professional team is an unrelated trade or business. Even though the income is unrelated, it generally would be excluded when figuring taxable income because the income is from the **rental of real property** (see below). However, if substantial services are provided by the university, this rental income becomes unrelated business **taxable** income.

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\(^1\) IRS Publication 598, "Tax on Unrelated Business Income of Exempt Organizations", March 2005, p.3

\(^2\) Ibid., p.3

\(^3\) Ibid., p.3
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3. **Museum shop.** An American folk art museum operates a shop and sells various items related to its mission but also sells scientific books and souvenirs. Sales of items which contribute to the museum’s exempt educational purpose by enhancing the public’s understanding and appreciation of art are not unrelated trade or business activities. On the other hand the sale of scientific books and souvenirs are unrelated.

**EXCLUSIONS:**

Certain **activities** are specifically **excluded from the definition of unrelated trade or business.** These items include but are not limited to:

- Activities of volunteers
- Items sold for the convenience of students and faculty
- Qualified sponsorship activities (i.e., use of business name, logo, or product line) but not advertising
- The sale of donated goods or low-cost items

Additionally, the following types of **income** are generally excluded when figuring **unrelated business taxable income:**

- Rental of real property (with certain exceptions described in IRS Publication 598)
- Research
- Gains and losses from the disposition of property

The way a transaction is structured can affect its taxability. The following example illustrates this point.

An exempt school has tennis courts and dressing rooms that it uses during the regular school year in its educational program. During the summer, the school operates a tennis club open to the general public. Employees of the school conduct the affairs of the club, including collecting membership fees and scheduling court time.

Another exempt school leases the same type of facilities to an unrelated individual at a fixed fee that does not depend on the income of the lessee. The lessee forms a tennis club, hires employees, etc.

In both of these situations the exempt purpose of the school is limited to the advancement of education. Therefore each of these activities is an unrelated trade or business. In the first instance the unrelated income is taxable. However, the income derived in the second situation is excluded from unrelated business taxable income as rental of real property.
EXEMPT ORGANIZATION BUSINESS INCOME TAX RETURN (990-T):

Tax-exempt organizations with gross income of $1,000 or more from unrelated business activities in a fiscal year must file the "Exempt Organization Business Income Tax Return". This return, IRS Form 990-T, is due annually on the 15th day of the fifth month after the tax year ends. **For UMS this would be November 15th.** In addition, a State of Maine corporate income tax return also must be filed by the same due date.

Quarterly estimated tax payments are due for any year in which the tax is expected to be $500 or more. Current IRS regulations should be followed in determining the amount and timing of quarterly estimated payments.

Expenses directly attributable to each unrelated business may be deducted to arrive at net UBI. This includes expenses incurred entirely for the production of UBI and allocation of expenses incurred partly in the production of UBI.

Once determined, net UBI is taxed at the corporate income tax rates applicable for each year. Alternative minimum tax calculations may apply if tax preference items (such as accelerated depreciation) are deducted from gross UBI. Investment tax credits may be taken against amounts due under UBIT if an investment is made primarily for the use of the unrelated activities. In general, UBIT losses may be carried forward or back to reduce future/prior year taxes. However certain expense deductions (such as advertising) are limited to the level of income produced.

AREAS FOR CONSIDERATION:

Tax-exempt organizations are subject to IRS audits whether or not they file an annual Form 990-T. Items investigated during audits of other colleges and universities have included the following. While these are some of the areas typically reviewed, this is not an all inclusive list.

- Bookstore sales of items with lives greater than one year
- Exchange of mailing lists with other not-for-profit institutions
- Rental of booth space for trade shows
- Sales of excess electricity generated by university power plants
- Hotel and restaurant services
- Providing laboratory services to the general public
- Travel tours for alumni
- Providing technical illustrating or drafting services to the public
- Operation of movie theaters open to the general public
- Paid parking lots open to the general public
- Career development/placement services for alumni
- Exercise/health club facilities open to the general public
- Converted agricultural product sales to the public
- Ice rink rentals/public skating fees
- Sales of excess computer capacity to the public
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- Golf course fees collected from alumni and the general public
- Advertising/endorsement income for inter-collegiate athletics
- Fees received for applied (commercial) research
- Fees for the cutting of timber

SENSITIVITY:

It is important to be aware of how the University’s activities impact local vendors. Some unrelated activities that UMS could enter into may not impact local vendors whereas others might directly compete with the community and may be perceived as subsidized by the taxpayers of the State of Maine.

For example, leasing out a baseball diamond may not be a sensitive issue due to the lack of collegiate level fields in the area. However, sales of computers to the general public by a campus computer store may be perceived as unfair competition for local vendors due to the educational discounts received.

UNDERSTANDINGS:

Campus chief financial officers are responsible for ensuring the financial viability of proposed campus unrelated business income activities to ensure there is no undue risk to existing assets.

The System Accounting Department will annually perform procedures to review for completeness of reported UBIT activities. This review may consist of examining selected financial accounts and transactions, inquiring of the Chief Financial Officers (CFO’s) as to the existence of UBIT activities, and visiting selected locations.

Any activity that involves a facility or property lease agreement for more than one year shall include language that the lease may be cancelled if the lease arrangement jeopardizes the facility or the property’s real estate tax exempt status.

IMPLEMENTATION OF AN UNRELATED BUSINESS ACTIVITY:

If a campus desires to enter into a business activity that may be unrelated to the UMS’s mission, the following steps must be taken in order to comply with the Trustees’ policy on Unrelated Business Income.

Each campus CFO is responsible for unrelated business activity on their campus and will ensure all proposed UBIT activity is thoroughly documented and approved prior to submission to the System CFO and Treasurer for review and approval. The campus CFO will ensure the financial viability of the proposed activity, review and document the impact on local vendors, and ensure compliance with this APL and any other required official documentation.
As required by Board of Trustee policy, the System CFO and Treasurer and, as needed, University Counsel’s office will review the campus proposal to ensure the appropriateness and completeness of the proposal and notify the campus CFO regarding approval. Paperwork supporting the approved activities will be kept on file in the Accounting Department.

Upon approval by the System CFO and Treasurer, the campus should contact the System Accounting Department for assistance in setting up accounts necessary to meet IRS reporting requirements. The campus will be responsible for maintaining all supporting records and for communicating necessary information to the System Accounting Department which will complete the Exempt Organization Business Income Tax Return (IRS Form 990-T) on a consolidated basis for the System each year.

RESPONSIBILITIES:

Because of the many exceptions and varied interpretations of IRS regulations, categorizing transactions as related or unrelated can be difficult. Each activity must be examined by the campus CFO to determine its taxable status.

Due to the complexity of applicable IRS regulations, campuses should contact the System Assistant Director of Accounting for assistance in determining whether an activity qualifies as unrelated business. The Accounting Department will also provide preliminary planning assistance to ensure all unrelated business transactions are structured to take advantage of IRS tax exclusions whenever possible.

CONCERNS BEYOND UBIT:

Unrelated business activity tax considerations go beyond UBIT:

**Tax Exempt Financing**

Property financed with tax exempt debt issuance needs to be monitored closely to avoid private business use. Bonds may lose their tax exempt status if more than 5% of the property is used for other than the organization’s exempt purpose. In fact, when issuing bonds, the Chief Financial Officer and Treasurer must sign an *Arbitrage and Use of Proceeds* document certifying that not more than 5% of the projects financed with proceeds of the bonds will be used directly or indirectly in any private business use that is unrelated to the University.
The test for private business use is complicated. For purposes of 990-T computations, many services which are from private sources, but synonymous with the exempt purpose of the organization, are disregarded. However, the same services are likely to be included for determining total private use. Additionally, private use is aggregated, so small activities conducted in facilities financed with bond proceeds can cumulatively cause a problem.

**Property Tax Considerations**

UBIT activities may impact the University’s property tax exemption. For example, providing personal services along with the rental of real property could cause the entire rental to be deemed personal property, thereby forfeiting the real property rental exclusion and subjecting the property to municipal property tax.

**Related Documents:**

Board of Trustees Policy 710: *Unrelated Business Income Tax*

Approved by the Treasurer of the University of Maine System. Official copy on file in the Treasurer’s office.

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Chief Financial Officer and Treasurer