

Unrelated business income (“UBI”) in tax-exempt organizations continues to be an area of scrutiny for the IRS. The Form 990-T Unrelated Business Income Tax Return is open for public inspection so the utmost care should be made in providing the UBI information requested.

UBI is defined as any activity considered to be: 1) not substantially related to the organization’s exempt purpose 2) a “trade or business” and 3) regularly carried on. Therefore, it follows that any activity that does not meet one of these criteria will be excluded from UBI. Thus, the first line of defense when determining whether an activity constitutes UBI goes back to the statutory definition, as follows:

Substantially Related: If the activity is substantially related to the University’s exempt purpose, then it should not constitute UBI. To be substantially related, the activity must contribute importantly to the University’s exempt purposes.

Not a Trade or Business: If the activity does not constitute a trade or business which presents sufficient likelihood of unfair competition with taxable entities then it should not constitute UBI. To be considered a trade or business, the activity must be conducted with a profit motive. Most potentially taxable activities would constitute a trade or business if conducted by taxable entities; therefore, we look to other exceptions to exclude these activities from taxation.

Not Regularly Carried On: If the activity is carried on sporadically or infrequently as compared to a commercial enterprise which is carried on regularly throughout the year or season, then it should not constitute UBI.

Additionally, statutory exclusions provide another opportunity to exclude income from taxation. These exclusions are as follows:

Convenience Exception: If the activity is carried on by the University, primarily for the convenience of its students, faculty or staff, it should be excluded from taxation. Prime examples of this exclusion at work on SUNY campuses are bookstores and cafeterias.

Volunteer Workforce: If a trade or business is conducted in which substantially all the work is performed for the organization by volunteers who are not compensated, then the activity should be excluded from taxation.

Passive Income: No Services Provided: If the activity generates only passive income such as interest, dividends, royalties, annuities and real estate rental income, then it should be excluded from taxation. Contributions are also included in this category. All passive items are statutorily exempted from the unrelated business income tax. This exception provides a significant opportunity for exclusion. Examples of passive income arrangements would be royalties from affinity cards, and investments in partnerships that generate interest, dividends, royalties and other types of passive income. However, if a partnership is leveraging investments (using debt to acquire additional investments) interest, dividends and other types of passive income could be partially categorized as UBI.