



Current Issues Impacting Higher Education Unrelated Business Income (UBI)

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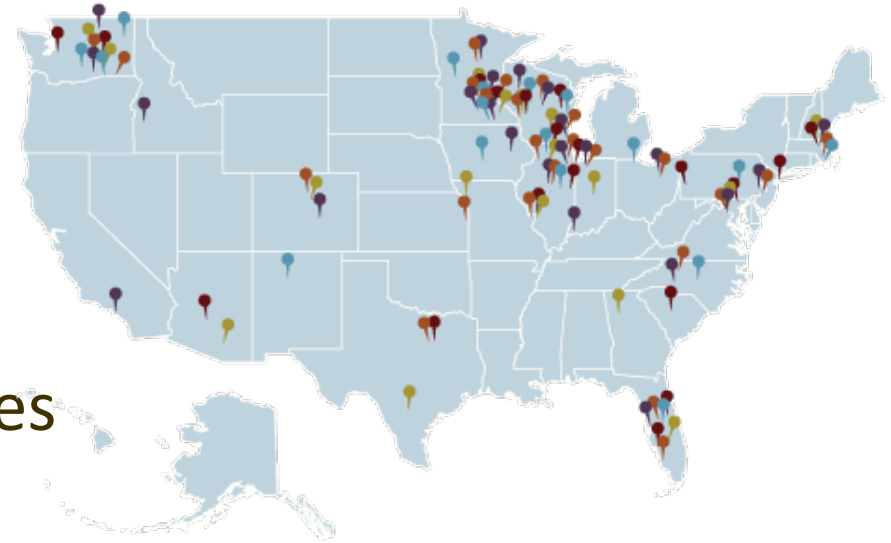
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- A professional services firm with three distinct business lines
 - Wealth Advisory
 - Outsourcing
 - Audit, Tax, and Consulting
- More than 4,500 employees
- Offices coast to coast
- Serving higher education for more than 50 years



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Speaker Introductions



- **Karen Gries, CPA**
Principal



- **Amy Hendley, CPA**
Director

Learning Objectives

- Describe the complex issues encountered by institutions of higher education
- Outline the importance of actively managing unrelated business income generated by the organization
- List changes to implement within the institution resulting in better management of UBI exposure



Agenda

- Provide an overview of current regulatory environment
- Review common sources of unrelate business income
- Next steps to assist with an institution's compliance requirements



The Function of the IRS

IRS mission: *Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.*



- FY 2015 – 1.7m organizations
- Tax revenue collections of \$3.3 trillion FY2015
- UBIT collections FY2015 were \$805m
 - Less than .05%

IRS EO Division FY 2017 Priorities

IRS EO Division will focus resources on five strategic issue areas:

- **Exemption** - non-exempt purpose activity and private inurement
- **Protection of Assets** - self-dealing, excess benefit transactions, and loans to disqualified persons
- **Tax Gap** - employment tax and UBIT
- **International** - oversight on funds spent outside the U.S., exempt orgs operating as foreign conduits, and FBAR
- **Emerging issues** - includes non-exempt charitable trusts and IRC 501(r) for hospitals



IRS Initiatives

IRS Focus Impacting Unrelated Business Income (UBI)

- **Data-driven decision making** – IRS is utilizing data mining based on tax filings to identify areas on non-compliance
- **Examinations** – Goal of 7,000 examinations in 2016
 - 2015 – 6,392
 - 2014 – 8,084
- **Resources constraints** – Although human capital resources are limited, IRS has redeployed individuals to the exam function



Examinations

- Accomplished through
 - Identifying and addressing existing and emerging high-risk areas of noncompliance
 - Effective use of existing resources with decisions made based on available data
 - Specifically, stakeholder input, reliable outside data, and public information



Examinations

EO use appropriate, cost-effective and least *intrusive* compliance opportunities

- Educational efforts
- Compliance reviews
- Compliance checks
- Correspondence examinations
- Field examinations



College and University Compliance Project

Examination of 34 institutions resulted in 90% with adjustments increasing UBTI totaling \$90m

Common adjustment areas:

- Fitness and recreation centers
- Sports camps
- Advertising
- Facility rentals
- Golf courses



College and University Compliance Project

Common reasons for adjustments

- Misclassification as a trade or business
- Misallocation of expenses
- Errors in computations or substantiation of NOLs
- Misclassification of related activities



Unrelated Business Income

Requirements to be classified as UBI

- Trade or business,
- Regularly carried on, and
- Not substantially related

Form **990-T** Exempt Organization Bus (and proxy tax und)
For calendar year 2005 or other tax year beginning See separate
Department of the Treasury Internal Revenue Service

A Credit line if address changed **B** Exempt under section:
 501 11
 408a 408b
 501a 501b

C Book value of all assets at end of year **F** Group exemption number (See instructions)
 Check organization type 501(c) 6

H Describe the organization's primary unrelated business activity
I During the tax year, was the corporation a subsidiary in an affiliated group?
If "Yes," enter the name and identifying number of the parent corporation

J The books are in care of **Part I** Unrelated Trade or Business Income

1a Gross receipts or sales		
b Less returns and allowances		c Balance
2 Cost of goods sold (Schedule A, line 7)		

- IRS and Tax Court cases assist in definitions

Common Sources of UBI within Higher Ed



Bookstores and Convenience Operations

- Structure differs amongst institutions
 - Lease to outside organization
 - Operated by the school
- Sales to students, faculty and other employees
 - Items related to educational purpose = not UBI
 - Items not related to educational purpose = UBI
 - Convenience items = not UBI
 - Alumni = UBI



Camps

- Depends upon whether camp is operated by the institution or outside party
 - Operation by the university is generally in furtherance of the university's exempt educational purpose and deemed related
 - Operation by a third party – tax treatment depends upon whether the university is providing services along with rental of real property or providing rental of real property



Facilities Usage

- Debt-financed rental
 - Property held to produce income to which there is acquisition or improvement indebtedness outstanding at any time during the year
 - Various exceptions exist

- Educational institution exception
 - IRC 514(c)(9) – certain debt incurred by an educational institution is not treated as acquisition indebtedness

Facility Usage Complexities

UBI may be present if rental includes:

- Provision of services
- Personal property with real property rental

Tax next steps:

- Contract language should mirror the arrangement
- Allocation of expenses based on outside use
- Existence of UBI may cause a portion of the facility to be subject to property taxes
- Evaluate for private business use if bond financed



Alternative Investments

Generally two major types:

- Limited partnerships
- Other entity structures, mainly offshore corporations

Key Considerations	Limited Partnerships	Offshore Corporations
Typical asset types	Private equity, Real estate, Commodities	Hedge funds
Fund issues a K-1	Yes	No
Federal UBI	Yes	No
State UBI	Yes	No
Foreign Filings	Yes	Yes



Alternative Investments

Partnership investments

- Partnership activities are attributed to the individual partners
- Requires analysis of Schedule K-1 for UBI reporting
 - Partnerships are required to disclose UBI to tax exempt partners
- State and local taxes may also apply
 - States are much more active in monitoring EO activities occurring within their borders
- Schedule K-1 disclosures may also require foreign filings



Foreign Activities

Penalties for Failure to File

- Form 926: 10% of FMV of property up to \$100,000
- Forms 5471 and 8858: \$10,000 per filing
- Form 8865: \$10,000 per filing (Cat. 1-2); or 10% of FMV of property up to \$100,000 (Cat. 3-4)
- Form 5713: \$25,000
- Form FinCEN 114: up to \$10,000 per filing
- FATCA: 30% of applicable payments

Royalties

- Royalty Arrangements
 - Payment for the use of an intangible property right that already exists
 - Specifically excluded from UBI as long as passive
 - Properly structured arrangements qualify for tax-free treatment
- Providing services in connection with the royalty may change the tax treatment

Tax next steps:

- Carefully review royalty agreements for considerations which may taint the revenue stream



Athletic Department

- Broadcast rights
 - Concession contracts
 - Concerts
 - Golf courses and other facilities
 - Alumni athletic memberships
 - Sports camps
-
- Requires careful analysis of the facts and circumstances to determine how the activities are structured and whether UBI is present



Exclusivity Arrangements

- May be separated into two categories
 - Exclusive sponsor arrangements and
 - Exclusive provider arrangements
- Exclusive sponsor arrangement
 - Company solely sponsors an event
 - Not deemed to be substantial return benefit
- Exclusive provider arrangement
 - Arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities
 - Generally regarded as substantial return benefit



Corporate Sponsorship Payments

- Payment made to an exempt organization with no expectation of substantial return benefit to the payer
- Acknowledgment includes:
 - Logos and slogans without qualitative or comparative language
 - Listing of sponsor locations, phone numbers, internet address, etc.
 - Web links must not go to sales page of the sponsor
 - Brand or trade names and produce or service listings
- In most instances, advertising = UBI



Corporate Sponsorship Complexities

- Tax-free treatment is not available if the payment is contingent on level of attendance at event
- Sponsor may be provided with disregarded benefits in exchange for the payment

Tax next steps:

- Establish criteria and protocol for determination of whether sponsorship vs. advertising and allowed language
 - Sponsorships may closely mirror advertisements
- Agreement must clearly state the expectations under the contract including any substantial return benefit



Advertising

- Advertising is often contained within exempt function publications
- Determination of whether the activity is related vs. unrelated
 - Based on how the activity is conducted, the IRS may argue it lacks attributes of a trade or business
 - Limits use of operating losses from the activity
- Computation of taxable income includes allocation of circulation revenue and readership costs



Identifying Unrelated Business Income

- Update or adopt UBI policies and accountability for reporting to finance
- Review accounting records and contracts for missed revenue
- Reach out and educate departments and decision makers on UBI
- Review contracts for attributes that may cause the revenue to be taxable
- Establish open lines of communication and responsibility within the various departments and areas for UBI reporting



Managing Unrelated Business Income

- Review contracts for requirements which may cause the revenue to be taxable
 - Establish expectations to review contracts prior to execution
 - Consider changing the language upon renewal
- Involve departments and program areas in the overall management of their UBI activities
- Consider changes to the structure of an arrangement resulting in a taxable activity being non-taxable
- Evaluate expense allocations
- Ongoing education and monitoring



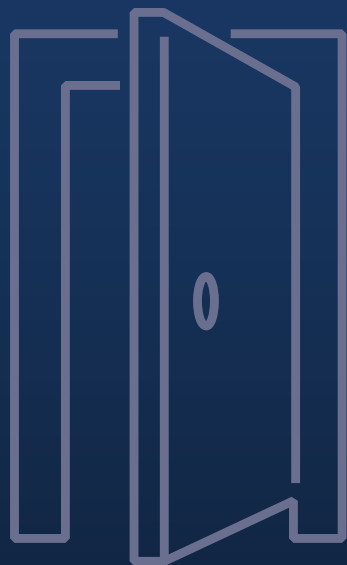
Minimizing Unrelated Business Income

- Consider changing the structure of an arrangement may qualify for an exception to UBI
- Document positions on activities which may give rise to inquiry
- Review NOL computations and basis for continued loss activities
- Carefully review and periodically update expense allocations
- Monitor for new regulations and case law impacting higher education activities



Questions





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