



Understanding UBI Qualifications in Higher Education

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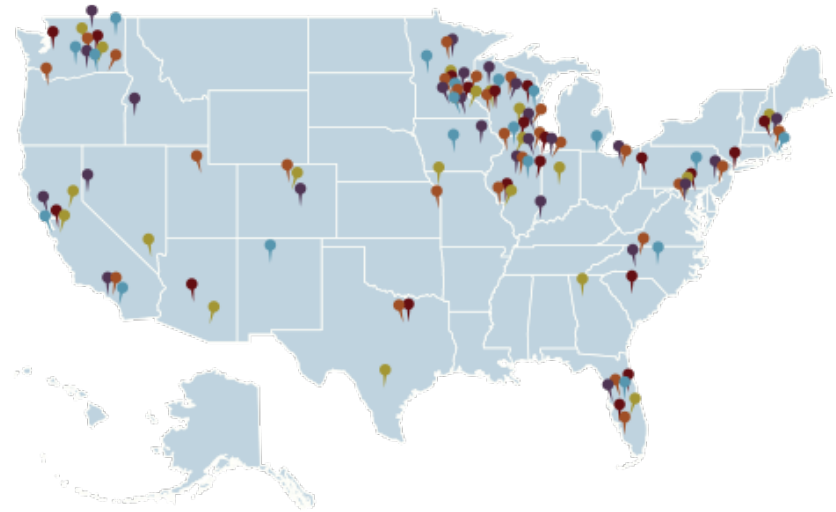
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- A professional services firm with three distinct business lines
 - Wealth Advisory
 - Outsourcing
 - Audit, Tax, and Consulting
- More than 5,000 employees
- Offices coast to coast
- Serving higher education for more than 50 years



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Speaker Introduction



Karen Gries, CPA
Principal

Learning Objectives

- Identify complex revenue streams often generating UBI
- Determine what segments of revenue are often considered UBI
- Outline compliance requirements and potential impact of UBI on your institution



Agenda

- Regulatory Focus
- UBI Fundamentals
- Common UBI Sources of Revenue
- Managing UBI Activities
- Q&A



IRS Audit Initiative – Report Issued in 2013

- Audit of 30 – 40 institutions
- Significant activities not reported on Form 990-T
- Disallowance of net operating losses
- Incorrect expense allocations
- Poor documentation and substantiation of activities
 - Fitness and recreation centers and sports camps
 - Advertising
 - Facility rentals
 - Arenas and golf courses



IRS UBI Statistics

- IRS SOI Tax Stats Historical Table 16

	2010	2011	2012	2013
EXEMPT ORGANIZATION UNRELATED BUSINESS INCOME TAX RETURNS				
Number of returns, total	43,184	45,384	46,168	46,380
With unrelated business taxable income	19,874	21,660	22,727	23,860
Without unrelated business taxable income	23,310	23,724	23,441	22,520
Gross unrelated business income	10,966	11,371	12,066	12,963
Total deductions	10,882	11,229	11,703	12,053
Unrelated business taxable income (less deficit)	83	142	362	909
Unrelated business taxable income	1,217	1,354	1,584	1,986
Deficit	1,134	1,212	1,222	1,077
Unrelated business income tax	341	364	428	576
Total tax	332	350	426	581

Money amounts are in millions of dollars

Issued January 10, 2017



Additional Regulatory Implications

- Unrelated business income may have implications beyond federal
 - State income tax
 - Local income tax
 - Property tax
 - Sales tax
 - Other



UBIT Fundamentals

Activity must meet three prong test to be considered unrelated

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

***Failure to meet one or more
prongs of the test = non-UBI activity***



Trade or Business

- Must look to how an activity is conducted
- Activity is carried on with the intent of generating a profit
- Having a profit motive does not equate to profitability
 - Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit. (IRC 513(c))



Regularly Carried On

- Comparable to commercial activities
- Activities carried on periodically or short period of time typically are not regularly carried on
- Fundraising activities are typically not regularly carried on



Not Substantially Related

- Activity is not related to the organization's exempt purpose
- Facts and circumstances of the activity must be carefully analyzed
- Activity must contribute importantly to the mission of the institution



Not Substantially Related

- Even activities within a broader exempt activity may be unrelated
 - ...an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization (513(c))
- Museum gift shop (Rev. Rul. 73-105)
- Ski facility (Rev. Rul. 78-98)
- Golf course (PLR 9720035)



Exclusions from UBI

- Interest, dividends, and annuities
- Capital gains
- Royalties
- Real property rentals
- Research
- Business conducted by volunteers
- Convenience exception
- Sale of donated merchandise
- Qualified sponsorship payments



Common Sources of UBI within Higher Ed



Royalties – Common Sources

- Use of an intangible asset such as institution's logo
 - Right to sell merchandise or services on campus
 - Right to sell advertising in publications
 - Mailing list and affinity card programs
-
- Typically excluded from unrelated business income
 - Exceptions
 - Debt-financed property
 - Substantial services



Royalties

- Arrangements that require the institution to perform services may cause the revenue stream or a portion to be taxable as UBI
- Minimal services allowed without tainting the nature of the royalty arrangement
 - Provision of mailing list
 - Quality control type functions are allowed



Research

- Excluded research includes:
 - Governmental research - performed for federal, state or local government
 - Performed by a college, university or hospital
- Publicly available research is also excluded
 - Must be free to the public
- Research does not include clinical trials or other testing
- Proprietary research is taxable as UBI



Qualified Sponsorship Payments (QSP)

- Payment to an exempt organization
- No expectation or agreement of substantial return benefit
- Qualified sponsorship payments are not UBI



Qualified Sponsorship Payments (QSP)

- Cannot be contingent upon:
 - Level of attendance at events
 - Broadcast ratings or coverage
 - Any other factor indicating the reach of an event or other exposure



Sponsor Acknowledgment

- The following are considered an acknowledgment
 - Exclusive sponsorship arrangements
 - Logos and slogans that do not contain qualitative or comparative descriptions
 - List of sponsor's locations, telephone numbers or internet address
 - Value-neutral descriptions including displays or visual depictions of payer's product-lines or services
 - Sponsor's brand or trade names and product or service listings
 - Payments for benefits with FMV that does not exceed 2% of the sponsorship payment



Substantial Return Benefit

- A benefit received by the sponsor other than:
 - Sponsor acknowledgement
 - Goods, services or other benefits a minimal value
 - ◇ FMV of all benefits is less than 2% of the payment
- Includes:
 - Advertising
 - Exclusivity provider arrangements
 - Royalties
 - Payments for services
 - Tickets
 - Other return benefits



Advertising = Substantial Return Benefit

- Qualitative or comparative language
- Price information
- Value indications or discounts
- Endorsement of sponsor
- Inducement to buy

Advertising = UBI



Exclusivity Arrangements

- Exclusive Provider Arrangement
 - Limits the sale, distribution, availability or use of competing products, services or services
 - Substantial return benefit
- Exclusive Sponsor Arrangement
 - Limits the types of sponsors
 - Is not substantial return benefit



Valuing Substantial Return Benefit

- Valued at fair market value
- Fair value should be determined at the time of execution of the agreement
- If the sponsor's payment does not exceed the substantial return benefit, none of the payment is a qualified sponsorship payment
- If the sponsor's payment exceeds the substantial return benefit, the excess is a qualified sponsorship payment



Substantial Return Benefit

- Sponsorship payments must first be allocated to substantial return benefit
- If benefits are less than 2% of the sponsor's payment, the benefits are disregarded and the entire payment is a sponsorship

Qualified Sponsorship Pmt = Charitable Contribution



Hyperlinks

- Institution including the sponsor's name and link on their website to the sponsor's home page is not a substantial return benefit or unrelated business income (PLR 200303062)
- Institution including the sponsor's name and link on their website to the sponsor's sales page may be a substantial return benefit (advertising)



Institution's Role in Agreements

- When structuring agreements with outside parties, it is important the party is not acting as an agent for the exempt organization
- When agency arrangements exist, the activities of the agent are attributed to the exempt organization
- May result in payments being reclassified and taxable as unrelated business income
- Often occurs with royalty agreements, publications, advertising, etc.



Investments

- Traditional investment structures
 - Cash
 - Stock
 - Bonds
- Non-traditional investment structures
 - Hedge funds
 - Partnerships
 - REITS
 - S-corps



Alternative Investments

- Investments structured as partnerships may result in unrelated business income to the partners
 - Foreign disclosure may also apply if investments are outside the United States
- Unrelated Business Income of Alternative Investments
 - Active trade or business enterprises
 - Debt-financed income
 - Rental activities
 - All S-corp activity



Alternative Investments

- The activities conducted by a partnership retain the same character as they flow through to tax-exempt partners
 - An activity deemed to be unrelated if the institution conducted it directly, is unrelated if it is attributed to the exempt partner through the partnership
- Debt-financed rules apply
 - Debt-financing with the purchase of the investment or within a partnership may result in unrelated business income to the institution
- Rental activity UBI rules apply



Partnership Investments

- Partnerships are not taxed at the partnership level
- Partners are required to report the appropriate partnership income on their tax filings
- A Schedule K1 is issued by the partnership to the partners advising the partners of the applicable taxability of the revenue and other allocations
- The partnership has the responsibility to advise tax-exempt partners of unrelated business taxable income and other tax related disclosures including income allocations to various states based on nexus



Utilization of Blocker Corporation

- Many tax-exempt partners consider investing in an investment blocker to avoid the pass through of unrelated business taxable income (UBTI)
- By utilizing the blocker, any potential UBTI flows to the corporation for the payment of tax liabilities vs. the tax-exempt organization
- Institutions must analyze the cost/benefit of utilization of a blocker



Investment in S-corp

- A S-corp is also required to issue a Schedule K1 to shareholders
- All activity reported to the tax-exempt shareholder is unrelated business income
 - No exclusions for interest, dividends, etc. apply
- Sale of stock in a S-corp also a UBI activity



Foreign Reporting with Alternative Investments

- Form 5471 - Information Return of US Persons With Respect to Certain Foreign Corporations
- Form 8858 - Information Return of US Persons With Respect To Foreign Disregarded Entities
- Form 8865 - Return of US Persons With Respect to Certain Foreign Partnerships
- Form 8886 - Reportable Transaction Disclosure Statement
- Form 926 - Return by a US Transferor of Property to a Foreign Corporation



Managing UBI Activities

- Identify UBIT Activities
 - Develop operational and reporting relationships with others on campus in areas where UBI activities may occur
 - Provide ongoing education and monitoring to those outside of the business office
- Consider using the IRS questionnaire on UBI activities to assist in identification of income sources
- Monitor loss activities to ensure proper classification



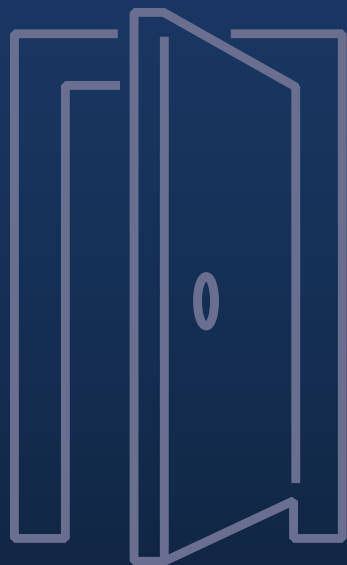
Documentation

- Document UBI positions including those activities not reported on the Form 990-T
 - Consider a comprehensive UBI assessment
 - Review sponsorship and royalty/affinity agreements
- Review and update expense allocations
- Monitor federal, state, and local for new regulations and case law impacting higher education activities



Questions?





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