

#### **400. Unrelated Business Income**

Baylor University is a tax-exempt organization under IRS code section 501(c)(3). As a result of this tax exemption, we are not required to pay income taxes on revenues generated from activities that are related to our exempt purpose. However, we are required to pay income taxes on any unrelated business activities. Unrelated Business Income Tax (UBIT) is designed to create a level playing field when a tax-exempt organization conducts activities which compete with taxable entities.

The University's tax-exempt purpose is described in our mission (instruction, research and public service) and in the IRS exemption letter which grants our tax-exempt status. Any activities which fall outside of this purpose could be subject to tax. For example, offering academic courses which lead to a degree is clearly related to our exempt purpose so any tuition revenue collected to pay for those courses is exempt from tax. If the university were to own and operate a dry cleaner on campus, this activity would clearly fall outside of our exempt purpose and these revenues would be taxed. Though these two examples are very straight-forward, many other activities do not clearly fall into either the related or unrelated buckets.

The IRS has adopted regulations which provide guidance about activities which may be taxed as unrelated. For income to be unrelated business taxable income (UBTI) the activity generating the income must be:

- A trade or business -- conducted with intent to generate profit,
- 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,
- 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.

Even though an activity may meet these criteria, a number of exceptions are available which exempt income from tax. Examples of these activities include the following:

- passive income such as dividends, interest, annuities, and royalties where no active business participation and management is involved;
- rents from real property (contingent with debt finance issue) and some personal property;
- income from certain forms of research;
- income generated from donated services or property;
- income produced from sales made primarily for the convenience of the organization's members, students, and employees (including faculty and staff); and
- special situations decided on a case-by-case basis

*Refer to IRS Publication 598 or the sections which follow for specific information on taxable activities. The Controller is responsible for compliance with Unrelated Business Income requirements and should be consulted with any questions.*