400.3 Royalties

A royalty may be generally defined as a tax, duty or compensation paid to owners of a patent, copyright, mineral interest, or other property right for the use of it or the right to exploit it. The exclusion of royalties from UBTI includes overriding royalties, net profit royalties, and royalty income received from licenses by the University as the legal and beneficial owner of patents assigned to it by inventors.

Licensing Agreements

The IRC Section 512(b)(2) royalty exclusion is commonly used by exempt organizations to exclude licensing fees from UBIT. The IRS generally agrees with this result, so long as the exempt organization plays a passive role in the licensing arrangement. However, where the exempt organization's involvement is active, the IRS will not characterize the payment as a royalty, excluded from UBTI. For example, if the University is providing endorsements or services that are important to the success of the arrangement, the IRS views the royalty payment as consideration for services performed and not a royalty.

Mailing Lists and Affinity Cards

Revenue from affinity credit card programs is generally excluded from UBTI, based on the following considerations.

- Mailing lists of potential card users should be made available on a selective basis, and minimal staff time and expenses should be allocated to maintenance and marketing of the list.
- Avoid providing specific services (i.e., advertising, promotion, endorsements, etc.) other than reviewing the materials for quality control. The agreement should expressly provide that the organization will not provide specific services.
- When services are provided, they should be "de minimis" or "courtesy" services.
- If the arrangement requires providing substantial services, create a separate agreement for the service component and allocate a portion of the income to services. This will avoid "tainting" the entire amount of income thus avoiding the full amount to be considered UBTI.
- By specifically terming the arrangement a "licensing agreement" and referring to the payments as "royalties", the University can avoid a certain amount of discrepancy.
- Any expenses incurred by the exempt organization in connection with the production, preparation or mailing of solicitation materials should be reimbursed by the receiving entity, to minimize the risk that these activities are deemed to make up part of the consideration for the licensing payments.