

Identifying Unrelated Business Income

The Internal Revenue Service requires tax-exempt organizations such as colleges and universities to declare and pay tax on net income from activity unrelated to the basic purposes for which the income tax-exemption was granted. The university's purpose is to provide education, research, and public service. Public service, however, does not, in itself, provide the basis for the university's tax exemption. Each activity that is public service oriented must be scrutinized to determine whether an educational or research purpose is also being served.

Three elements must be present for an activity to be considered unrelated to the university's tax-exempt purposes of education and research. The activity must be 1) a trade or business, 2) regularly carried on and 3) not substantially related to the university's exempt purpose.

As a general rule, providing goods and services to the public (alumni is included in this category) is considered a taxable activity. Other examples of activities that would most likely generate unrelated business income are advertising, travel tours, and renting equipment to non-university personnel.

There are specific activities identified in the federal tax law which are exempted from unrelated business income tax even though they may otherwise have the characteristics of an unrelated trade or business. One of note is qualified sponsorships.

A qualified sponsorship payment from a person engaged in a trade or business, with no expectation of any substantial benefit other than use or acknowledgement of the name or logo of the trade or business, is excluded from unrelated business income. However, advertising products or services is taxable. The following factors would indicate that an organization is engaged in advertising:

- qualitative or comparative language;
- call to action;
- inducement to buy, sell, rent or lease sponsor's product;
- price savings information;
- endorsement.

It is very important that all unrelated business activities are reported on the federal tax return. The Internal Revenue Service can and will assess costly penalties and interest charges for underpayment of taxes.

The information provided above is not exhaustive. Unrelated business income tax analysis can be complex requiring significant review to properly determine whether or not an activity is a source of taxable income to the university. If you think you have, or plan to start, an activity that may result in a tax liability for the university please contact Lisa Assad, lisa.assad@vt.edu, or Barbara Starling, starlibs@vt.edu, in the Controller's Office to discuss the matter.