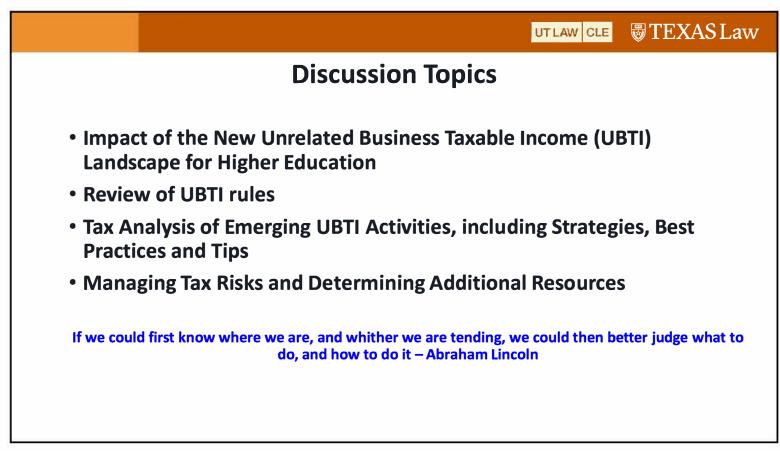# MANAGING UBTI TO INFINITY AND BEYOND

4:20 to 5:20 p.m.
Otis Hotel Austin and Live Webcast
Thursday, June 13, 2024

Robert W. Friz
Partner with PwC

Edward J. Jennings
University of Michigan

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Discussion Topics

- **Impact of the New Unrelated Business Taxable Income (UBTI) Landscape for Higher Education**

- **Review of UBTI rules**

- **Tax Analysis of Emerging UBTI Activities, including Strategies, Best Practices and Tips**

- **Managing Tax Risks and Determining Additional Resources**

If we could first know where we are, and whither we are tending, we could then better judge what to do, and how to do it – Abraham Lincoln
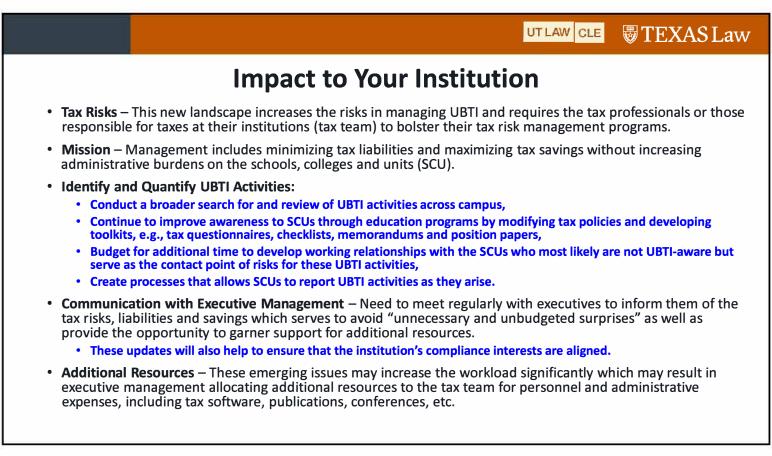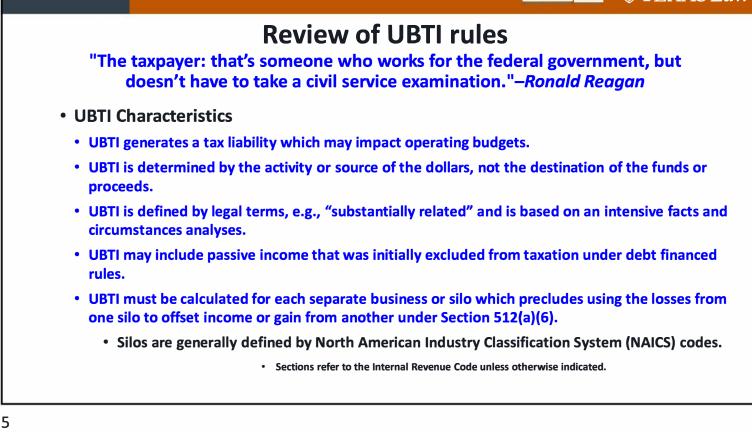
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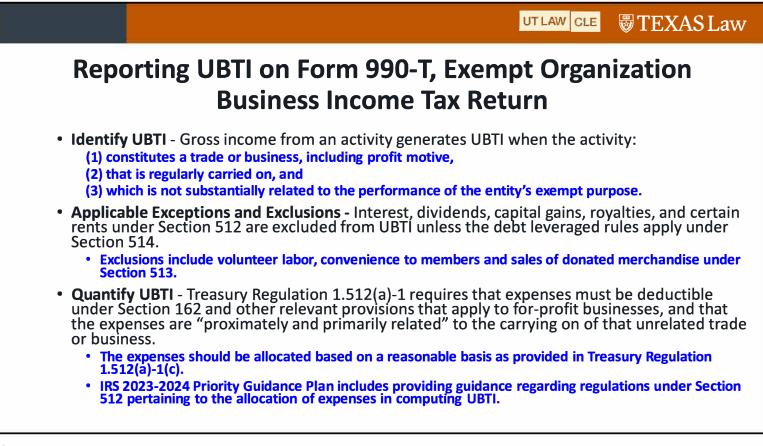# Impact of the New UBTI Landscape for Higher Education

Change is like heaven; we all want it just not now - Anonymous

- **New Tax Landscape –** The 'blueprint' of managing tax risks for higher education has expanded since the pandemic. The workplace has changed with employees working remotely, new opportunities have arisen to earn energy tax credits, funding models have been introduced to provide stability in a volatile market, and colleges and universities are looking to the future by growing their endowments.

- **Emerging UBTI Issues:**
  - Colleges and universities are exploring leasing vacant office space to unrelated parties as a result of employees working remotely which derives rental income.
  - Institutions are constructing energy efficient buildings and purchasing energy equipment, e.g., charging stations, as a result of the energy tax credits which may result in deriving revenues when used by the general public.
  - Treasury and Investment Departments are incurring commercial debt, e.g., lines of credit to cover working capital shortages and to finance the growing infrastructure of the institution, earning interest on the debt instruments.
  - Endowments are investing in alternative investments and separate managed accounts to bolster the rate of return on investments, generating income from operations and debt leveraged activities.

Impact to Your Institution

- **Tax Risks –** This new landscape increases the risks in managing UBTI and requires the tax professionals or those responsible for taxes at their institutions (tax team) to bolster their tax risk management programs.

- **Mission –** Management includes minimizing tax liabilities and maximizing tax savings without increasing administrative burdens on the schools, colleges and units (SCU).

- **Identify and Quantify UBTI Activities:**
  - Conduct a broader search for and review of UBTI activities across campus,
  - Continue to improve awareness to SCUs through education programs by modifying tax policies and developing toolkits, e.g., tax questionnaires, checklists, memorandums and position papers,
  - Budget for additional time to develop working relationships with the SCUs who most likely are not UBTI-aware but serve as the contact point of risks for these UBTI activities,
  - Create processes that allows SCUs to report UBTI activities as they arise.

- **Communication with Executive Management –** Need to meet regularly with executives to inform them of the tax risks, liabilities and savings which serves to avoid "unnecessary and unbudgeted surprises" as well as provide the opportunity to garner support for additional resources.
  - These updates will also help to ensure that the institution's compliance interests are aligned.

- **Additional Resources –** These emerging issues may increase the workload significantly which may result in executive management allocating additional resources to the tax team for personnel and administrative expenses, including tax software, publications, conferences, etc.

Review of UBTI rules

"The taxpayer: that's someone who works for the federal government, but doesn't have to take a civil service examination."–*Ronald Reagan*

- **UBTI Characteristics**
    - **UBTI generates a tax liability which may impact operating budgets.**
    - **UBTI is determined by the activity or source of the dollars, not the destination of the funds or proceeds.**
    - **UBTI is defined by legal terms, e.g., "substantially related" and is based on an intensive facts and circumstances analyses.**
    - **UBTI may include passive income that was initially excluded from taxation under debt financed rules.**
    - **UBTI must be calculated for each separate business or silo which precludes using the losses from one silo to offset income or gain from another under Section 512(a)(6).**
        - **Silos are generally defined by North American Industry Classification System (NAICS) codes.**
            - Sections refer to the Internal Revenue Code unless otherwise indicated.

Reporting UBTI on Form 990-T, Exempt Organization Business Income Tax Return

- **Identify UBTI** - Gross income from an activity generates UBTI when the activity:
    (1) constitutes a trade or business, including profit motive,
    (2) that is regularly carried on, and
    (3) which is not substantially related to the performance of the entity's exempt purpose.
- **Applicable Exceptions and Exclusions -** Interest, dividends, capital gains, royalties, and certain rents under Section 512 are excluded from UBTI unless the debt leveraged rules apply under Section 514.
    - **Exclusions include volunteer labor, convenience to members and sales of donated merchandise under Section 513.**
- **Quantify UBTI** - Treasury Regulation 1.512(a)-1 requires that expenses must be deductible under Section 162 and other relevant provisions that apply to for-profit businesses, and that the expenses are "proximately and primarily related" to the carrying on of that unrelated trade or business.
    - **The expenses should be allocated based on a reasonable basis as provided in Treasury Regulation 1.512(a)-1(c).**
    - **IRS 2023-2024 Priority Guidance Plan includes providing guidance regarding regulations under Section 512 pertaining to the allocation of expenses in computing UBTI.**

Title search: Managing UBTI to Infinity and Beyond

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"Managing UBTI to Infinity and Beyond"