NEW YORK UNIVERSITY
A private university in the public service

Office of General Counsel
Elmer Holmes Bobst Library
70 Washington Square South
New York, New York 10012-1091
Phone: 212 998 2240
Fax: 212 995 3048

February 15, 2012

OFFICE OF GENERAL COUNSEL MEMORANDUM

UNRELATED BUSINESS INCOME TAX

As a tax-exempt organization described in section 501(c)(3) of the Internal Revenue Code, NYU generally is not required to pay federal income tax on activities related to its educational and charitable activities and on certain other types of income (such as its investment income). However, income from activities of NYU that are not related to its educational and charitable purposes often results in NYU's having to pay "unrelated business income tax" ("UBIT").

The rules governing UBIT are intended to put tax-exempt organizations on the same footing as for-profit businesses, so that tax-exempt organizations do not have an unfair competitive advantage when they are essentially acting like for-profit businesses. Income subject to UBIT must be reported to the Internal Revenue Service on NYU's annual tax return (Form 990- T) and the gross unrelated business income less allowable expenses is taxed at the regular corporate tax rates.

These rules are complex, and you should seek advice from the Office of General Counsel if you have questions. In addition, all UBIT must be reported to the Office of the Controller, Tax Division, which files NYU's annual tax return. Below is a general overview of the rules most relevant to NYU.

General Rule

Subject to a number of exceptions, income received by NYU generally will be subject to UBIT if it results from a "trade or business" that is "regularly carried on" and is not "substantially related" to NYU's exercise of its tax-exempt purposes.

- ***Trade or Business***: A "trade or business" is any activity carried on for the production of income from the sale of goods or performance of services.
- ***Regularly Carried On***: The term "regularly carried on" is analyzed with respect to comparable commercial activities of nonexempt organizations, so it can include activities that may not seem frequent or continuous in the ordinary sense of those words.

- ***Not Substantially Related***: An activity is "substantially related" when the conduct of the activity has a substantial causal relationship to the achievement of the organization's tax-exempt purposes – in NYU's case, to its educational and charitable purposes. The fact that the funds from the activity will be used for the organization's tax-exempt purposes does not of itself make the activity "substantially related." The most famous example involves NYU's prior ownership of Mueller's Macaroni. NYU had argued, unsuccessfully, that it should not be subject to tax on the profits of the company because the "destination of the income" was NYU, which intended to use the income for its educational and charitable purposes.

Common Sources of UBIT: Advertising and Dual Use of Facilities

Providing Goods or Services to Persons Outside the NYU Community

A common source of UBIT involves the provision of goods or services to those not involved in an exempt organization's carrying out of its charitable activities. In the case of NYU, for example, this can include sales by the NYU book store to the public or use of the NYU gym by the public.

Dual Use of Assets or Facilities

If an asset or facility that is used by NYU to conduct its educational and charitable purposes also is used for commercial activities, the income received from the use of the asset or facility for commercial purposes may be subject to UBIT. For example, if an NYU garage is used for both NYU personnel and the public, the public use is subject to tax.

Advertising

Advertising is considered to be an unrelated activity, even when it occurs in the context of a related activity (a rule known as the "fragmentation" rule). For example, if a school of NYU publishes a journal relating to a particular area of study or research, income received from the sale of the magazine would not be taxable because the activity is considered related; but any income received from advertising in the magazine would be taxable because the advertising income is separately analyzed and deemed unrelated.

"Advertising" is defined as any message which promotes or markets any trade or business, service, facility or product. The term includes messages containing qualitative or comparative language, price information or other indications of savings or value, as well as messages containing an endorsement or an inducement to purchase or use a company's service or product.

Exceptions to UBIT

There are a number of exclusions and exceptions to UBIT. Below are the ones that arise most frequently in the course of the University's activities.

Convenience of Members
Income from activities that NYU conducts primarily for the convenience of its students, faculty, employees and patients typically is excluded from UBIT. A common example of this is income from the University's operation of campus cafeterias or gift shops. This exception does not apply to the extent of use by the public.

Volunteer Activities
Income from activities in which substantially all the work is performed without compensation is also excluded. Some fundraising activities, such as volunteer operated bake sales, may meet this exception.

Dividends, Interest, and Royalties
Dividends, interest, annuities and other income received from the University's ordinary and routine investments generally are not subject to UBIT. In addition, royalty income typically is not subject to UBIT. Note that the income must truly be passive in order to meet the exception. In other words, NYU may not provide services in connection with its receipt of income, such as assisting in the promotion of products for which it receives royalties. In addition, these exceptions may not apply to the extent that NYU has debt-financed the activity (e.g., bought stock on margin).

Rents from Real Property
Rents (including license fees) from the use of real property typically are exempt from UBIT so long as the rental / license fees are not based on the net income generated by the user and services (such as catering) are not provided. Leasing property has other significant implications and we recommend your reviewing our memorandum "Considerations in Leasing and Licensing in University Facilities for Non-University (Third Party) Use."

Qualified Sponsorship Payments
Income received from a sponsorship arrangement in which the sponsor receives no substantial return benefit from NYU other than use or acknowledgment of the sponsor's name or logo also is excluded from UBIT. For more about this exception, see our memorandum "Corporate Sponsorship Arrangements."

Selling Donated Merchandise
Activities that consist of selling merchandise, substantially all of which was received by NYU as gifts or contributions, do not generate UBIT. The operation of many thrift stops by exempt organizations would meet this exception.

Further Resources

All UBIT needs to be reported to the Office of the Controller, Tax Division.

If you have legal questions about leasing University facilities for third party use, you can find a member of the Office of General Counsel who practices in this area by visiting our practice areas page and scrolling to "Tax".