UNIVERSITY SYSTEM OF MARYLAND
FINANCIAL REPORTING INFORMATION REQUIREMENTS

UBIT Reporting Requirements

<u>Summary of Reportable Tax Information and Detail of Information Needed to Prepare Form 4562, for each unrelated business income activity</u>

Purpose: Information needed to compile System-wide tax return reporting financial activity associated with activities that represent unrelated business income according to the Internal Revenue Code and IRS guidance. Each institution will be expected to review revenues and the nature of operations for any activity occurring on the institution that appears on the listing '***List of Activities That Should Be Reviewed For Possible Reporting of UBIT'*** (page 65), evaluate these activities using criteria for tax reporting (page 66), track and identify revenues and expenses associated with unrelated business income activities, and accumulate documentation that would, in an audit, facilitate the substantiation of amounts reported on the System's annual IRS Form 990-T, Exempt Organization Business Income Tax Return.

Format: Information is to be provided by unrelated business income tax activity, meaning that revenues, expenses, and information required to complete the depreciation forms must be provided on a separate, distinct set of forms for each reportable activity. A reportable activity is an individual activity, or group of activities that constitute an integral operation.

If the institution has two or more unrelated business income tax activities, a separate and distinct Summary of Reportable Tax Information for UBIT Activity, and Detail of Information Needed to Prepare Form 4562 is to be provided for each.

It is critical that a documentation trail be developed as a part of the process to compile the information and maintained by the institution in the event of an audit, whether by the Internal Revenue Service, the independent auditors, or even the System Office of Internal Audit. This documentation must facilitate tracing of amounts from the institution's accounting system to the information reported on the ***Summary of Reportable Tax Information*.**

Note: Each institution (vice president for administration) will be required to assert positively that:

the institution has performed a review of institutional activities to identify potential activities that might generate unrelated business income,

assessed, for determination of whether tax reporting is required, the business-purpose of potential activities that might generate unrelated business income, and

compiled financial information for each identified unrelated business income activity and documented the information sources for revenues and each expense, including the basis for any allocation of expenses, in such a manner that the build-up and support for the financial information reported can be clearly tied back to the institution's underlying financial records.

<u>Suggested approach - Unrelated Business Income Tax reporting</u>

What Activities to Report:

In evaluating whether an activity should be reported on the tax return, document the facts and analysis for each factor critical to the conclusion reached.

You should document and substantiate the profit motive for any reported activity showing consistent net losses year after year or else discontinue reporting it on the income tax return. Verifiable evidence includes authoritative documentation such as meeting minutes that indicate the implementation of a new operational approach reasonably expected to enhance profitability.

Explain any instances where UBIT activities reported last year are not being reported this year.

Each reported activity should be described in detail. If contractors are involved, are they truly independent and bear the risk of loss or are they merely agents of the university, much like employees? If the operation is run by an independent contractor that pays the university a fixed amount or a percentage of the gross revenue, and the university does not provide services of a type or level beyond those that are customary in a rental situation, then the activity is not a trade or business to the university, and therefore not taxable.

Document Source References:

Reference the source of every figure on all forms and schedules.

The source should be thoroughly disclosed for any figure that does not tie directly to the institution's accounting system, and the rationale for its use explained. The rationale for methodology inherent in all allocation calculations should be made clear and be persuasively justified.

The above documentation should be maintained by the institution as support for UBIT tax reporting.

Suggested approach - Unrelated Business Income Tax reporting (continued)

Revenue:

Document the cut-off rule used when a single event straddles fiscal years. Strive for consistency over time and across activities.

Where an activity comprises a mixture of UBIT and non-UBIT components that need to be identified:

- describe distinguishing criteria,
- describe procedures and roles, and
- describe audit trails of such determinations and indicate where kept.

If the presence of the imposition of MD Sales Tax is used to distinguish components, then justify through explanation.

Expense:

The only expenses that may be deducted are those that are “ordinary and necessary”.

The entity is the University System of Maryland (USM), not the institution or department. Accordingly, internal transfers should be thoroughly understood in determining the amount, if any, of expenditures (and/or revenue) to be reported. An example of a transaction likely to be non-reportable is one bearing the description, ‘fund balance transfer’.

Complete the bond issues information for interest expense reported on the attachment to the tax return.

Suggested approach - Unrelated Business Income Tax reporting (continued)

Allocations of Expense:

The amount of expense attributable to the unrelated business part of the activity can rarely be directly identified. More often one must allocate on the basis of resources used, as for example by counting days and square feet. Allocation on the basis of revenue is one step further less direct. The additional assumption required is that revenue is directly proportional to the use of resources. In such case, demonstrate or show affirmatively that the non-unrelated business part of the activity is not enjoying disproportionately more freebies or discounts in user fees. Otherwise, an adjustment to the allocation calculation is needed.

Justify the expense allocation method selected for reasonableness considering feasibility.

Generally, building-related indirect costs, depreciation and interest, are allocated by building usage (commonly by square feet and days).

In multi-step allocations, describe all steps. Example: Step 1: Utilities allocated to individual buildings. Step 2: A building’s utilities is allocated to UBIT vs. non-UBIT.

Revise or update allocation rates, if feasible.

Review:

Have somebody other than the preparer check calculations for clerical accuracy.

Somebody having excellent quantitative skills should check the logic of allocation calculations.

Compare figures and ratios (such as net income to gross revenue) for each activity to the prior year and explain relatively large changes. One possible source is a major change in allocation rate, because, for example, the use of resources has changed markedly.

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UBIT Return Preparation Process

List of Activities To Be Reviewed for Possible Reporting of UBIT:

<u>From IRS Questionnaire prepared September, 2008</u>:

A. Advertising
Printed publications
Other printed material
Internet
Facilities (Billboard, scoreboard, etc.)
TV/Radio broadcasting

B. Corporate Sponsorships
Printed materials including publications
Events
Internet
Facilities (Billboard, scoreboard, etc.)
TV/Radio Broadcasting

C. Rental
Facility rental
Rental of arena
Recreation center usage
Athletic facilities usage
Personal property rental
Telecomm related or broadcast tower rentals
Other rentals

Highlighted and italicized items represent activities historically reported by USM institutions

D. Other
Catalog sales
Internet sales
Travel tours
Broadcast rights
Royalties from oil and gas interests
Affinity cards
Mailing list rentals
Logo usage
Working interest in oil, gas, etc.

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Catalog sales
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Travel tours
Broadcast rights
Royalties from oil and gas interests
Affinity cards
Mailing list rentals
Logo usage
Working interest in oil, gas, etc.
Other royalties
Exclusive use contracts
Commercial research
Patents
Copyrights and trade names or trade secrets
Operation of a hotel
Operation of conference center
Operation of Restaurant
Catering services
Food services
Credit card promotions
Computer services
Exploited exempt activity income (non-advertising)
Bartering
Parking lot operations
Power generations
Bookstore
Golf course
Partnership allocations
S-Corp allocations
Income from controlled entities

E. Other activities not included above
Day camp
Performing arts

Suggested approach - Unrelated Business Income Tax reporting (continued)

The activity/income is not taxable as "unrelated business" if any of the following are true:

The activity is substantially related to the organization's tax-exempt mission	512(a)(1)
The goods/services provided must contribute importantly to accomplishing the tax-exempt purposes.	1.513-1(d)(2)
The portion of the size and scope of an activity in excess of what contributes importantly to accomplishing the tax-exempt purposes is "unrelated".	1.513-1(d)(3)
An activity does not lose its identity as a trade or business merely because it is carried on within a larger aggregate of activities. (Example: Bookstore operation may have separate "related" and "unrelated" components.)	513(c)
Sale of products resulting from the performance of exempt functions is "related" (e.g., sale of milk from dairy herd used for academic research).	1.513-1(d)(4)(ii)
The activity is not regularly carried on	512(a)(1)
Think of how frequently a for-profit organization would conduct the activity.	1.513-(1)(c)
The activity lacks profit motive as evidenced by continuous losses over a number of tax periods	
The profit motive is lacking if the activity is not carried on for the production of income.	1.513-1(b)
Another indicator of profit motive is the appearance of commercialism such as promotional efforts performed.	
The activity is carried on primarily for the convenience of the organization's members	513(a)(2)
The income is from research conducted by a college, university, or hospital	512(b)(8)
"Research" excludes activity that is commercial/industrial such as ordinary testing or inspecting of materials and the designing or construction of equipment and buildings.	
The income is from ordinary and routine investments	512(b)(1)
The rental income is from real property and is not determined by the lessee's profits	512(b)(3)
Personal services must not be provided other than those customarily provided with rentals (such as providing utilities, cleaning common areas, and collecting trash).	1.512(b)-1(c)(5)
Rent from personal property leased with the real property is not more than 10% of total rent	512(b)(3)
Between 10% and 50%, the real property rental exclusion is allocated accordingly. If greater than 50%, there is no exclusion.	
The income is royalty income	512(b)(2)
The gain is from the sale of investments and other non-inventory property	512(b)(5)
The income is from mortgaged real property owned by a school, its support organization, or its partnership interest	514(c)(9)
If it were not for this exclusion, the unrelated debt-financed income rules would make income from the rental or gain on sale of real property taxable notwithstanding exclusions noted above.	
The activity is one in which 85% or more of the work is performed with unpaid labor	513(a)(1)
The income is from the sale of merchandise of which 85% or more was donated to the organization	513(a)(3)
The income is from the receipt of qualified sponsorship payment	513(i)
Acknowledgement of payments received from business persons in connection with the organization's activities are not deemed taxable advertising income on condition that the acknowledgement does not rise to the level of a solicitation. Also there must be no other substantial return benefit.	

UBIT Depreciation Practices of USM

The main reference we follow is IRS Publication 946, How to Depreciate Property. URL: Page numbers refer to the version of February 27, 2015.

We generally use straight-line GDS (S/L-GDS) for regular tax purposes, and straight-line ADS (S/L-ADS) for property that has been tax-exempt debt financed and for alternative minimum tax purposes, where applicable.

The depreciable life of an asset for GDS and ADS is based upon the type of asset. The following guide is based on what USM has found most useful over the years, but is not intended to substitute for a careful reading of the IRS publication, especially Appendix B. The information comes from pages 35, 36, 100.

GDS/ADS depreciable life (in years):

5/5	Information Systems (including computers and their peripheral equipment), automobiles, taxies, and general purpose trucks weighing less that 13,000 pounds
5/6	Data handling equipment other than computers (including typewriters, calculators, copiers,) and general purpose trucks weighing more than 13,000 pounds
5/9	Buses
7/10	Office furniture, fixtures, and equipment: (includes files, safes, communications equipment)
7/12	Use for personal property for which no class life is designated
5/20	Land improvements: Sidewalks, roads, fences, landscaping, shrubbery, transmitting towers
31.5/40	“Nonresidential” (1) real property placed in service before May 13,1993
39/40	“Nonresidential” real property placed in service after May 12, 1993

Note: An addition you make to an existing depreciable asset is treated as a separate depreciable asset. So the depreciable life of an addition or an improvement to a building will begin when the addition or improvement is placed in service, not when the building was originally placed in service.

Nonresidential real property (defined on page 32 of the publication) even includes hotels and inns. This is because to qualify as residential rental property, the rental income must come from dwelling units. But a dwelling unit does not include a unit in a hotel or other establishment where more than half the units are used on a transient basis.

UBIT Depreciation Practices of USM (continued)

The depreciable life generally begins when the property is placed in service, which means when the property is ready and available for a specific use (Page 7 of the publication). However, there are rounding rules that determine the precise date when the depreciable life begins (Page 37 of the publication):

Mid-Month (MM) convention: Applies to real property. Treat the placed in service/disposal date as the middle of the month.

Mid-Quarter (MQ) convention: Applies to personal property if more than 40% of all such MACRS personal property was placed in service during the last 3 months of the tax year. Treat the placed in service/disposal date as the middle of the quarter.

Half Year (HY) convention: Applies to personal property to which the MQ convention is not applicable. Treat the placed in service/disposal date as the middle of the tax year.

ADS Election:

For regular tax purposes, ADS (straight-line) in lieu of GDS may be elected for property placed in service during the reported tax year. The process is as follows.

First, any items of property that are tax-exempt debt financed must use ADS (straight-line). The remaining items placed in service use GDS (straight-line) to the extent ADS is not elected as follows:

For real property, the ADS election may be made on an item-by-item basis. An item would be the acquisition or capital improvement to a building or garage.

For personal property, the ADS election must be made on a category-by-category basis. A category is a single class of depreciable personal property of an activity of a USM institution. A class of property is property having both the same GDS recovery period and ADS recovery period. Recall that an “activity” may be comprised of multiple “sub-activities” based upon the institution’s established practice.