

OFFICE OF THE CONTROLLER

Tax Team

Income Tax

March 2024



Purpose

Tax concepts are often challenging, and not always intuitive. While departments are not expected to be tax experts, there is an expectation that departments use available resources to become familiar with basic concepts and comply with any applicable requirements.

The purpose of this session is to provide guidance on the basics of income tax, illustrate applicable scenarios and examples, and provide references to various resources.





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Definitions and Basics



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Income Tax

Income tax is a type of tax imposed on the income generated by businesses and individuals.

In accordance with Internal Revenue Code (IRC) Section 115 and Internal Revenue Service (IRS) determination, the University is exempt from paying federal income tax on the income related to the University's exempt purpose (e.g., teaching, instruction, research, public service).



Unrelated Business Income Tax

However, the University may also engage in other activities that do not directly relate to its exempt purpose. These other activities are subject to income tax under IRC Section 115 at regular corporate rates and are referred to as Unrelated Business Income Tax (UBIT).

This section of the IRC is designed to prevent tax-exempt organizations from having an unfair advantage over for-profit businesses that pay tax on income generated in the same manner.

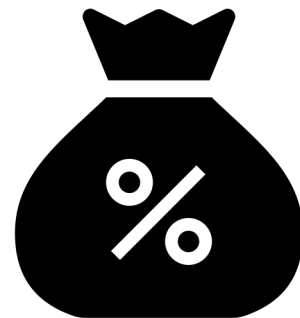
The IRS is concerned about how the funds are generated rather than how the funds are used.



Annual Filing

On an annual basis, the Controller's Office Tax Team reports UBIT to the IRS by filing the Form 990-T, Exempt Organizations Business Income Tax Return.

The return is due on **November 15th** each year. A six-month extension is available if needed, which pushes the due date to May 15th.



Annual Questionnaire

Each year, the Controller's Office Tax Team distributes an annual UBIT questionnaire to units to collect the data required to file the return.

An electronic questionnaire is distributed to a unit-level contact through [Jotform](#). If you think your unit was omitted from the previous distribution, please reach out to the Tax Team accordingly.

Departments are responsible for disclosing the necessary information. Any penalties that result from omissions or incorrect data will be the responsibility of the department.

As a general rule of thumb – when in doubt, disclose the activity!



Criteria for UBIT

Unrelated business income is defined as income derived from:

1. a trade or business,
2. which is regularly carried on, and
3. which is not substantially related to the performance of the entity's tax-exempt function.

All three elements must be present to constitute unrelated business income.



Criteria 1: Trade or Business

A trade or business, as defined by the IRC, is widely encompassing. It includes any activity carried on for the production of income from the sale of goods or the performance of services. Characterization as a trade or business depends on the level of active participation by the University in generating revenue.



Criteria 2: Regularly Carried On

Business activities of the University will be deemed to be regularly carried on based on frequency and continuity, and if pursued in a manner generally similar to comparable commercial activities of non-exempt organizations. When activities are consistently promoted and carried on by the University, they meet the requirement of regularity.



Criteria 3: Not Substantially Related

The relationship between the revenue-generating activity and the University's exempt purpose (e.g., teaching, instruction, research, public service) determines whether this criterion is met. Activities that are deemed not to contribute importantly to the University's mission are considered not substantially related.



Examples of Common UBIT Activities

- Advertising income
- Childcare centers
- Conferences, Meetings, and Training Programs
- Corporate Sponsorship Payments
- Merchandise operations
- Operation of parking lots
- Professional entertainment events
- Summer sports camps
- Use of Facilities by the General Public



Advertising Income

Advertising is an area that must be carefully considered when assessing UBIT implications. The content and nature of the advertisement dictates UBIT applicability.

Advertising = UBIT

Includes endorsements, inducements to use, sell, or purchase certain products or services, and/or messages that contain qualitative or comparative language, indications of value, or price information.

Qualified Sponsorship Payments \neq UBIT

Mere acknowledgement; a payment made without any arrangement or expectation that the payor will receive a benefit in return; follows the “business card rules” (e.g., company logo, location, contact numbers, website, neutral-value descriptions, displays, or depictions of products and services).



Childcare Centers

If the purchasers of the services are students, faculty, or staff, the childcare center is considered as provided for their convenience and is not subject to UBIT.

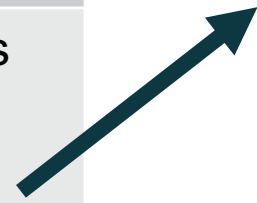
However, if the service is available to the general public as well, the portion of the generated revenue attributable to the general public may be subject to UBIT depending on various factors such as education training and college credit given for student participation at the center.



Conferences, Meetings, and Training Programs

These activities generally arise in one of three instances:

Categories	Treatment
University conference centers/facilities are used for internal, related* meetings and conferences <i>*If, for example, a University department rents a space for an unrelated purposes (e.g., Christmas party, retirement reception), it would be subject to UBIT</i>	Non-taxable
University rents conference centers/facilities to external entities	It depends
University enters into a contract with another entity to provide special training programs and classes for its employees	



If strictly space rental = Non-taxable

If personal property (e.g., tables, chairs, AV equipment, etc.) is rented in conjunction with the space or University services are provided (e.g., set-up, tear-down, etc.) = generally Taxable

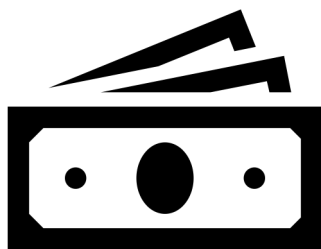
If third-party courses/events are educational in nature and further the mission of the University = generally Non-Taxable



Corporate Sponsorship Payments

Payments to the University in return for mere mention or acknowledgement are generally exempt from UBIT.

However, when the payor receives a substantial return benefit in addition to the acknowledgement, UBIT is applicable. This is defined as any benefit (e.g., good, service, etc.) received with an aggregate fair value of more than 2% of the payment amount.



Merchandise Operations

Merchandise sales are typically fragmented into three major categories:

Categories	Examples	Treatment
Directly educational materials	Books, general school supplies (e.g., notebooks, paper, pens), etc.	Non-taxable
Non-educational, convenience items	Clothing and novelty items with USC logo (e.g., mugs), low-cost items with recurrent demand (e.g., health and beauty aids, candy, greeting cards, newspapers, etc.) <i>*Does not apply to any items with a useful life of more than one year</i>	Non-taxable
Other merchandise sales	Items that do not fall into the categories above – other apparel, cameras, small appliances, etc.	Taxable

Operation of Parking Lots

When a University has excess parking spaces available and leases them to local businesses or members of the general public, the activity is generally subject to UBIT.

In addition, parking revenue generated from unrelated events is also subject to the UBIT.



Professional Entertainment Events

When a University sponsors a professional performance involving paid entertainers, not students, such events are subject to UBIT if operated in substantially the same manner as a commercial operation rather than in a manner that primarily serves as an integral part of the education program of the University.

Example: Certain events held at the Colonial Life Arena are subject to UBIT; University-related events such as basketball games and commencements are not, but concerts/events are.



Summer Sports Camps

When camps are conducted either (1) by the University for the general public using its own facilities and employees, or (2) by a third-party leasing facilities from the University, the generated revenue is typically subject to UBIT.

However, certain exemptions may apply depending on the nature of the camp, including:

- Facilities are rented to an unrelated individual for a fixed fee not dependent on the profit from the camp's operation
 - ✓ No profit motive, no University provided no respective services
- Camp operated for lessons and instruction of disadvantaged youth
 - ✓ Related to the University's exempt purpose



Use of Facilities by the General Public

Facility usage (e.g., fitness centers) by students, faculty, and staff is related to the University's exempt purpose and not subject to UBIT.

However, usage of University facilities by the general public, including alumni, retirees, and spouses, is generally subject to UBIT.



Deductions and Exceptions



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Deductions

Two tests must be met for an expense to be deductible:

- it must be allowable as a business deduction under the tax code (e.g., “ordinary and necessary” business expenses); and
- it must be directly connected with the carrying on of the unrelated trade of business (e.g., proximate and primary)



Deductions – Allocating Expenses

Some expenses are 100% deductible (e.g., the salary of a person who spends 100% of their time on the unrelated trade or business).

However, in many cases, expenses are used for both related and unrelated activities (e.g., assets, depreciation, other expenses) and must be proximately and primarily related to the unrelated activity and allocated on a reasonable basis. Adequate records must be maintained to support the allocations.

Departments are responsible for tracking the expenses attributable to unrelated activity.



Exceptions

Income attributable to the following sources/activities are generally excluded from UBI:

- Passive income (e.g., interest, dividends, royalties, rents from real property, revenue from property sales)
- Income generated from donated services/property
- Research activities
- Volunteer activities
- Sales of contributed property
- Activities for convenience of members
- Low-cost/incidental items



Scenarios



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Scenario 1:

During each fiscal year, the departmental Business Manager completes a monthly analysis of its financial data to identify and document any activity that may be subject to UBIT. She's unsure whether several activities should be included, but makes note of them anyways. When the annual UBIT questionnaire is received from the Controller's Office Tax Team, she discloses all activity.



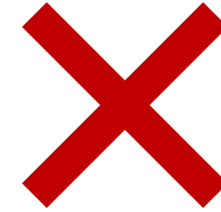
Rationale: This is a great practice and is highly recommended! Staying up to date on any potentially applicable activities throughout the year will assist with the questionnaire completion process after year-end. We rely on departments to disclose relevant activity to us – you are the experts of your activity and financial activity. If you're unsure, disclose the activity. Once disclosed, the Tax Team completes the analysis and follow-up necessary to determine whether UBIT applies. But without that disclosure, a complete analysis cannot be performed.



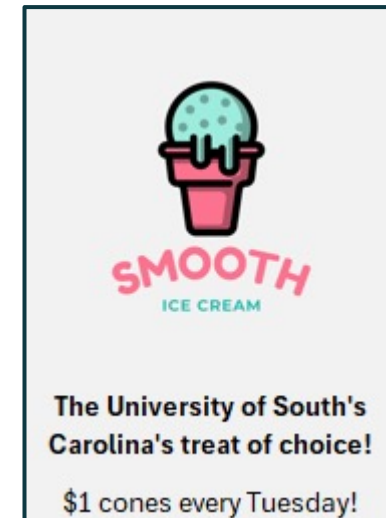
Scenario 2:

A department hosts a quarterly event and provides programs to attendees. Several pages of the program are reserved for sponsors, who pay a fee to have a company advertisement included in the program. The income from both advertisements would be excluded from UBIT since all income was derived from a University event.

Rationale: The nature of the advertisement dictates whether it is subject to UBIT, not whether it's associated with a University event. Ad #2 meets the “business card rules” and would not be subject to UBIT. However, Ad #1 includes both inducements to sell and indications of value and price information and **would** be subject to UBIT.



Ad #1



Ad #2



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Scenario 3:

ABC Company pays \$10,000 to a department for a company acknowledgement to be included in a department's upcoming journal. In exchange, the company's name and logo is included on a quarter page sized advertisement in the journal and the company's CFO receives four tickets to attend the next home football game, valued at \$75 each. Since the advertisement followed the "business card rules" the payment is excluded from UBI.



Rationale: The payor received a substantial return benefit in addition to the acknowledgement. The aggregate fair value of the football tickets is \$300, which exceeds 2% of the payment amount ($\$10,000 * 2\% = \200). As a result, the full \$10,000 is applicable to UBIT.



Scenario 4:

A department rents its conference room to an external party for a Christmas party, which it recognizes as an unrelated activity. The department's custodian earns \$15/hour and spends five hours completing set-up, tear-down, and clean-up services related to the event. As a result, \$75 is identified as deductible for UBIT purposes. Time sheets and other records are maintained as support.



Rationale: Rather than deducting the custodian's full salary, only those expenses directly attributable to the unrelated activity were identified as eligible for deductibility. In addition, a reasonable allocation method was used. Further, the department was diligent in ensuring adequate records were maintained to support the calculation.



Training Resources and Contacts



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Office of the Controller Website

Our website was recently redesigned to provide a more user-friendly experience. Tax information can be found under the **Compliance and Tax Management** section:



Quick Links to Resources

- [IRS Determination Letter – Section 115](#)
- [About Form 990-T](#)
- [IRS UBIT Guidance](#)
- [SCDOR Webpage – Additional Withholding for Non-Resident Contractors](#)
- [SC DOR Form I-312](#)



Questions / Issues

If you have questions or experience any issues, please contact the Tax Team at tax@mailbox.sc.edu.

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THANK YOU!

Office of the Controller



Alone, we can do so little; together,
we can do so much.



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