

TO: NDSU President's Cabinet, Deans, Directors, and Department Chairs

FROM: John Adams, VP for Finance & Administration

DATE: August 20, 2009

RE: Unrelated Business Income (UBI)

Tax-exempt organizations are created for a particular exempt purpose. North Dakota State University (NDSU) is exempt from Federal income tax under section 115 of the Internal Revenue Code as an instrumentality of the state of North Dakota<sup>1</sup>. Established as North Dakota's Land-Grant institution in March 1890, NDSU was created to "serve three basic functions, resident education, research and extension."<sup>1</sup> In recent years, the Internal Revenue Service (IRS) has begun to focus on any income generated from activities that are not substantially related to the organization's particular exempt purpose; ruling such income to be unrelated business income (UBI) and therefore subject to taxation.

In order for an activity to be a considered UBI, the following elements must exist:

- The activity is a trade or business that is conducted with a profit motive-The activity is priced above cost and is operated to generate income.
- The trade or business is regularly carried on-The activity is conducted on a regular basis (e.g. not a one-time event)
- The conduct of the activity is unrelated to the tax exempt purpose-The activity is not directly related to the exempt purpose of "education, research and extension."<sup>1</sup>

UBI is not uncommon in exempt organizations and is not an issue (beyond paying income tax) unless the unrelated activity is substantial in relation to the organization's overall activities. Examples of potential UBI activities at other institutions include:

- Operation of a parking lot for private events
- Operation of a fitness center for the general public
- Operation of a cafeteria for catering to the general public
- Operation of travel tours for the general public
- Advertising to the general public
- Sales of excess utilities
- Sales of goods/services to the general public
- Rental of space to the general public

NDSU currently engages in a number of activities that are treated as UBI and tax is paid on the net income from these activities. Tax expenses are billed back to the department generating the income.

Most recently, the IRS has debated the difference between research and testing; declaring that research income is tax-exempt for most educational institutions, but finding testing income to be taxable. However, given NDSU's unique status as a Land-Grant institution, certain "testing" activity may also be deemed a related activity.

If you have specific questions related to UBI, please contact Ramona Adams (231-5661), Controller's Office.

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<sup>1</sup> July 2, 1964, IRS ruling from Acting Chief, Exempt Organizations Branch, R. J. Stakem, confirming February 20, 1936, ruling affirming "the North Dakota Agricultural College to be a instrumentality of the state of North Dakota...."