

UNRELATED BUSINESS INCOME

As an institution whose primary missions are education, patient care and research, Thomas Jefferson University, Thomas Jefferson University Hospital, and Jefferson University Physicians (herein referred to as “Jefferson”) have been granted an exemption from payment of federal tax on income generated for services related to these missions. Despite this exemption, Jefferson (along with other nonprofit, tax-exempt organizations) is still subject to federal income tax for “unrelated business taxable income.” The purpose of this pamphlet is to heighten organizational understanding and awareness of unrelated business income so that Jefferson complies with the applicable Internal Revenue Code regulations and to ensure that unrelated business income receives appropriate consideration during the planning and establishment of new business ventures. In order to accomplish these two objectives, this pamphlet will provide:

1. An overview of unrelated business income;
2. An explanation of the impact of unrelated business income on Jefferson;
3. A description of the impact on the provider of unrelated business income activities;
4. Criteria and situations creating unrelated business income; and
5. Procedural guidelines for reporting unrelated business income.

OVERVIEW OF UNRELATED BUSINESS INCOME

Regulations for unrelated business income were implemented by the federal government to prevent tax-exempt organizations from obtaining unfair competitive advantages in activities where commercial businesses were required to pay taxes. In general, unrelated business income is derived from regularly carried on trade or business activities not substantially related to the primary missions of the organization. Furthermore, the Internal Revenue Service tends to classify activities as unrelated if they are in competition with commercial businesses in the same geographical location. An exception to these general definitions exists when an activity is carried on primarily for the convenience of an organization’s members, students, patients or employees. Other exceptions also apply, so determination of unrelated business income is sometimes difficult.

In recent years, unrelated business income has received increased attention from federal, state and local governments. The scrutiny has resulted from governmental budget deficits and pressures applied by small businesses. There is a perception by some public officials that nonprofit, tax-exempt organizations do not shoulder their fair share of governmental costs due to their tax-exempt status. In addition, small businesses contend that despite current tax laws, nonprofit organizations still enjoy unfair competitive advantages in the marketplace. Regardless of the validity of these positions, Jefferson must be sensitive to these concerns.

IMPACT ON JEFFERSON

Jefferson complies with the Internal Revenue Code by filing Form 990-T, “Exempt Organization Business Income Tax Return.” This federal income tax return requires all sources of Jefferson’s unrelated business revenues and expenses to be reported and provides for the payment of tax (at the corporate income tax rate) if tax is due. In addition, recognizing that unrelated activities do

exist, Jefferson has created for-profit corporations (for example, TJU, Inc.) which are subject to federal income tax and file separate returns.

The issue of unrelated business income is not limited to liability for corporate income tax. Receipt of substantial unrelated business income by a tax-exempt organization could also ultimately jeopardize an organization's tax-exempt status. This could occur if the Internal Revenue Service maintains that the primary purpose of the organization is to receive income from activities that are unrelated to its exempt purposes.

IMPACT ON THE PROVIDER OF UNRELATED BUSINESS INCOME ACTIVITIES

Within Jefferson, departments engaging in or contemplating unrelated activities must be aware of the impact on the institution and their departments. In order to minimize such impact, departments should inform their divisional financial management and the Controller's Office of all activities they believe may be unrelated. This notification will allow for an analysis of the activity and identification of any possible tax exposure and data requirements. Departments should be aware that they must keep complete and accurate financial and statistical records so that Jefferson complies with the Internal Revenue Code. For more information on this matter, please refer to the Procedural Guidelines that follow.

CRITERIA AND SITUATIONS CREATING UNRELATED BUSINESS INCOME

In order to assist departments in determining whether they are engaged in unrelated activities, the following questions should be asked:

1. Does the department provide services to organizations and/or individuals other than Jefferson's patients, students or employees? (For example, the Internal Revenue Service does not consider alumni to be directly connected to the University.)
2. Are these services regularly performed? That is, do they have a frequency or continuity similar to comparable commercial activities of a for-profit organization?
3. Do the services performed have only an insignificant casual relationship to the accomplishment of Jefferson's education, patient care or research exempt purposes?
4. Are these services performed with the intent of generating revenues? That is, does a profit motive exist?
5. Are the services also available from commercial businesses?
6. Are advertising or promotional materials or retailing methods such as mail order catalogs or display systems used to encourage sales?
7. Is the price charged for the services competitive with the market (with no discounts for Jefferson's patients, students or employees)?

If the answer to any of the above questions is "yes," please contact the Controller's Office for further guidance.

PROCEDURAL GUIDELINES FOR REPORTING UNRELATED BUSINESS INCOME

As noted previously, Jefferson is required to file Form 990-T to report any unrelated business income received during the year. In order to satisfy this requirement and assist the Controller's Office in preparing the tax return, departments engaging in unrelated activities must provide appropriate financial and statistical information.

Accordingly, departments are required to maintain complete, accurate financial and statistical records. Departments should develop procedures to document information required to be reported to the IRS on Form 990-T, including:

1. Revenues relating to unrelated activities versus total departmental revenues;
2. Employee effort directly attributable to unrelated activities;
3. Expenses directly attributable to unrelated activities;
4. Usage of equipment and/or facilities directly attributable to unrelated activities; and
5. Organizations and individuals served through unrelated activities.

This information will assist the Controller's Office in determining revenues and deductible expenses to be reported for tax purposes. Deductible expenses include allocated items such as departmental salaries and depreciation. The allocation of these expenses is based upon departmental maintained statistics. In addition, such records establish the validity of amounts reported on the tax return in the event of an Internal Revenue Service audit.

Departments should seek assistance from divisional financial personnel and the Controller's Office in establishing these records.

Conclusion

The goal of the pamphlet is to convey a general understanding of unrelated business income so that the implications for Jefferson and departmental operations of engaging in such activities can be properly addressed. The intent is not to stifle unrelated activities but rather to ensure that they are properly treated.

Due to the complexity of unrelated business income, this pamphlet is not meant to be all-inclusive. Unrelated activities need to be evaluated on an individual basis. Should you require assistance in addressing concerns raised by this pamphlet, please do not hesitate to contact the Controller's Office at (215) 503-5178.