

# Private Use of University Facilities

Tax-Exempt Bond Compliance  
Traps for the Unwary



# Setting the Stage

- UR is a 501(c)(3) organization exempt from the payment of income tax on most of its revenue
- 501(c)(3) entities must be organized “**exclusively** for charitable, **scientific** or **educational** purposes”.
- Regulations specify that the organization must serve a public rather than private interest



# 501(c)(3) purposes

- **Exclusively** – series of rules and regulations developed to allow for incidental exception
- **Educational** – instruction or training of an individual for the purpose of improving or developing capabilities.
- **Scientific** – for public interest; results of research made public on a non-discriminatory basis or research directed toward benefiting the public.



# Private Use

- Any use (whole or part) in an activity that is an **unrelated trade or business** (**not exclusively for education, scientific or charitable purposes**) or related to our exempt purposes but for **private benefit** is considered private use.
- Private use must be very carefully approved and managed to avoid serious tax issues.



# Private Use

- Many Examples (bookstore, dining facilities, room rentals); Focus today is on Research
- Research/Lab work:
  - Safe harbor for sponsored research: publication rights, UR owns IP, sponsor gets rights to IP on arms-length terms. This applies to MTAs too.
  - Examples of research projects that are and are not private use.
  - Clinical trial agreements as an example



# Private Use

- Work for government or other foundations/charitable organizations probably ok unless terms obviously contradict the safe harbor principles above.
- Research that is proprietary (i.e. confidential results) to a company is private use even though there are legit research aims.
- Testing/service agreements, private companies using our labs for their research are other examples of potential private use.



# Unrelated Trade or Business Income

- UBIT – income from a trade or business activity that is **regularly carried on** by the University and **not substantially related** to the University’s exempt purposes (research, education, health care)
- Main litmus test is whether the activity is carried out by the commercial sector – concept of “level playing field”



# UBIT

- Substantially related – goes back to our scientific/educational/health care mission
- Regularly carried on – discrete activity over discrete period of time that is not expected to be repeated is likely ok. Any special space allocation will raise concerns
- UBIT considered when pricing UBIT work
- So all UBIT is private activity but there are some research projects that are not UBIT but also are private activity
- Examples (proprietary research)





# Tax exempt bonds

- 501(c)(3) bonds (TEB) – No more than 5% (3%) of net proceeds used for private business use (PBU)(means private activity/UBIT)
- In addition – use of facilities by an employee in consulting or other personal business use or use of our facilities by a non-University employee would be PBU for our tax-exempt bonds tests.



# TEBs

- How do you measure the 3% limit.
  - HARD
  - Measured on a bond issue and facility basis
  - Must use a method that is reasonable and consistently applied
  - Average the private use over the life of the TEB (usually 30 years).
  - Space allocation is easiest but probably least useful to SRLs.



# TEBs

- 1998 Central Utilities Chiller \$4 million
- 1998 Telecom switch \$7 million
- 1999 TransgMouse renovation \$1 million
- 2003 Chilled Water loop constr \$ 2 million
- 2004 – Cogeneration Facility \$45 million

15 pages of high level bond proceeds usage that must be allocated to facilities to make definitive determination



# TEBs

- Consequences of exceeding the 3% limit:
  - Default in tax covenant for that bond issue
  - Cross default to all other bond issues
  - \$900 million of our Bonds go taxable



# Path Forward

- Work with Office of Counsel to review all agreements (or POs) that could be problematic as private use to see if we can fit them into one of three boxes:
  - Research (not for private benefit)
  - Education
  - Not regularly carried out
- If no box, we can look at a Plan B that involves allocation of bond proceeds



# Plan B

- All of our bond proceeds must be mapped to facilities throughout the University (e.g. cogen facility must be allocated based on some reasonable use of energy)
- Based on that allocation, we can begin to determine private use limitations for discrete parts of our facilities
- This will take a lot of time and money and may not solve any problems



# Process

- For now, we need to tighten our procedures and make sure that any contract for work done at the University paid for by a private company is examined for private use issues
- All efforts should be made at the outset of the project discussions to try to fit the arrangement into one of the three boxes listed before (basic research, education, not regularly carried out)





UNIVERSITY *of* ROCHESTER