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Educational Organizations: Revenue Generated from Room Rentals

In a 2011 private letter ruling, the IRS has ruled that revenue generated from renting rooms to persons other than students constitutes unrelated business taxable income.¹ The ruling is consistent with the IRS's recent focus on examining the trade or business-like activities of educational institutions and reevaluating whether such activities are substantially related to the educational activities of such institutions.

The ruling addressed revenue from providing temporary housing to students waiting for long-term dormitory assignments, and from providing rooms on an overnight basis to non-students, such as family members of students, potential students and their family members, and guest speakers.

After reiterating its longstanding position that revenue generated from providing living quarters to students does not constitute unrelated business taxable income, the IRS ruled that revenue generated from renting rooms to persons other than an institution's students constitutes unrelated business taxable income. The ruling revoked a 2006 ruling to the same institution that indicated

that temporary living quarters provided to family members of students and faculty, potential students and their family members, guest speakers, and musical performers did not constitute unrelated business taxable income (the 2011 ruling does not address faculty).

Generally, unless a specific exception applies, an educational institution's income from a commercial activity constitutes unrelated business taxable income if the income is from a trade or business type activity that is both (i) regularly carried on by the institution and (ii) not substantially related to the institution's educational activities. Although renting rooms is generally considered a trade or business activity, when the renters are students it is considered to be substantially related to an institution's educational activities. To the contrary, renting rooms to non-students in a manner similar to that of a commercial hotel is generally not considered to be substantially related to an institution's educational activities.

¹ Private Letter Ruling 201106019 (Feb. 11, 2011). Though private letter rulings generally may not be cited as precedent, they do provide an indication of the views of the IRS with respect to a particular area of the law. See I.R.C. § 6110(k)(3).



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In the present case, the building was operated in a manner similar to that of a boutique hotel. The availability of rooms was publicized on the institution's website and rooms were offered to the general public on a first-come-first-served basis. The ruling broadly stated that the renting of rooms to persons other than students constitutes unrelated business taxable income.

However, the ruling did not address factual circumstances outside of the scope of the commercial-like activities described in the ruling, such as the renting of rooms to non-students in an infrequent, non-commercial manner. Similarly, the ruling did not address room rentals arising through activities that are substantially related to educational purposes, such as the operation of a hotel as part of an educational institution's hotel management program.

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The IRS's position in the 2011 ruling, and its revocation of the 2006 ruling, demonstrate a narrowing view of the type of activities the IRS considers to be substantially and causally related to an institution's educational purposes. In addition, it is important to note that the 2011 ruling was published at a time when the IRS is strictly scrutinizing the commercial activities of educational institutions. This heightened scrutiny began in the fall of 2008 with the issuance of compliance questionnaires to hundreds of colleges and universities. The questionnaires focused on unrelated business income, endowments and executive compensation practices.

Questions or Assistance?

The members of our Colleges and Universities Client Team, as listed on page 1 of this alert, are available if you have any questions.



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