



Corporate Financial Services

Overview of University Tax Issues

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Corporate Financial Services

Course Objectives

- **To provide University personnel with an overview of the University's "major tax issues" to:**
 - ❑ Help you manage your department's tax compliance responsibilities – this course is not designed to make you a tax expert
 - ❑ Alert you to potential tax planning/saving opportunities to reduce your department's out-of-pocket "tax" costs and compliance burden
 - ❑ Minimize the University's overall tax liability



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Course Objectives

● **To summarize the University's:**

- Tax status and major tax exemptions
- Tax compliance obligations under existing tax laws and regulations (i.e., reporting, withholding, & documentation requirements)
- Tax-related policies, procedures, and resources
- Risks and adverse consequences for non-compliance with existing tax laws



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Agenda

- | | |
|-----------|--|
| 1:00-1:15 | University's Tax Status & Exemptions |
| 1:15-1:45 | Unrelated Business Income Tax |
| 1:45-2:15 | California Sales and Use Tax |
| 2:15-2:30 | Break |
| 2:30-2:45 | Classifying Service Payments |
| 2:45-3:15 | Payments to Non-Residents |
| 3:15-3:45 | Employee Fringe Benefits & Recruiting Incentives |
| 3:45-4:00 | Questions |



UC's Tax Status & Major Exemptions



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● **Federal Income Tax Status**

- ❑ IRS Determination Letter - UC's Federal Income Tax Status
- ❑ Dual status –
 - IRC § 115 Organization – State Agency
 - IRC § 501(c)(3) Organization – Educational Organization
- ❑ Exempt from paying Federal Income Tax
 - Exception – Unrelated Business Income Tax
- ❑ Exempt from filing Federal Income Tax Returns (Form 990)
 - Exception - Form 990-T, Unrelated Business Income Tax
- ❑ UCLA's Federal Tax Identification Number – 95-6006143
 - Other UCLA Tax Identification Numbers located in Accounting Manual T-182-735, Appendix D.



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● Federal Income Tax Status (cont.)

■ Handling Requests for UCLA's:

- 501(c)(3) Status – **IRS Determination Letter**
- Tax Returns (Form 990) – IRS Determination Letter (exempt from 990 filing requirement)
- UCLA's Tax Identification Number – **Form W-9 – Prepared Form on Tax website**

● State Income Tax Status

- **FTB Determination Letter** - UC's California Income Tax Status
- Exempt from paying California Income Tax
- Exempt from filing California Income Tax Returns (Including California 109)



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● Local (County and City) Taxes

- ❑ UC is constitutionally exempt
 - **Exception** – Unrelated Business Activities
- ❑ Exemption Includes:
 - Real & Personal Property Taxes
 - Business License Taxes & Registration
 - City Utility Taxes (Phone & Utility Bills)
 - Occupancy Taxes – (Depends on City)
 - Accounting Manual T-182-75, Exhibit A

● Federal Excise Taxes

- ❑ Several exemptions (including Telecommunications, FCET, and federal motor vehicle excise tax) – See Accounting Manual T-182-22



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Taxes Applicable to the University

1. **Unrelated Business Income Tax**
2. **Sales and Use Tax** – no institutional exemption
3. **Employment Taxes and Withholding**
 - ❑ Employee compensation & fringe benefits
 - ❑ Non-payroll payments to non-U.S. residents
 - ❑ Non-payroll payments to non-California residents

Note: The tax consequences of charitable contributions and various gifting techniques are generally handled by UCLA Foundation since they manage these transactions.



University Tax Reporting

● Major Tax Filings

- ❑ Annual Form 990-T, Unrelated Business Income Tax Return – consolidated filing for all UC activities
- ❑ Sales & Use Tax Returns
- ❑ Forms W-2 – Employee Wage & Tax Statement
- ❑ Forms 1042-S – U.S. Source Income of Foreign Persons
- ❑ Forms 1099 – Non-employee compensation
- ❑ Forms 1098-T – Tuition Payments Statement



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Unrelated Business Income Tax (UBIT)



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Unrelated Business Income Tax (UBIT)

- UBIT imposes corporate income tax – Graduated Rate on the income of Tax-Exempt Organizations conducting commercial type activities unrelated to their exempt purpose (*Unrelated Trade or Business*)
- UBIT enacted in 1950 to eliminate unfair competition by Tax-Exempt Organizations conducting commercial activities otherwise available by for-profit taxable businesses



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UBIT

- UBIT is only an issue where income is earned
- “Directly connected” expenses can offset taxable income
- Reasonable allocation required for dual-use expenses and facilities
- UCLA departments with an Unrelated Trade or Business will be required to:
 - provide annual financial information to Tax Services on the activity’s income and expenses for inclusion in UC’s Annual Consolidated Unrelated Business Income Tax Return, and
 - pay the tax due for their activity’s income



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General Rule

Income from an Unrelated Trade or Business is taxable unless it meets one of several specific exemptions



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● Unrelated Trade or Business

3 Requirements

- ❏ Trade or Business
- ❏ Regularly Carried On
- ❏ Not Substantially Related to University's Exempt Purposes
 - *education, research, patient care (Not public Service)*



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● Trade or Business

- ❑ An activity/service conducted for the production of income - **profit motive test**
- ❑ IRS position - consistent losses indicate lack of profit motive and therefore trade or business requirement not met



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● Not Substantially Related

- ❏ Requires analysis of relationship between activity generating the income and UC's exempt purposes
- ❏ Activity is "substantially related" only when it contributes importantly to the accomplishment of the organization's exempt purposes
- ❏ Use of funds for exempt purposes will not satisfy the relatedness test



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● Example - Not Substantially Related

■ PLR 9645004



- Amounts received by a university from **use of its golf course by alumni** results in UBI
- Use of the golf club by alumni does **not “contribute importantly” to university’s exempt purposes**
- No causal connection between alumni use of golf course and accomplishment of any exempt educational purpose



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● Regularly Carried On

- ❑ To be “regularly carried on” an activity must:
 - Show a “frequency and continuity” and
 - Be pursued in a manner similar to a comparable commercial business
 - Case by case analysis
- ❑ Intermittent, casual or sporadic activities are generally not regularly carried on



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● Regularly Carried On

- ❏ **Example:** The University operates a sandwich stand at a state fair for a two-week period. Taxable restaurants and other food service businesses are normally conducted on a year-round basis
- ❏ The sandwich stand is not a regularly carried on business activity



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● Regularly Carried On

- ❏ **Example:** The University owns a parking lot near the campus, which is used by students, faculty and employees during the week. The University permits members of the general public to use the parking lot on weekends for a parking fee comparable to nearby commercial parking lots
- ❏ The use of the parking lot by the general public is a regularly carried on business activity since it is operated on a year-round basis



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● Exceptions/Exclusions

- ❑ Convenience of Members - Faculty, Staff, Students & Patients
- ❑ Research - Excludes testing (e.g. testing of products for corporations)
- ❑ Real Estate Rents - Except if services are provided to occupant
- ❑ Donated Merchandise
- ❑ Volunteer Labor
- ❑ Passive Income - Dividends Interest, & Royalties
- ❑ Qualified Sponsorship Payments – not advertising



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● Convenience of Members

- ❏ Activities conducted primarily for convenience of Students, Staff, Faculty, Patients
 - E.g., bookstores, campus hotels & restaurants, vending operations, social facilities, parking lots
- ❏ Merchandise sold or services provided to the general public, alumni, non-UC organizations are possible candidates for Unrelated Business Income Tax
- ❏ Consider location & accessibility of like commercial merchandise or services



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● Research

- ❑ Conducted by a tax-exempt University, or
 - ❑ For any level of government, or
 - ❑ If results are made freely available to public
- **Not exempt research** - Commercial testing & inspection of products for commercial activities, e.g., quality control programs or ordinary testing for certification purposes as a final step before marketing



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● Real Property Rents (RP)

- ❑ Rents from Personal Property (PP) not excluded
- ❑ Mixed Leases – Real & PP
 - 10% or less PP – all rents excluded
 - 11% - 50% PP – RP rents excluded
 - 50% or more PP – none of the rents are excluded
- ❑ Routine services such as cleaning ok
- ❑ Parking fees from unrelated activities – not excluded as real property rents



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● Donated Goods Exception

- Income from sales of donated merchandise
- E.g., thrift shops

● Volunteer Labor Exception

- Income from activities where >85% of workers are uncompensated volunteers
- E.g., hospital gift shop run by volunteers



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● Passive Income - Dividends, Interest, Royalties

- ❑ E.g., income from investments, licensing rights for use of University's name, etc.
- ❑ Income not excluded if University provides services in connection with licensing/royalty agreement – no longer passive activity



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- ❑ Consider an arrangement between UCLA & AT&T where AT&T provides UCLA employees with calling cards and pays UCLA a percentage of all charges made on the cards. Under the arrangement UCLA provides AT&T with a list of employees and is required to update the list quarterly. UCLA also agrees to market AT&T calling cards through campus communication channels at UCLA's cost.
- ❑ **Problematic? Why?**



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● Qualified Sponsorship Payments

- ❑ Payments for which the sponsor will receive **no substantial service or benefit** from UCLA (**less than 2% of the payment**) – exempt
 - **Payment may not be contingent upon level of attendance, broadcast ratings, or other factors indicative of the level of public exposure
- ❑ Each benefit or service provided to sponsor must be valued at FMV
- ❑ **Non-Taxable Acknowledgements** – such as including sponsor's name, logo, address, telephone numbers in event materials – exempt
- ❑ **Taxable Acknowledgements & Advertising** - Information indicative of advertising such as qualitative or comparative language, price information, endorsements, call to action, inducement to buy - taxable
- ❑ Payment may be bifurcated between qualified sponsorship (exempt) and taxable acknowledgements & advertising



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● Potentially Taxable Activities

- ❑ Public use of facilities (if not related to education, research or patient care)
- ❑ Provision of goods/services to non-UC users & alumni
- ❑ Advertising
- ❑ Corporate sponsorship arrangements
- ❑ Licensing arrangements



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● Public Use of Facilities

- Recreational & parking facilities
- Other campus facilities - e.g., used for filming
- Alumni - Generally considered as members of the public



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● Provision of goods or services to non-UC members & alumni

- Sale of pharmaceuticals, lab services, and equipment to non-patients or unrelated entities
 - may include non-UC employed physician's private practice patients, other hospitals, other medical providers
- Certain clinical trials involving routine testing for commercial enterprises



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● Advertising

- ❏ Commercial advertising in University periodicals is taxable
- ❏ Exception: Related advertising
 - Advertising published in college newspaper as part of instructional program
 - Students actively involved in solicitation, sale and publication
- ❏ Know difference between advertising & non-taxable acknowledgements/sponsorships



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Corporate Sponsorship

- ❑ Contributions from corporate donors if they receive advertising in University publications
- ❑ Internet linkages from UCLA web sites to on-line stores of sponsors may cause a portion of contributions to be taxable

Licensing Arrangements

- ❑ For use of name, logos, endorsements, where UCLA provides services important to the success of the commercial arrangement



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● Minimizing Your Exposure

- ❏ Get Tax Services involved in the planning stages of new income generating activities and agreements that might give rise to UBIT
- ❏ Review existing income producing activities for UBIT exposure
- ❏ **Complete UC Non-Financial Questionnaire** (NFQ) for new or questionable activities
- ❏ Document facts and tax position - Be sure all forms documentation are consistent position taken
 - E.g., Third party agreements, fee structures, advertising and promotional materials



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Where To Go For Help

- Tax Services Web Site - <http://www.tax.ucla.edu>
 - **UBIT Guidelines & Non-Financial Questionnaire**
 - UC Business & Finance Bulletin A-61
- **UC Tax Status & Determination Guide**
- **UCLA Tax Contact**
 - Scott Monatlik smonatlik@finance.ucla.edu x 46724
 - Upma Budhraja ubudhraja@finance.ucla.edu x 49868



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Unrelated Business Income Tax Case Studies



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Case Study 1

- The UCLA Travel Center offers travel services, including tickets, hotel reservations, and rental cars, to students, faculty, staff and visitors. The visitors include recruitment candidates, speakers and honored guests. The services are available through other channels (such as commercial travel agencies), but the University can obtain special pricing. The Travel Center also helps travelers to deal with university travel policy and expense settlement. The Travel Center's services are for travelers on university business, not on personal or leisure trips.
- 1. Is the income of the UCLA Travel Center subject to UBIT? Why?**
 - 2. Would your answer change if the Travel Center expanded its services to include leisure travel programs for UCLA Alumni? Why?**



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Case Study 1 - Solution

- 1. Is the income of the UCLA Travel Center subject to UBIT?**
Why? No, the travel center is related to the exempt purposes of the University because it facilitates travel for University staff, faculty and visitors traveling on University business. Therefore it does not satisfy the "not substantially related" requirement" of a unrelated trade or business.
- 2. Would your answer change if the Travel Center expanded its services to include leisure travel programs for UCLA Alumni?**
Why? Yes, since leisure travel for Alumni is not a necessary aspect of operating a University (not substantially related), would be regularly carried on, and assumed to be a profit making activity, the provision of leisure travel services to Alumni would be subject to UBIT.



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Case Study 2

- UCLA Healthcare is looking for corporate sponsors to support a new Trauma Center at Westwood Hospital. Sponsors at the “gold level” would receive the following benefits in exchange for a \$50,000 sponsorship payment:
 1. Sponsors name, logo, address, phone and internet address on all promotional literature regarding the new trauma center
 2. Link on UCLA Healthcare’s home page to sponsor’s home web page or on-line store.
 3. 2 season basketball tickets (Valued at \$800)
 4. 1 page of space to use as the sponsor decides in all issues of UCLA Magazine for a year (Valued at \$5,000)
- **Is the \$50,000, or any portion of the payment subject to UBIT? Why?**



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Case Study 2 - Solution

1. Sponsors name, logo, address, phone and internet address on all promotional literature regarding the new trauma center (Exempt – Non-Taxable Acknowledgement – not a substantial return benefit)
2. Link on UCLA Healthcare’s home page to sponsor’s home web page or on-line store (Link to home page Exempt, link to on-line store looks more like advertising – value of such link may be considered taxable advertising subject to UBIT)
3. 2 season basketball tickets (Valued at \$800) (Exempt – UCLA Athletic ticket sales is related exempt purpose income)
4. 1 page of space to use as the sponsor decides in all issues of UCLA Magazine for a year (Valued at \$5,000) (Taxable Advertising – UCLA doesn’t limit content to Non-Taxable Acknowledgement)



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Case Study 3

- The UCLA Tiverton House is a 100-room hotel designed to meet the needs of UCLA Medical Center patients & families. Guests of the Tiverton House include current Medical Center patients, including those that require on-going outpatient services, family members of UCLA patients, and other visitors to the UCLA Campus such as recruitment candidates and speakers. While there are commercial hotels located near the campus such as the "W" or the Doubletree that provide similar services, the Tiverton House is able to offer UCLA visitors more affordable accommodations because of UCLA's tax-exempt status.
- 1. Is the income of the UCLA Tiverton House subject to UBIT? Why?**
 - 2. Would your answer change if the Tiverton House offered accommodations to the general public and those without a direct connection to UCLA programs? Why?**



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Case Study 3 Solution

- 1. Is the income of the UCLA Tiverton House subject to UBIT? Why?** No, the operation of the Tiverton House is substantially related to the exempt purposes of the University because it provides affordable and convenient accommodations to UCLA patients and their families during treatment which directly supports UCLA's healthcare programs. Providing affordable and convenient accommodations to other invited guests conducting University business is directly related to the accomplishment of the University's educational mission. Therefore income of the Tiverton House does not satisfy the "not substantially related" requirement" of a unrelated trade or business.

Income of the Tiverton House might also be excluded from UBIT under the "convenience exception" since it limits its services to UCLA patients, families and other University business invitees.



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Case Study 3 Solution (Cont.)

- 1. Would your answer change if the Tiverton House offered accommodations to the general public and those without a direct connection to UCLA programs? Why? Yes, since providing hotel accommodations to the general public is not a necessary aspect of operating a University (not substantially related), would be regularly carried on, and assumed to be a profit making activity, the provision of accommodations to the general public would be subject to UBIT even if the income was used to subsidize the costs of accommodations to UCLA patients and their families. The convenience exception would not apply to services provided to the general public.**



California Sales and Use Tax



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Current Environment

- **UC has no institutional exemption** from California Sales & Use Tax despite our status as a state agency.
- **California State Board of Equalization (SBE) administers the sales and use tax** – UCLA is routinely audited by the SBE and is currently under audit for the period 4/1/05 – 3/31/08
- **Difficult area of law** since rules are not often intuitive and full of exceptions
- **UCLA paid approximately 20 million** in Sales & Use Tax in FY 07/08



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Sales Tax

- Imposed on **retail sales** of **tangible personal property (TPP)** **in California**
- **Seller** responsible for collecting/remitting sales tax
- Tax is applied to the **sales price**



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When Sales Tax Applies - Generally applies when the University:

- **Sells TPP to persons other than UCLA departments or the Federal Government**
 - In general, tax does not apply to sales to UCLA departments or other UC campuses, since they are part of the same legal entity (you cannot sell to yourself)
 - However, if a department purchases an item for resale (i.e. no tax paid), and then sells that item to another department or UC campus for internal use, tax applies to the sales price
 - **UCLA has the legal liability** to collect the proper amount of sales tax and remit it to the SBE



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When Sales Tax Applies (Cont.) - Generally applies when the University:

- **Purchases TPP from California vendors**
 - **California vendors have the legal liability** for charging UCLA the proper amount of tax and remitting it to the SBE



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Use Tax

- Imposed on the storage, use, or consumption (in California) of tangible personal property (TPP)
- Purchaser is responsible for remitting use tax
- Tax is generally applied to the purchase price



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When Use Tax Applies - Generally applies when the University:

- **Purchases TPP from out-of-state vendors**
- **Uses TPP that was originally purchased (without tax) for the purpose of reselling it**
 - In both cases, UCLA is responsible for self-accruing the proper amount of California Use Tax and remitting it to the SBE



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General Rule

All sales or purchases of tangible personal property are subject to California Sales or Use Tax, *unless a specific exception applies and is documented*



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Major Exceptions

1. Items for Resale

- Items that are purchased without tax and later resold at retail
 - Eye-glass frames purchased by the Jules Stein Institute for sale to patients
 - Books purchased by the bookstore for sale to students
- **Includes property that becomes a component part of property later sold at retail**
- **Property used by UCLA instead of being resold is taxable when it is removed from resale inventory and consumed.**



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Major Exceptions

1. Items for Resale (Cont.)

- **Seller must obtain “Resale Certificate”**
- **6 items required for valid Resale Certificate**
 - Name & address of purchaser
 - Purchaser’s California Seller’s Permit Number
 - Description of the property to be purchased
 - Statement that property is being “purchased for resale”
 - Date
 - Signature of purchaser
- **Permit # alone is not enough**



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Major Exceptions

2. **Items Specifically Exempted** from California Sales & Use Tax
 - Services unrelated to the sale of TPP (e.g. repair and installation labor)
 - Medicines (e.g. prescription medicines and implants)
 - Canned software delivered electronically
 - Property purchased for federal contracts
 - must have title clause that property is owned by federal government
 - See "Common Sales and Use Tax Exemptions" handout



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➤ Major Exceptions

3. Out-of-State Sales

- Items sold to out of state purchasers
- Requires bills of lading/documentation to support that items were "shipped/delivered" to an out-of-state purchaser
- Items purchased from out of state vendors are subject to use tax if property is used in California



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Computer Software

- Software (canned) - purchases of canned (off the shelf) software including charges for license fees, site licensing, upgrades and other end user fees
 - TPP delivered – taxable
 - Delivered via "Load-n-Leave" – exempt
 - Delivered via telecommunication lines – exempt
 - See "Software License – CA Sale Tax Guide" hand-out

- Software (custom)
 - More than 50% custom – exempt
 - Less than 50% custom – partially exempt



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Software Maintenance Contracts

- Generally provide updates, corrections and support
- Software – canned (see "Software Maintenance – CA Sale Tax Guide" handout)
 - Mandatory
 - Taxable unless both the software and the maintenance are delivered electronically
 - Optional
 - With tangible property – 50% exempt
 - Without tangible property - 100% exempt
- Software – custom (more than 50% of the charges are for custom programming)
 - Maintenance is exempt



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UCLA Sales & Use Tax Rate

➤ State	7.00%
➤ County	.25%
➤ Local	<u>1.00%</u>
▪ Combined Statewide Rate	8.25% (a)
➤ District Tax (Los Angeles County)	<u>1.50%</u> (b)
➤ Total Combined Rate	<u>9.75%</u>

(a) The Combined Statewide Tax Rate (8.25%) applies to all sales or purchases in California

(b) District taxes vary from 0.00% to 2.00%. Generally, district taxes apply if the seller does business in the district where the TPP is first used. Otherwise, the Combined Statewide Tax Rate applies



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CA Sales & Use Tax Rates

- Tax rates vary among California locations because of District Taxes. District taxes are added to the Statewide Rate of 8.25% to get the Combined Tax Rates for various districts
- E.g., Combined Tax Rates for:
 - UCLA – Los Angeles County - **9.75%**
 - Lake Arrowhead – San Bernardino County – **8.75%**
 - UCI – Orange County – **8.75%**
 - UC Merced – Merced County – **8.25%** (no district taxes)
 - UCSF – San Francisco County – **9.50%**
- See SBE web site for listing of all districts tax rates at *www.boe.ca.gov*



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District Taxes - UCLA Sales Activities

- **Sell taxable TPP to purchaser in Los Angeles County**
 - Charge UCLA's tax rate - 9.75%

- **Sell taxable TPP to purchaser in another district within California:**
 - If UCLA doesn't have a business within the district
 - collect the combined Statewide rate of 8.25%
 - If UCLA does have a business within the district
 - collect the other district's combined Sales and Use Tax Rate



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District Taxes - UCLA Purchases

- **Purchase TPP from California vendor who is not required to collect LA County district tax and charges the 8.25% state-wide rate**
 - Accrue the 1.5% difference (9.75% minus 8.25%)
- **Purchase TPP at a lower district rate than the one imposed on the district of first functional use. For example, purchase TPP in Orange County, (e.g. delivered to UCI) but first use will be at UCLA**
 - The Orange County .5% district tax is lower than the 1.5% Los Angeles County district tax. Since the TPP's first functional use is in the Los Angeles District, accrue the 1.00% difference



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Why is Sales and Use Tax compliance important at the department level?

➤ **To minimize the department's total tax cost by:**

- Utilizing and documenting all available exemptions
- Avoiding sales & use tax audit assessments for non-compliance
- Reducing tax-related administrative burden



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Audits

- Generally occur **every three years** & cover a three year period – currently under audit for the period 4/1/05 – 3/31/08
- Typically result in both **assessments (for deficiencies)** and refunds (for overpayments)
- Assessments are problematic because they **come years after related funds are available**
- **Departments** may be held responsible for errors leading to deficiencies and may be held **financially responsible** for related assessments



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Sales & Use Tax Management Tips

- **Familiarize yourself with the general rules, as well as any special rules and exemptions applicable to your departments unique activities**, e.g. food services, library activities, patient hospitals, etc.
- **Identify tax implications in advance** – e.g., prior to beginning a new sales activity involving TPP or prior to purchasing an item of TPP
- **Implement internal controls** to monitor compliance and documentation
- **Know where to go for additional information** and ask for help before the sales or purchase transaction has been negotiated



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Where To Go For Help

- **Tax Services Web Site** - <http://www.tax.ucla.edu>
 - UC Sales & Use Tax Manual
 - UC AMC T-182-73
- **UCLA Tax Contacts**
 - Accounts Payable Transactions:
 - Campus – Renee Roth– rroth@finance.ucla.edu, x 48778
 - Med Center – Josue Gustilo – jgustilo@mednet.ucla.edu, x 43210
 - All other transactions:
 - Scott Monatlik – smonatlik@finance.ucla.edu, x 46724
 - Upma Budhraj – [ubudhraj@finance .ucla.edu](mailto:ubudhraj@finance.ucla.edu) x 49868
- **State Board of Equalization (SBE) Web Site**
 - <http://www.boe.ca.gov>



Sales & Use Tax Case Studies



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Case Study 1

UCLA Athletics purchased, for resale, 10,000 "Beat USC," "Trash the Trojans," and "USC Sucks" football pennants for the Big Game in Los Angeles. No tax was paid or accrued at the time the pennants were purchased by Athletics because UCLA issued a valid resale certificate to the vendor. The 10,000 pennants were sold as follows:

1. 7,000 are sold to Bruins' fans at the game.
2. 500 are sold via mail order to UCLA alumni living outside of California.
3. 400 were sold via mail order to UCLA alumni in Orange County.
4. 300 were sold to the Chancellor's office and paid for by departmental recharge.
5. 700 are given to Athletic Department staff and friends.
6. 100 are stolen by drunken USC fans at the game.
7. 1,000 pennants remain unsold at the end of the game. Athletics throws these away because the date makes them worthless.

Indicate if items 1-7 are subject to California Sales or Use Tax, and if so, at what rate of tax.



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Sales & Use Tax Case Study 1 - Solution

1. 7,000 are sold to Bruins' fans at the game. **(S/T – 9.75% - sale of taxable TPP in district UCLA does business in – subject to statewide rate plus district taxes for Los Angeles County)**
2. 500 are sold via mail order to UCLA alumni living outside of California. **(Exempt – Out-of-State Sales)**
3. 400 were sold via mail order to UCLA alumni in Orange County. **(S/T - 8.25% - no UCLA business activity in Orange County, no district tax applicable – only statewide rate applies)**
4. 300 were sold to the Chancellor's office and paid for by departmental recharge. **(U/T – 9.75% - items bought for resale ex-tax, later used instead of resold)**
5. 700 are given to Athletic Department staff and friends. **(U/T – 9.75%)**
6. 100 are stolen by drunken USC fans at the game. **(Exempt – no taxable sale or use)**
7. 1,000 pennants remain unsold at the end of the game. Athletics throws these away because the date makes them worthless. **(Exempt – no taxable sale or use)**



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Case Study 2

In 2005, UCLA Healthcare purchased 2 state of the art MRI (Magnetic Resonance Imaging) machines for \$200,000 each to use in hospital operations. Sales tax was paid to the vendor at the time of purchase. Due to recent technological advances, UCLA has decided to replace their existing MRI machines with 2 new ones.

When negotiating the purchase of the 2 new replacement MRI machines from the same California vendor, UCLA agrees to trade-in one of the old MRI machines for a credit of \$10,000 against the purchase price of the 2 new MRI machines, which is \$250,000 each (before the trade-in allowance). The other old MRI will be sold to a private physician in Los Angeles for \$5,000.

What are the Sales & Use Tax consequences of the above transaction?



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Sales & Use Tax Case Study 2 - Solution

➤ Purchase Transaction

Sales Price of New MRIs (\$250,000 each)	\$500,000
Sales Tax (9.75%)	<u>48,750</u>
Price before Trade-in Allowance	\$548,750
Less: Trade-in Allowance	<u>(10,000)</u>
UCLA's Out-of-Pocket Cost New MRI's	\$538,750

➤ Sales Transaction

Sales Price of Old MRI to LA Physician	\$5,000
Sales Tax (9.75%)	<u>488</u>
Total Due UCLA for Old MRI	\$5,488



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Classifying Service Payments

- Employees vs. Independent Contractors
- Compensation vs. Scholarship/Fellowships



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Why is Proper Classification Important?

- **Employers have a financial incentive to treat service providers (workers) as independent contractors or scholarship/fellowship recipients** because of reduced employment taxes, benefits costs, & administrative burden
- **IRS leans towards employee classification** because it means increased income and employment taxes to the taxing authorities
- Worker classification audits are common IRS targets because the **penalties for misclassifying workers are significant**
- **UC departments are financially liable** for misclassification errors relating to their department's workers
- **Non-tax costs** associated with misclassification can also be significant (e.g., retroactive retirement benefits for workers determined on audit to be employees)



Corporate Financial Services

● Tax Reporting & Withholding

■ Employees

- Compensation reported on Form W-2
- Wages subject to income tax and FICA withholding

■ Independent Contractors

- Payments of \$600 or more per year reported on Form 1099-MISC
- No federal income tax withholding required for U.S. residents
- No California income tax required for California residents
- No employment tax withholding required

**Special rules apply for non-residents – discussed later



Corporate Financial Services

● Tax Reporting & Withholding

■ Non-Compensatory Scholarship/Fellowship Recipients

- No income tax reporting by UCLA required for U.S. and California residents
- No federal income tax withholding required for U.S. residents
- No California income tax required for California residents
- No employment tax withholding required

**Special rules apply for non-residents – discussed later



Corporate Financial Services

Tax Costs of Misclassification

- Penalty for improper classification
 - ❏ If a Form 1099 was filed:
 - 1.5 % of wages
 - 20% of employees share of FICA
 - 100% of employer's share of FICA
- Penalty for failure to file returns and pay tax
 - ❏ Up to 25 % of taxes that should have been withheld/paid
- Penalty for willful failure to collect tax
 - ❏ 100% of the taxes if worker failed to pay income taxes



Corporate Financial Services

- Assume department misclassifies 5 workers each earning \$20,000 per year, 1099's were filed, audit conducted 2 years after returns filed
- Penalties
 - 1.5% of 100,000 \$1,500
 - 20% of Employee FICA
(20% * 7.65% * \$100,000) \$1,530
 - 100% of Employer FICA
(100% * 7.65% * 100,000) \$7,650
 - 25% failure to file return/pay tax \$25,000
 - Total Penalties \$35,680
- Interest
 - 7% * \$35,680 * 2 yrs \$4,995
- Total cost of misclassification \$40,676*

*** @ 41% of Compensation**



Corporate Financial Services

● Common IRS Targets

- ❏ Dual Status Workers
 - both independent contractor & employee for the same employer in same tax year
 - Both employee and non-compensatory scholarship/fellowship recipient in the same year
- ❏ Instructors/Teachers/Researchers
- ❏ Physicians/Hospital Workers
- ❏ Information Technology Workers



Corporate Financial Services

● Who are Employees?

- ❑ People who generally work for one employer at a time
- ❑ Hired to perform core University functions
- ❑ Often have on-going relationship with the University
- ❑ Subject to direction and control of another University employee and University policy
- ❑ University provides space & materials to perform their job
- ❑ Eligible for employee benefits such as health care insurance, retirements benefits, sick & vacation leaves, etc.



Corporate Financial Services

● Who are Independent Contractors?

- ❑ People in business for themselves who have clients other than the University
- ❑ Have financial investment & risk of loss for their business activities
- ❑ Hired to perform specific, often one-time tasks
 - Offer highly specialized services & expertise for a short period of time
 - Don't provide routine or core University services
- ❑ Individuals who can provide evidence of business licenses, business liability insurance, other business attributes



Corporate Financial Services

● University Policies

❏ **Business & Finance Bulletins:**

- BUS-77, Independent Contractor Guidelines
- BUS-34, Securing the Services of an Independent Consultant

❏ **Accounting Manual Chapter**

- AMC T-182-77, Taxation of Scholarship and Fellowship Grants and Educational Assistance

***All available on the Tax Services Web Page



Corporate Financial Services

● Legal Framework –Employees or I/C

- ❖ Degree of Control is important and is based on following 3 types of control.
- ❖ Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
- ❖ Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
- ❖ Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?
- ❖ **Key Concept - Control**
 - An employer-employee relationship exists when the employer has the right to direct and control the means and methods by which the worker accomplishes their work, and the overall results to be accomplished



Corporate Financial Services

- **Documentation - UC BUS-77 Pre-Hire Worksheet - being replaced by new worksheet (hopefully)**
 - ❑ Designed to help departments with proper worker classification and documentation of I/C status
 - ❑ No one factor is determinative
 - ❑ Factors are not weighted equally
 - ❑ All facts & circumstances will be weighed in the event of an audit



Corporate Financial Services

- Legal Framework – Compensation or Non-Compensatory Scholarship/Fellowship
- Accounting Manual T-182-77
 - ❑ IRC Code Section 117
 - Exempts “qualified scholarships or fellowships” from income – amounts received & expended for tuition, fees, books, & supplies required for attendance of student at academic institution
 - Amounts in excess (e.g., **room & board**) - **taxable**
 - ❑ Definition: A scholarship or fellowship is any amount paid to aid an individual pursue study or research



Corporate Financial Services

● Key Concepts—No Service Requirement

- ❏ A requirement to provide teaching, research, or other services as a condition of the fellowship shall cause some/all of the scholarship/fellowship to be taxable
- ❏ A requirement that the recipient pursue studies, research, or other activities primarily for the benefit of the grantor is treated as a requirement to perform services
- ❏ the fair market value of the services provided will be treated as employee compensation



Corporate Financial Services

Minimizing Your Exposure

- Understand the consequences of misclassifying workers
- Comply with UC policy on worker classification
- Properly document independent contractor and scholarship/fellowship relationships
 - ❑ Complete "**Independent Contractor Pre-Hire Worksheet**" if classifying worker as independent contractor
 - ❑ Be sure terms of fellowship, applications, award letters and other related documents don't require a service component
- Ask for advice when uncertain



Corporate Financial Services

Worker Classification Case Studies



Corporate Financial Services

Worker Classification - Case Study 1

- **Employee or I/C?** - The firm is a state university where the worker is a computer consultant. The work is performed both at the university and at the worker's business location pursuant to a written agreement. The worker was not given training, supervised or controlled, but he was provided with the data necessary for analysis and systems development. The worker provided his own equipment. Services were provided under the worker's business name. Similar services were provided by the worker for others. The worker represents himself to the public as being in the business of performing the same or similar services and advertises his availability to do so. Both the university and the worker retain the right to terminate services at any time. **PLR 9320036**



Corporate Financial Services

Compensation Vs. Scholarship - Case Study 2

- Susan Smith is pursuing a Master's degree at UCLA in Chemistry. The Chemistry department provides Susan with a stipend of \$15,000 per year to assist her with her educational pursuits. As one of the conditions of receiving the stipend, Susan is required to serve a year's term on the Chemistry Chair's Student Advisory Committee, which is comprised of 12 Chemistry student members and one member of the Chairs administrative staff. The committee meets for 3 hours weekly and is responsible for developing recommendations for the Chair, from the students perspective, on how to improve Chemistry's graduate program and better utilize certain financial resources. While it is rarely, if ever enforced, the Committee bylaws, which were approved by the Chair, states that a Committee member's stipend will be reduced in the event they have 2 unexcused absences from the committee meetings.
- **Is the \$15,000 payment to Susan a scholarship/fellowship payment or compensation for services?**



Corporate Financial Services

Case Study 2 - Solution

- The fair market value (FMV) of the services required to be performed as a condition of the fellowship needs to be determined and paid as employee compensation through the payroll system. The FMV is the amount that would be paid to a University employee for providing like services.
- The remainder of the fellowship can be paid out through the Student Billing & Receivable System (BAR) and taxed as a non-compensatory scholarship fellowship.
- Documents supporting the valuation of the compensation and the non-compensatory fellowship components should be retained in the department's files in the event the allocation is challenged on audit.



Corporate Financial Services

Payments to Federal and California Nonresidents



Corporate Financial Services

Scope

- Discussion pertains to non-employee payments through UCLA's Accounts Payable (A/P) or Student Billing and Accounts Receivable (BAR) systems to individuals that are:
 - U.S. Nonresident Aliens (NRA) for federal income tax purposes
 - California Nonresidents (NCR) for California income tax purposes
- Issues not covered
 - A/P payments to foreign entities
 - Employee payments through the Payroll System to NRA & NCR

****For additional information - Payroll offers excellent in-depth non-resident alien training class through Skillnet**



Corporate Financial Services

Federal Tax Withholding and Reporting Requirements for Payments to U.S. Nonresident Aliens (NRAs)



Corporate Financial Services

Type of Non-Employee Payment

- Payment for personal services
 - Guest speakers fees
 - Consultants fees
 - Performers fees
- Reimbursement for travel and subsistence expenses
- Scholarship and fellowship payments
- Other
 - Prizes and awards
 - Royalties
 - Human subject payments



Corporate Financial Services

Payee Immigration and Tax Residency Status

- Is the payee eligible for the payment under his or her visa status?
- Is the payee a resident alien or nonresident alien for tax purposes?
 - Tax reporting and withholding requirements for resident aliens and nonresident aliens are different
 - Tax residency for foreign students, independent contractors and other payees can be determined by using GLACIER, UCLA's nonresident alien tax compliance system
- For information on visa eligibility, tax residency and GLACIER, see the "Payments to Non-Citizens" section on the Payroll Services website *<http://map.ais.ucla.edu/go/1004187>*



Corporate Financial Services

Source of payment

- Nonresidents are taxed on U.S. source income. Income classified as “foreign source” is not subject to U.S reporting or withholding.
- Sourcing payments made to nonresident aliens:
 - Pay for **personal services** - sourced by where the services are performed
 - **Scholarships and fellowships**
 - If the educational activity is in the U.S., sourced by residence of payer
 - If the educational activity is outside the U.S. , considered foreign source
 - **Royalties** (e.g. use of books, plays and films), sourced by where the property is used
 - **Prizes and awards**, generally sourced by residence of the payer



Corporate Financial Services

Federal Tax Withholding and Reporting

General Rule : All payments of U.S. source income to a Nonresident Alien (NRA) are subject to federal income tax reporting and withholding at 30%, unless a specific exception or tax treaty provision applies and is documented.



Corporate Financial Services

Federal Tax Withholding and Reporting (Cont.)

General Rule: All U.S. source honoraria payments to a Nonresident Alien (NRA) on a B-1, B-2, WB or WT visa status must satisfy the following immigration requirements:

- Must be usual academic activity
- Not exceeding 9 days in duration at UCLA
- NRA hasn't received honoraria or travel expenses from more than 5 educational institutions in previous 6 month period



Corporate Financial Services

Exceptions:

- Travel Expense Reimbursements
- Foreign Source Income
- Payments Excluded from Income by a Tax Treaty
- Qualified Scholarship Payments



Corporate Financial Services

Travel Reimbursements

- Reporting & Withholding not required for University business expenses - if substantiated in accordance with UCLA Travel Policy
- SSN or ITIN not required
- Declaration of Immigration Status by Non-U.S. Citizens, required. See Travel website www.travel.ucla.edu
- Restrictions for foreign payees with B-2, WT visa status
 - Must be usual academic activity
 - Not exceeding 9 days in duration at UCLA
 - NRA hasn't received travel expenses from more than 5 educational institutions in previous 6 month period
 - Make sure Section E of the Declaration of Immigration Status by Non-U.S. Citizens is completed.



Corporate Financial Services

Foreign Source Income

- Foreign source income received by NRAs is exempt from U.S. income tax
- Examples of foreign source income:
 - Independent contractors – Income received by NRA independent contractors who perform all of their services outside the U.S.
 - Scholarship and fellowship recipients – Scholarship or fellowship income received by NRAs studying or performing independent research entirely outside the U.S.
- UCLA Foreign Source Income Statement is required. See the Tax Services website for the Statement and Department Guidelines.
 - *<http://www.tax.ucla.edu/Tax%20Forms%20and%20Publications.htm>*



Corporate Financial Services

Income Excluded by a Tax Treaty

- The U.S. has tax treaties with certain countries that allow NRAs to exclude certain types of U.S. income from U.S. tax withholding – *Determined by GLACIER and reviewed by Payroll Services*
- Payee must have U.S. Tax Identification Number to claim treaty exemption
- Income and treaty exemption must be reported by UCLA on an annual IRS Form 1042-S
- Independent Contractors apply for treaty exemption on IRS Form 8233 – *Generated by GLACIER*
- Students apply for treaty exemption on IRS Form W-8BEN – *Generated by GLACIER*



Corporate Financial Services

Qualified Scholarship Payments

- UCLA scholarship payments that are used for required course expenses such as tuition, books, & mandatory course supplies, are exempt from federal income tax withholding and reporting as “qualified scholarships” under IRS Section 117
- “Non-qualified scholarships” - amounts in excess of Sec 117 amounts (e.g., room & board) are subject to 30% federal income withholding and reporting for NRAs on Form 1042-S
 - **Exception - F, J M or Q visa holders are taxed at 14%**
 - **Tax rates determined by BAR Tax Module after students enter data in GLACIER to determine residency**
- To be eligible for exemption, Scholarships can not involve the provision of current, past, or future services by the scholarship recipient



Corporate Financial Services

Things to Remember

- **Special Restrictions** for honoraria & travel payments to NRA with **Visa Types B-1, B-2, WB, or WT**
 - Honoraria Payments – Set up in GLACIER no more than 1 month prior to visitor's arrival. Notify Mike Sattin and provide him copy of I-94
 - Travel Payments – Declaration of Immigration Status by Non-U.S. Citizens
- **Must have taxpayer identification number** (SSN or ITIN)
 - To be eligible for Tax Treaty benefits
 - UCLA Acceptance Agent Sandy Sabeti at Tax Services can assist with obtaining ITINs for individuals eligible for tax treaty benefits
- **Withhold at 30% and report unless tax treaty or specific exemption applies**
- **In advance of payment** – Communicate expected rates of withholding to payees so they know what their "net payment" will be to avoid misunderstandings and possible gross up costs



Corporate Financial Services

California Tax Withholding and Reporting Requirements for Payments to California Nonresidents



Corporate Financial Services

A/P Payments

General Rule

- All payments for non-employee services performed in California to a California nonresident are subject to California income tax reporting and withholding at 7% if annual payments exceed \$1,500.
 - Includes **independent contractor payments, honoraria & guest lecture fees, human subject payments**, etc.
 - Annual payments of \$1,500 or less are exempt from income tax & reporting.
 - Use **FTB Form 590** to determine California residency.



Corporate Financial Services

Scholarship/Fellowship Payments

General Rule

- Scholarship/fellowship payments to UCLA students & fellows studying or performing independent research at UCLA are exempt from California income tax withholding and reporting by UCLA.
- Recipients are responsible for reporting and paying any tax due on scholarship/fellowship payments received from UCLA with their individual state income tax returns even though no institutional tax reporting currently required by UCLA.



Corporate Financial Services

Where To Go For Help

- **Tax Services Web Site** - <http://www.tax.ucla.edu>
 - [UC AMC T-182-27](#), Federal Taxation of Aliens
 - [UC AMC D-371-77](#), State Tax Withholding from Nonwage Payments to Nonresidents of California
 - Payments to Non-Citizens – Payroll Services – www.payroll.ucla.edu
- **Training** - Non-Resident Alien Taxation series by Payroll Office
- **UCLA Tax Contacts**
 - Campus A/P issues – Renee Roth– rroth@finance.ucla.edu, x 48778
 - Scholarship/Fellowship payments processing– Ana Lebon – alebon@gdnet.ucla.edu, x 64309
 - Residency, treaty and scholarship / fellowship tax issues:
 - Gayelea Allison – gallison@finance.ucla.edu, x 48726
 - Michael Sattin – msatin@finance.ucla.edu, x75774
 - Heather Kira-Hoeke – hhoeke@finance.ucla.edu, x48730
 - Tax ID Numbers – Sandy Sabeti – ssabeti@finance.ucla.edu, x 40538
 - Other: Scott Monatlik – smonatlik@finance.ucla.edu, x 46724
Upma Budhraja – ubudhraja@finance.ucla.edu, x49868



Corporate Financial Services

Nonresident Taxation – Case Study

The Psychology Department invited a visiting professor from a German University to speak on the stress of student life. The professor entered the U.S. on B-2 visa and was expected to deliver two lectures during the course of one week at UCLA. The Department agreed to reimburse the professor for her actual travel expenses, in addition to paying her a \$2,000 honorarium.

- **Indicate the income tax reporting and withholding consequences of this payment arrangement.**
- **Would it matter if the professor were planning to work for UCLA for 2 weeks instead on 1? Explain.**



Corporate Financial Services

Case Study Solution

- **Indicate the income tax reporting and withholding consequences of this payment arrangement.**
 - Honoraria Payment
 - Federal income tax withholding at 30%, unless eligible for tax treaty and payee has U.S. Taxpayer Identification Number.
 - State income tax withholding at 7%.
 - Travel Reimbursement
 - Requires completion of UCLA Declaration of Immigration Status by Non-U.S. Citizens because B-2 visa status – 3 requirements must be met.
 - No federal or California income tax withholding or reporting required if substantiated through UCLA Travel.



Corporate Financial Services

Case Study Solution (Cont.)

- Net Honoraria Check:
 - Gross Payment \$2,000
 - Less FIT (30%) (600)
 - Less SIT (7%) (140)
 - Net \$1,260

- **Would it matter if the professor were planning to work at UCLA for 2 weeks instead on 1? Explain.** Yes, since professor's activities at UCLA will exceed 9 days, payment for honorarium can not be made under this arrangement.

- **Planning** – Have the professor come in on a J visa if stay must exceed 9 days.



Corporate Financial Services

Employee Fringe Benefits



Corporate Financial Services

General Rule

The fair market value of a fringe benefit must be included in an employee's income, unless excluded under a specific exception and the exception is documented.



Corporate Financial Services

Employee Fringe Benefits

- **Automobiles** - Personal use of a University-provided automobile is taxable
- **Housing** - Taxable unless employee is required to live on or near campus
- **Moving** - Moving of household items and travel to new location not taxable (meals are taxable)
- **Loans** - Forgone interest is taxable unless exempt loan



Corporate Financial Services

Employee Fringe Benefits

- **Discounts** - Up to 20% tax-free (e.g. sporting tickets, theater tickets)
- **Club Dues** - Personal use of a club is taxable, e.g., social, business, athletic, luncheon, sporting, hotel, airport, etc.
- **Educational Assistance** – Non-Taxable if:
 - Job Related
 - Undergraduate Course
 - Graduate Course - if RA or TA
 - Graduate Course – for staff, up to \$5,250 per year
 - Note: Taxable if for non-job related graduate level assistance in excess of \$5,250 per year.



Employee Fringe Benefits

Quick Reference Guide

- Use **UCLA Recruiting Incentives Summary** for UC policy and tax treatment of various recruiting incentives for UCLA Faculty and Senior Management.



Corporate Financial Services

Fringe Benefits – Case Study

- UCLA is recruiting a new Athletic Director. The successful candidate will receive the following items, in addition to his/her regular UCLA salary:
 1. A leased car for his wife provided by UCLA Transportation.
 2. A low-interest MOP loan for the purchase of a new home.
 3. Reimbursement of \$5,000 to complete the final semester of his masters degree in sports psychology.
- Indicate if items 1-3 are taxable and indicate the reason for any exemptions claimed.



Corporate Financial Services

Fringe Benefits – Case Study Solution

- ❏ Indicate if items 1-3 are taxable and indicate the reason for any exemptions claimed.
 - ⌘ A leased car for his wife provided by UCLA Transportation. (Taxable, no available exclusion, value of personal use of University resources is taxable)
 - ⌘ A low-interest MOP loan for the purchase of a new home. (Loans under authorized UC loan programs are allowable under UC policy, and bona fide loans are exempt from tax since they are required to be repaid and do not constitute income.)
 - Reimbursement of \$5,000 to complete the final semester of his masters degree in sports psychology (Exempt under UC's new Section 127 Plan– up to \$5,250 per year)



*Overview of University
Tax Issues*

Questions