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Southern Illinois University  
Office of Tax Compliance

A large, faded version of the Southern Illinois University seal is centered in the background. It contains the same text and imagery as the smaller logo in the top left.

Tax Guide  
for Academic and  
Administrative  
Departments

November 4, 2020

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## TABLE OF CONTENTS

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<b>PURPOSE OF THIS GUIDE</b> .....	<b>4</b>
<b>TAX-EXEMPT STATUS</b> .....	<b>5</b>
<b>UNRELATED BUSINESS INCOME TAX</b> .....	<b>6</b>
Overview .....	6
Common Exceptions to Unrelated Business Income.....	7
Common Activities that Raise UBIT Concerns for Universities.....	8
Rules for Certain Activities.....	9
Corporate Sponsorships.....	9
Rental Income .....	12
Sponsored Research .....	14
Royalties.....	15
Ownership of Equity by the University .....	17
Computing Net Unrelated Business Taxable Income .....	18
Filing Requirements and Rates .....	19
Department Responsibilities.....	19
Additional Resources .....	20
<b>SCHOLARSHIPS AND FELLOWSHIP GRANTS</b> .....	<b>21</b>
Tax Treatment.....	21
Definitions.....	21
Payment for Services not a Scholarship or Fellowship Grant.....	22
University Reporting Responsibilities .....	23
Department Responsibilities.....	24
Additional Resources .....	26
<b>EMPLOYEE AND INDEPENDENT CONTRACTOR CLASSIFICATIONS</b> .....	<b>27</b>
Overview .....	27
Classifications.....	27
Analysis .....	28
Additional Resources .....	29
<b>HONORARIUM PAYMENTS</b> .....	<b>30</b>
Honorary Payment or Wages .....	30
Assignment of Income .....	30
<b>HUMAN SUBJECT/PARTICIPANT PAYMENTS</b> .....	<b>31</b>
<b>ROYALTY PAYMENTS</b> .....	<b>32</b>
Royalties Paid to Faculty/Creators/Inventors.....	32
Royalties Paid by Issuance of Equity Shares .....	33
<b>FRINGE BENEFITS</b> .....	<b>34</b>
Overview .....	34
Employer-Provided Vehicles .....	34
Additional Resources .....	37
Employer-Provided Clothing or Clothing Allowance .....	38
<b>STUDENT FICA EXCEPTION</b> .....	<b>40</b>
Safe Harbor Guidelines .....	40
Treasury Regulations Test.....	43

<b>HOTEL OPERATOR’S OCCUPATION TAX</b> .....	<b>45</b>
Additional Resources .....	45
<b>SALES AND USE TAX</b> .....	<b>46</b>
Illinois .....	46
Additional Resources .....	51
Other States .....	51
<b>FORM AND INSTRUCTION APPENDIX</b> .....	<b>52</b>

# PURPOSE OF THIS GUIDE

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Revision Dates: July 21, 2014; January 7, 2013; February 19, 2010; August 6, 2008  
Creation Date: May 2, 2008

The Board of Trustees of Southern Illinois University (“University”) is committed to ensuring compliance with federal, state, and local tax laws. This guide is maintained by the Office of Tax Compliance and is intended as a general information reference tool to assist academic and administrative departments in complying with the tax laws. This guide does not address all of the tax matters relevant or potentially relevant to the University.

***Unless otherwise indicated, the tax laws contained in this guide are federal tax laws applicable to U.S. citizens, permanent residents, and resident aliens. Different U.S. tax laws apply to nonresident aliens. For additional information on payments made to or on the behalf of nonresident aliens, contact Kay Marrow at the SIUC [Center for International Education](#) or visit the [Payroll Office](#) website at SIUE.***

*Unless otherwise indicated, SIUC refers to the Carbondale campus and its schools within the Carbondale campus system. SIUE refers to the Edwardsville campus and its schools within the Edwardsville campus system.*

# TAX-EXEMPT STATUS

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Revision Dates: July 21, 2014; January 18, 2011; March 9, 2009; November 24, 2008; September 24, 2008  
Creation Date: May 2, 2008

The Board of Trustees of Southern Illinois University (“University”) is a body politic and corporate of the State of Illinois created by statute in 1869. The organizing statute is now codified under [The Southern Illinois University Management Act](#). Having been created directly by the State of Illinois legislature, typical corporate organizational documents, such as articles of incorporation, do not exist.

As an instrumentality of the State of Illinois, the IRS recognizes the University as exempt from federal income tax under Internal Revenue Code (IRC) § 115(1). The University’s [IRS Determination Letter](#) confirms the University’s tax-exempt status. In addition, the IRS has recognized the University, see [University’s Affirmation Letter](#), as exempt from federal income tax as an organization described in IRC § 501(c)(3) and as a public charity of the type described in IRC §§ 509(a)(1) and 170(b)(1)(A)(ii). The University’s income is also exempt from Illinois income tax. However, the University is subject to federal and Illinois income tax on any unrelated business taxable income it generates. See **UNRELATED BUSINESS INCOME TAX** for additional information. The University is also exempt from certain federal, state, and local taxes on goods and services purchased for its own use. See **SALES AND USE TAX** for additional information.

The University is not required to file **IRS FORM 990**. The filing requirements for **IRS FORM 990** do not apply to a state institution of which the income is excluded under IRC § 115.<sup>1</sup>

The University is one legal entity comprised of two operating institutions – Southern Illinois University Carbondale (SIUC) and Southern Illinois University Edwardsville (SIUE). The School of Medicine operates under the Carbondale Campus. As the Carbondale and Edwardsville campuses are component parts of the University, the IRS does not recognize them individually as tax exempt. Instead each campus is tax exempt under the University’s exemption. Should a campus need to prove exemption status, the [University’s Affirmation Letter](#) may be provided with the explanation that the campus or school is tax exempt as it is a component part of the University.

## *Effect on Agency Account and University Related Organizations*

Agency account organizations and University Related Organizations exist and operate independently from the University. Agency accounts are funds held by the University as custodian for certain student, faculty, and staff organizations. Agency account organizations and University Related Organizations, such as foundations, alumni associations, and the Illinois non-profit corporate outgrowths, are not authorized to use or rely on the University’s federal and state tax-exempt status and special exemptions.

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<sup>1</sup> Treas. Reg. § 1.6033-2(g)(1)(v), Rev. Proc. 95-48, 2006 Instructions for Form 990 and Form 990-EZ

# UNRELATED BUSINESS INCOME TAX

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Revision Dates: January 9, 2015; March 9, 2009; November 24, 2008; September 24, 2008  
Creation Date: May 2, 2008

## Overview

The University is subject to an income tax on its unrelated business income. This tax is referred to as the unrelated business income tax (UBIT).<sup>2</sup> To be considered unrelated business income, the activity producing the income must:

- be conducted as a trade or business;
- be regularly carried on; and
- not be substantially related to the accomplishment of a religious, charitable, scientific, literary, educational, or any other similar purpose or function.<sup>3</sup>

### Trade or Business

The term “trade or business” generally includes any activity carried on for the production of income from selling goods or performing services. An activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities that may, or may not, be related to the exempt purposes of the organization.<sup>4</sup>

Example. Soliciting, selling, and publishing commercial advertising is a trade or business even though the advertising is published in a university’s educational booklet.

In determining whether an activity is subject to the UBIT, one issue that sometimes comes into play is whether the university engaged in the activity with the intent to make a profit. If so, the activity is generally held to be a trade or business with any net income potentially subject to UBI tax. If the activity is not engaged in for profit, however, it is not a trade or business, and the university will not report the activity on its **IRS FORM 990-T** and Illinois **FORM IL-990-T**.

### Regularly Carried On

Business activities ordinarily are considered “regularly carried on” if they show a frequency and continuity and are pursued in a manner similar to comparable commercial activities of nonexempt organizations.<sup>5</sup>

Example. A university auxiliary’s operation of a sandwich stand for 2 weeks at a state fair would not be regularly carried on. However, operating a commercial parking lot every Saturday, year-round, would be regularly carried on.

### Not Substantially Related

An activity conducted by the University is “not substantially related” if it does not contribute

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<sup>2</sup> IRC § 511(a)(2)(B)

<sup>3</sup> IRC § 512(a)(1), IRC § 513(a)

<sup>4</sup> Treas. Reg. § 1.513-1(b)

<sup>5</sup> Treas. Reg. § 1.513-1(c)

importantly to the accomplishment of a religious, charitable, scientific, literary, educational, or any other similar purpose or function. An activity cannot qualify as substantially related solely because its income is needed or used to fund the conduct of an exempt function.<sup>6</sup>

Example 1. Use of a university-operated bowling alley by the general public and leasing rooms for wedding receptions conducted in a commercial manner does not contribute importantly to a religious, charitable, scientific, literary, educational, or any other similar operating purpose or function and is therefore “not substantially related”.

Example 2. If a university maintains a dairy herd for educational and research purposes, the sale of milk and cream produced in the ordinary operation of these activities is considered substantially related because the activity that produced them furthers an educational or scientific purpose. However, if the university were to use the milk and cream in the further manufacture of food items, such as ice cream, pastries, etc., the sale of these products is an unrelated trade or business.<sup>7</sup>

#### Common Exceptions to Unrelated Business Income

- Activity Staffed with Volunteer Labor<sup>8</sup>
- Activity Carried on for Students and Employees Convenience<sup>9</sup> (e.g., a university-operated housing dining facility for students and employees)
- Activity of Selling Donated Merchandise<sup>10</sup>
- Activity of Soliciting and Receiving “Qualified Sponsorship Payments”<sup>11</sup> (for additional information on “qualified sponsorship payments”, see **Corporate Sponsorships**)
- Dividend and Interest Income<sup>12</sup>
- Royalty Income<sup>13</sup>
- Rental Income from Real Property and Incidental Rental Income from Personal Property<sup>14</sup>
- Gains and Losses from Selling or Exchanging Property Other than Inventory<sup>15</sup>
- Certain Research Activity Income<sup>16</sup>

Special rules apply when income is received from an entity in which the University holds more than 50% of the voting power or value<sup>17</sup> or is derived from property acquired with borrowed funds.<sup>18</sup>

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<sup>6</sup> IRC § 513(a)

<sup>7</sup> Treas. Reg. § 1.513-1(d)(4)(ii)

<sup>8</sup> IRC § 513(a)(1)

<sup>9</sup> IRC § 513(a)(2)

<sup>10</sup> IRC § 513(a)(3)

<sup>11</sup> IRC § 513(i)(1)

<sup>12</sup> IRC § 512(b)(1)

<sup>13</sup> IRC § 512(b)(2)

<sup>14</sup> IRC § 512(b)(3)

<sup>15</sup> IRC § 512(b)(5)

<sup>16</sup> IRC § 512(b)(7-9)

<sup>17</sup> IRC § 512(b)(13)

<sup>18</sup> IRC § 512(b)(4)

Common Activities that Raise UBIT Concerns for Universities<sup>19</sup>

- Bookstore Operations
- Dormitory Rentals to General Public
- Advertising Income
- Corporate Sponsorships
- Hotel and Restaurant Operations
- Travel Tours
- Operation of Parking Lots
- Participation in Partnerships
- Professional Entertainment Events
- Use of Recreational Facilities by General Public
- Summer Sports Camps
- Publishing Activities
- Affinity Credit Cards
- Sale, Rental, or Exchange of Mailing Lists
- Concession Sales
- Catering Activities
- Treatment of Alumni
- Conferences, Meetings, and Training Programs
- Athletic Events/Television and Broadcast Rights
- Retirement Homes
- Intellectual Property Issues
- Internet Fundraising and Advertising Issues
- Ownership of S Corporation Stock
- Sale of Products Derived from Conduct of Related Activity
- Business Incubator Activities

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<sup>19</sup> Harding Jr., Bertrand M. (2008). *The Tax Law of Colleges and Universities*. (Third Edition). Hoboken, New Jersey: John Wiley & Sons, Inc.



## Rules for Certain Activities

### Corporate Sponsorships

#### Introduction

On April 25, 2002, the IRS published final regulations under IRC § 513(i) regarding the tax treatment of corporate sponsorship payments received by organizations, such as the University.<sup>20</sup> The final regulations apply to all payments solicited or received after December 31, 1997. One of the statutory exceptions under the UBIT rules is the activity of soliciting and receiving “qualified sponsorship payments”.

#### What is a “qualified sponsorship payment”?

A qualified sponsorship payment is any payment made by any person (“sponsor”) engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any “substantial return benefit” from the University. If the sponsorship payment is deemed to be a qualified sponsorship payment, the payment is not subject to the UBIT.

A qualified sponsorship payment does not include any payment contingent upon attendance level, broadcast ratings, or other factors indicating the degree of public exposure to one or more events. However, if the payment is contingent upon holding the event (regardless of how many people attend) or broadcasting (regardless of the number of listeners), the payment is not automatically disqualified from the definition of qualified sponsorship payment.

#### How is “payment” defined?

Payment means the payment of money, the transfer of property, or performance of services, including barter transactions (or “trade-outs”).

#### What is a “substantial return benefit”?

A substantial return benefit is any benefit received by the sponsor other than (1) the University’s “use or acknowledgement” of the name, logo, or product-lines of the sponsor’s trade or business, or (2) any goods or services that have an insubstantial value, and, therefore, qualify as “disregarded benefits”. Generally, if a substantial return benefit exists, there is potential unrelated business income.

Click [here](#) to view examples.

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<sup>20</sup> Treas. Reg. § 1.513-4

### How is “use and acknowledgement” defined?

Use and acknowledgement consist of:

- Logos and slogans that do not contain comparative or qualitative descriptions of the sponsor’s products, services, facilities, or company;
- A list of the sponsor’s locations, telephone numbers, or Internet address;
- Value-neutral descriptions, including displays or visual depictions, of the sponsor’s product-line or services;
- The sponsor’s brand or trade names and product or service listings; and
- Exclusive *sponsorship* arrangements.

Logos or slogans that are an established part of a sponsor’s identity are not considered to contain qualitative or comparative descriptions. Mere display or distribution, whether for free or remuneration, of a sponsor’s product by the sponsor or the University to the general public is not considered an inducement to purchase, sell, or use the sponsor’s product.

The final regulations apply to any communications medium in which an acknowledgement is transmitted. They affect print and Internet announcements as well as broadcast announcements.

### What are “disregarded benefits”?

Benefits with a minimal fair market value are considered disregarded benefits. The value is minimal if the aggregate fair market value of all benefits provided to the sponsor (other than “use or acknowledgement” benefits previously mentioned) in connection with the sponsorship arrangement during the University’s fiscal year is not greater than 2% of the sponsorship payment. If a sponsor receives a substantial return benefit, only the amount of the sponsorship payment exceeding the fair market value of the substantial return benefit is a qualified sponsorship payment, and the amount of the substantial return benefit may be subject to the UBIT.

Click [here](#) to view examples.

### How is the value of benefits determined?

Benefits are valued at fair market value. Fair market value is the price at which the benefits are provided under a standard arms-length transaction. **The University bears the burden of establishing the fair market value of benefits provided to a sponsor.** All benefits provided to a sponsor must be separately determined and separately valued.

The final regulations provide a strong incentive to maintain detailed records of the activities associated with sponsorship payments. If the University does not establish that the sponsorship payment exceeds the fair market value of any substantial return benefit, no part of the payment may be treated as a qualified sponsorship payment. Similarly, **if the University fails to determine a good faith valuation, the IRS may make the valuation.**

### When should benefits be valued?

For binding written contracts, the valuation date is the date the contract was entered into,

regardless of when the payment is made and benefits are received. Without a binding written contract, the valuation date is the date the benefits are received.

What are examples of benefits that may be provided to a sponsor that are subject to the 2% threshold?

Examples of benefits that may be provided to a sponsor that are subject to the 2% threshold include:

- Goods, facilities, services, or other privileges (e.g., complimentary tickets and parking, receptions and dinners for donors, etc.);
- Exclusive or nonexclusive rights to use an intangible asset (such as a trademark, patent, logo, or designation) of the University;
- Advertisements; and
- Exclusive *provider* arrangements.

How is “advertising” defined?

Advertising is any message or other programming material that is broadcast, or otherwise transmitted, published, displayed or distributed, and which promotes or markets any trade or business, or any service, facility, or product. Advertising includes messages containing comparative or qualitative language, price information, indications of savings or value (such as coupons), an endorsement, or an inducement to purchase, sell, or use any service, facility, or product. A single message that contains both advertising and an acknowledgement is advertising.

What is an “exclusive provider arrangement”?

An exclusive provider arrangement is one that limits the sale, distribution, availability, or use of competing products, services, or facilities in connection with a University activity, and is generally considered a substantial return benefit. In contrast, an arrangement that merely acknowledges the payor as the exclusive sponsor of a University activity does not, by itself, constitute a substantial return benefit.

Example. An agreement that committed a university, in exchange for a \$1 million contribution, to sell only Mountain Dew in the university vending machines would, in most circumstances, constitute a substantial return benefit; whereas, an agreement that committed a university, in exchange for a \$1 million contribution, to acknowledge Mountain Dew as the exclusive sponsor of the homecoming football game would not constitute a substantial return benefit.

The general rules under exclusivity arrangements apply to vendor contracts including those negotiated under a competitive bidding process. If the nature of the goods or services necessitates the use of only one provider because of limited space, or the competitive bidding process requires acceptance of only the lowest bid, then the University has not entered into an exclusive provider arrangement. Only if the University *agrees* to limit distribution of competing products would the sponsorship become an exclusive provider arrangement.

How are hyperlinks between the University and sponsor's website treated under the final regulations?

The final regulations use 2 examples to explain when a hyperlink constitutes an acknowledgement or an advertisement. In the first example, a tax-exempt organization merely posts a list of sponsors on its website and links to each sponsor's website. These links are considered acknowledgements. In the second example, a tax-exempt organization provides a link to the sponsor's website, which claims that the tax-exempt organization endorses the sponsor's products. If the endorsement was made with the tax-exempt organization's knowledge and permission, it is considered advertising and treated as a substantial return benefit.

Will you be entering into a corporate sponsorship agreement?

Before entering into a corporate sponsorship agreement with a business, departments should contact the Office of Tax Compliance for suggestions on how the University may be able to mitigate any potential adverse tax consequences.

Departments should also consult with the appropriate campus UBIT person listed below for assistance in determining what portion, if any, is subject to the UBIT.

SIUC  
Brian Kerley  
Accounting Services  
Mail Code 6812  
536-2623  
bkerley@siu.edu

SIUE  
Lea Tompkins  
Administrative Accounting  
RH 0110  
650-3276  
[ftompki@siue.edu](mailto:ftompki@siue.edu)

## Rental Income

Introduction

If the University receives rental income for the use of its space or property in connection with an activity substantially related to the University's exempt purpose, the income is not taxable.<sup>21</sup> To be substantially related, the activity must contribute importantly to the accomplishment of a religious, charitable, scientific, literary, educational, or any other similar purpose or function.<sup>22</sup> If the activity is not substantially related, it may still be excluded from the UBIT if it qualifies for the unrelated real property rental income exclusion.

Unrelated Real Property Rental Income Exclusion

Real property includes but is not limited to: facilities, buildings, rooms, land, or space. Generally, unrelated real property rental income may be exempt from the UBIT<sup>23</sup> if all of the following conditions are met:

- The rent is not calculated based on the tenant's net income;<sup>24</sup>

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<sup>21</sup>Treas. Reg. §1.513-1(d)

<sup>22</sup> IRC §513(a)

<sup>23</sup> IRC §512(b)(3)(A)(i)

<sup>24</sup> IRC §512(b)(3)(B)(ii)

- The leasing entity does provide services for the convenience of the tenant;<sup>25</sup> and
- No more than 50% of the rental payments are attributable to personal property leased together with the real property.<sup>26</sup>

#### Services Provided for the Convenience of the Tenant

The unrelated real property rental income exclusion does not allow the lessor to perform services for the lessee which are not necessary for occupancy but more for the convenience of the lessee. For instance, services necessary for occupancy such as heat, light, trash removal and cleaning of public areas generally will not spoil the tax-exempt treatment of the unrelated real property rental income. However, services provided for the convenience of the tenant including, but not limited to, catering, table service, maintenance, security, or linen service will generally cause the rental income to be subject to the UBIT.<sup>27</sup>

#### Personal Property Rental Income

Personal property generally includes, but is not limited to, equipment, furniture, clothing, or other tangible goods. As with real property rentals, if the personal property rental activity is substantially related to the University's exempt purpose, the income is not taxable. If the activity is not substantially related, the income is subject to the UBIT, unless the following two conditions are met:

- The personal property is leased together with real property and the real property rental income qualifies for the unrelated real property rental income exclusion described above; and
- The rent attributable to the personal property is no more than 10% of the total rent to be received.<sup>28</sup>

#### Unrelated Personal Property Rented together with Unrelated Real Property

As discussed above, subject to specific conditions, Congress has provided an exclusion from the UBIT for the rental income of unrelated real property and incidental unrelated personal property. However, if the rental of the unrelated personal property is more than 10% of the total rent, only a portion of the rental income is excluded from the UBIT.

- If no more than 10% of the total rent to be received is attributable to personal property, the rent attributable to the personal property is disregarded as incidental and the total rent is exempt from the UBIT.<sup>29</sup>
- If 10% to 50% of the rent to be received is attributable to personal property, the rent must be allocated between the real property and personal property. The portion attributable to real property is exempt from UBIT and the portion attributable to personal property is subject to the UBIT.

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<sup>25</sup> Treas. Reg. §1.512(b)-1(c)(5)

<sup>26</sup> IRC §512(b)(3)(B)(i)

<sup>27</sup> Treas. Reg. §1.512(b)-1(c)(5)

<sup>28</sup> IRC Sec. 512(b)(3)(A)(i) and (ii)

<sup>29</sup> Treas. Reg. §1.512(b)-1(c)(2)(ii)

- If the rent attributable to personal property exceeds 50%, all of the rent for both the real property and the personal property is subject to the UBIT.<sup>30</sup>

### Leased Not Licensed

For income generated from the use of University space or property to be denominated as “rent,” the property must be leased rather than licensed.<sup>31</sup> Otherwise, the income will not qualify for the unrelated real property rental income exception. A lease grants the tenant exclusive possession of the premises, while a license allows only general possession.<sup>32</sup>

## Sponsored Research

### Introduction

Congress has determined income from certain activities conducted by tax-exempt entities should not be subject to the UBIT even if the activity meets the three-part test used to identify unrelated business income. Two exceptions to the UBIT which apply to sponsored research activities are:

- Research conducted for the federal or any state government;<sup>33</sup> and
- Research performed by a university for any person.<sup>34</sup>

While these two exceptions are quite broad and appear to apply to all sponsored research activities conducted by the University, they only apply if the activity in question constitutes “research.” Thus, these two exceptions do not apply if the activity is treated as “testing” or otherwise incident to commercial operations.<sup>35</sup> Generally, the University will be exposed to UBIT on income derived from its sponsored research activities if those activities are deemed by the IRS to be “testing.”<sup>36</sup>

### What is “testing”?

The IRS has defined “ordinary testing” to mean “a standard procedure is used, no intellectual questions are posed, the work is routine and repetitive and the procedure is merely a matter of quality control.”<sup>37</sup> In another example, one court described “ordinary testing” as “generally repetitive work done by scientifically unsophisticated employees for the purpose of determining whether the item tested met certain specifications, as distinguished from testing done to validate a scientific hypothesis.”<sup>38</sup> Whether an activity is deemed to be testing will depend on all the facts and circumstances.

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<sup>30</sup> Treas. Reg. §1.512(b)-1(c)(2)(iii)

<sup>31</sup> Harding Jr., Bertrand M. (2014), *The Tax Law of Colleges and Universities*, (Fifth Edition). Alexandria, Virginia: Bertrand M. Harding, p. 32

<sup>32</sup> Priv. Ltr. Rul. 9740032

<sup>33</sup> IRC § 512(b)(7)

<sup>34</sup> IRC § 512(b)(8)

<sup>35</sup> Treas. Reg. § 1.512(b)-1(f)(4)

<sup>36</sup> Harding, Bertrand M., *Unrelated Business Income Tax Aspects of Southern Illinois University Sponsored Research Activities*.

<sup>37</sup> Gen. Couns. Mem. 39883

<sup>38</sup> *Midwest Research Institute v. U.S.*, 52 AFTR 2d 83-5419

### Clinical Testing of Drugs

The IRS has determined that the clinical testing of a drug for safety and efficacy in order to enable the manufacturer to meet FDA requirements for marketing is an activity ordinarily carried on as an incident to a pharmaceutical company's commercial operations. The fact that the testing must be done by highly qualified professionals does not change its basic nature. Such testing principally serves the private interest of the manufacturer rather than the public interest and income from the activity is generally subject to the UBIT.<sup>39</sup>

### Certain "for benefit" and "not for benefit" Testing of Drugs

In connection with drug testing under an agreement with a commercial drug company, the IRS has distinguished "for benefit" testing from "not for benefit" testing. In doing so, they determined that studies of a drug given to patients with the disease for which eventual commercial use of the drug is intended is "for benefit" testing and does not constitute an unrelated trade or business. "For benefit" testing serves patient care purposes and adds to the body of available scientific knowledge concerning drug use. Additionally, the testing in these instances has been less closely related to the manufacturer's obtaining FDA approval. Thus, such activity may not be subject to the UBIT. In contrast, "not for benefit" testing will almost always be treated as unrelated business income, subject to the UBIT.<sup>40</sup> Such studies are not related to the patients' care purposes and the private purposes outweigh the charitable purposes of the studies.

## **Royalties**

### Background

A royalty is a payment for the use of a valuable intangible property right. For the University, this may include payments received from a third party for the use of a number of different intangible property rights including payments for the use of trademarks, trade names, service marks, copyrights, patents, the right to sell goods or services on campus, the right to use mailing lists, and various other rights. Payments associated with the use of these rights are ordinarily classified as royalties.<sup>41</sup>

### Introduction

Royalties received by the University under intangible property licensure agreements generally meet the conditions of the three-part test used to identify unrelated business income. Royalties, however, are one of the types of income for which Congress provides an exception to the UBIT.<sup>42</sup> Thus, to the extent the payments are bona fide royalties, the exception will apply.

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<sup>39</sup> Rev. Rul. 68-373

<sup>40</sup> PLR 8230002

<sup>41</sup> Rev. Rul. 81-178

<sup>42</sup> IRC § 512(b)(2)

### *Bona Fide Royalties*

There are three factors that can preclude tax-free treatment of “royalty” payments received by the University in connection with its licensing agreements. The first is the provision of services by the University in connection with the revenue generating activities arising from a licensing agreement. Royalties do not include payments for services rendered by the owner of the intangible property.<sup>43</sup> Whether services are called for in the licensing agreement or provided outside of the responsibility to do so, the IRS will seek to re-characterize all or part of any payments which are attributable to services provided by the University as taxable services income.

The second factor is the existence of an agency relationship between the University and the licensee. This would arise if the University retains control over or restricts the revenue generating activities of a licensee with respect to the use of the intangible property.<sup>44</sup> If the IRS deems an agency relationship exists, the payments under the licensing agreement will be taxable as unrelated business income. However, the retention of quality control rights or controls to protect the University’s reputation will not suggest an agency relationship.<sup>45</sup>

The third factor that may preclude tax-free royalty treatment is the existence of a joint venture relationship between the University and a licensee. The IRS will scrutinize certain factors in the relationship between the parties to determine whether they have a joint venture intention, whether the payments to the University are based on net profits and losses of the venture, whether the venture maintained separate books of account, or whether the parties jointly managed the enterprise.<sup>46</sup> Facts and circumstances that indicate the existence of a joint venture will generally preclude tax-free treatment of payments made under the agreement.

### *Technology Transfer*

The University advances its research enterprise, in part, through the development and licensure of intangible property. This process transfers new technologies developed at the University into the marketplace. The tax treatment of consideration received by the University under its licensure agreements will depend on the character of what the University provides to the licensee in exchange for the consideration received under the agreement. The tax treatment of consideration received by the University is generally not changed by the form of the payment it receives from the licensee.<sup>47</sup> For example, if the University receives equity in addition to, or in lieu of, a cash royalty payment, the fair market value of all consideration received is treated the same as the receipt of cash. If consideration, in whatever form received, under a licensing agreement qualifies as a bona fide royalty within the meaning of the Internal Revenue Code,

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<sup>43</sup> Sierra Club Inc. v. Commissioner, 78 AFTR 2d 96-5005, 6/20/1996

<sup>44</sup> Harding Jr., Bertrand M. (2014), *The Tax Law of Colleges and Universities*, (Fifth Edition). Alexandria, Virginia: Bertrand M. Harding, p. 39-42

<sup>45</sup> Rev. Rul. 81-178

<sup>46</sup> Harding Jr., Bertrand M. (2014), *The Tax Law of Colleges and Universities*, (Fifth Edition). Alexandria, Virginia: Bertrand M. Harding, p. 38-39. Also see: *Sierra Club, Inc. v. Commissioner*, 103 TC 307

<sup>47</sup> IRC § 61



the income will not be subject to the UBIT.<sup>48</sup> However, the University may be subject to the UBIT on the income received through the equity interest. Please see the section “Ownership of Equity by the University” for more information.

## **Ownership of Equity by the University**

The ownership of equity in a public or private enterprise gives rise to various unrelated business income issues for the University depending on the organizational form and the activities of the enterprise.

### Partnerships

Partnerships (including Limited Liability Companies and Limited Liability Partnerships) are pass-through entities. Pass-through refers to the way income and expenses accrue to the owners. Generally, pass-through entities pay little or no income tax to taxing authorities directly because the income and expenses generated from the partnership flow through and are taxable to each partner.

For the University, a partnership interest will generate unrelated business income if the partnership's activity is not related to the University's exempt purpose.<sup>49</sup> The University must include its share of the partnership's income and expenses in the calculation of unrelated business taxable income subject to all the exceptions, additions, and limitations applicable to the University.<sup>50</sup> Therefore, if the partnership generates income that is normally tax-exempt when earned directly by the University, such as interest income, the University's share of the interest income earned by the partnership retains its character and remains tax-exempt for purposes of the University's tax return. On the other hand, if the partnership generates income taxable if earned directly by the University, it should be reported as unrelated business income. Partnerships are required to furnish their owners, an IRS Schedule K-1 with the information necessary to calculate unrelated business taxable income.<sup>51</sup>

Another item to consider regarding partnership interests is the University's 501(c)(3) tax-exempt status may be at risk when it enters into a partnership with a for-profit entity. One reason for this concern is a partnership, by definition, is engaged in an activity for the purpose of earning a profit, which is in direct conflict with the University being organized exclusively for an exempt purpose. Also, the University can be viewed as using its income and assets to benefit the for-profit partner in violation of the rules against benefiting private interests. Tax-exempt organizations have entered into partnerships with for-profit entities without losing their 501(c)(3) tax-exempt status by ensuring two conditions of the partnership: 1) the partnership is organized for and engages exclusively in 501(c)(3) activities and 2) the tax-

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<sup>48</sup> IRC § 512(b)(2)

<sup>49</sup> IRC § 512(c)(1)

<sup>50</sup> Treas. Reg. § 1.512(c)-1

<sup>51</sup> IRC § 6031(d)

exempt organization is in control of the partnership to ensure the partnership will always be operated for such purposes.<sup>52</sup>

### S Corporations

S corporations are also pass-through entities in which the income and expense items of the entity pass through to the shareholders for tax reporting. However, a 501(c)(3) organization's interest in an S corporation is treated as an interest in an unrelated trade or business.<sup>53</sup> Therefore, all items of income, loss, or deduction from the S corporation are taken into account for UBIT, as well as any gain or loss on the disposition of the S corporation stock.<sup>54</sup> None of the UBIT exceptions or exemptions otherwise available to the University may be used with an S corporation interest.

### C Corporations

Unlike partnerships and S corporations, C corporations pay taxes on income generated from their operations directly to the federal and state governments. Thus, the owners of C corporation stock do not report any of the corporation's income on their own income tax returns. If a C corporation chooses to distribute earnings and profits to its owners, the payment is generally taxable to the owner. For the University, however, and other exempt entities, Congress provides an exception to the UBIT imposed on dividend income to the extent the income is a dividend distributed from a C corporation.<sup>55</sup>

## **Computing Net Unrelated Business Taxable Income**

The UBIT is imposed on the University's unrelated business taxable income, which is defined as unrelated business income minus expenses directly connected with carrying on the activity producing the unrelated business income.<sup>56</sup> To be directly connected, deductions must bear a proximate and primary relationship to the conduct of the unrelated business activity.<sup>57</sup>

### Direct Expenses - Expenses Attributable Solely to Unrelated Business Activities<sup>58</sup>

Example. An employee of a university who devotes full-time to an unrelated business activity or an entire building used in the conduct of an unrelated business activity would be directly connected. The expenses that would be deductible would be the salaries and fringe benefits paid to the employee, as well as the costs attributable to the building (including depreciation).

### Indirect Expenses

If buildings, equipment (or other assets), and/or personnel are used both to carry on activities that are in furtherance of a religious, charitable, scientific, literary, educational, or any other

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<sup>52</sup> Rev. Rul. 98-15

<sup>53</sup> IRC § 512(e)(1)

<sup>54</sup> IRC § 512(e)(1)

<sup>55</sup> IRC § 512(b)(1)

<sup>56</sup> IRC § 512(a)(1)

<sup>57</sup> Treas. Reg. § 1.512(a)-1(a)

<sup>58</sup> Treas. Reg. § 1.512(a)-1(b)

similar purpose or function and to conduct an unrelated business activity, expenses attributable to the buildings, equipment (or other assets), and/or personnel must be allocated between the two uses on a reasonable basis.<sup>59</sup>

Example. A university regularly conducts activities that are in furtherance of an educational purpose in its auditorium as well as special events (e.g., concerts, movies, plays) for the general public that produce unrelated business income. The expenses attributable to the building and the employees must be allocated between the two uses on a reasonable basis:

The university conducted unrelated business activities 73 days in the auditorium last year. Expenses attributable to the auditorium include repairs & maintenance, utilities, and depreciation which total \$75,000. To determine the amount deductible, divide the number of days the auditorium was used for unrelated business activities (73) by the total days the building was available for use (365) and multiply that percentage by the total amount of expenses (\$75,000)<sup>60</sup>:

First Step:  $73/365 = 20\%$

Second Step:  $20\% \times \$75,000 = \$15,000$

If the university's employees devote 10% of their time to unrelated business activities, then a deduction of 10% of their salaries and fringe benefits is allowed.

## Filing Requirements and Rates

For each fiscal year, the University is required to file federal **IRS FORM 990-T** and Illinois **FORM IL-990-T** income tax returns to report net income (loss) earned from unrelated business activities subject to the UBIT by November 15<sup>th</sup> following the fiscal year ending June 30<sup>th</sup>.

For federal income tax purposes, net income subject to the UBIT is imposed at the current corporate tax rates. Effective January 1, 2018, UBI is subject to a flat tax rate of 21 percent.

For Illinois income tax purposes, net income subject to the UBIT is imposed at the current income tax rate of 7.0% plus replacement tax of 2.5%.

## Department Responsibilities

It is critical for departments to perform a methodical and comprehensive review of each income-producing activity it conducts. **Every income-producing activity must be analyzed to determine whether it is subject to the UBIT.** Departments should consult with its Campus Tax

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<sup>59</sup> Treas. Reg. § 1.512(a)-1(c)

<sup>60</sup> The denominator should be the total number of days the building is available for use during the year, not actual usage (see PLR s 9147008, 9149006, and 9324002, and GCM 39863).

Liaison. Departments may also complete the SIU Unrelated Business Income Questionnaire to assist in determining whether the activity's revenue is subject to the UBIT or not. The completed Questionnaire should be sent to the Campus Tax Liaison at the address provided below. The Campus Tax Liaison, in coordination with the Tax Compliance Office, will review the Questionnaire to determine if the revenue is subject to the UBIT or not.

If an income-producing activity is determined to be subject to the UBIT, the Campus Tax Liaison will instruct the department on the campus' reporting process and timelines.

#### Campus Tax Liaisons

SIUC  
Brian Kerley  
Accounting Services  
Mail Code 6812  
536-2623  
[bkerley@siu.edu](mailto:bkerley@siu.edu)

SIUE  
Lea Tompkins  
Administrative Accounting  
RH 0110  
650-3276  
[ftompki@siue.edu](mailto:ftompki@siue.edu)

#### **Additional Resources**

[SIU Unrelated Business Income Questionnaire](#)

Additional information is available in [IRS Publication 598, Tax on Unrelated Business Income of Exempt Organizations](#) and the **INSTRUCTIONS FOR FORM 990-T**.

# SCHOLARSHIPS AND FELLOWSHIP GRANTS

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Revision Dates: March 9, 2009; November 24, 2008; September 24, 2008; August 6, 2008  
Creation Date: May 2, 2008

## Overview

The Internal Revenue Code governs the manner in which scholarships and fellowship grants are taxed to the recipients and the University's reporting responsibilities with respect to scholarships and fellowship grants.

Students may receive financial support from the University for education or living expenses that departments may denominate as scholarships, fellowship grants, prizes, awards, stipends, allowances, assistantships, and traineeships. Financial support can come in the form of money or waivers/credits on the student account.

## Tax Treatment

Generally, a scholarship or fellowship grant is tax-free to the recipient only if:

- the recipient is a candidate for a degree at an eligible educational institution;<sup>61</sup> and
- the scholarship or fellowship grant is used to pay qualified tuition and related expenses.<sup>62</sup>

Qualified tuition and related expenses are:

- tuition and fees required for enrollment or attendance;<sup>63</sup> and
- fees, books, supplies, and equipment required for courses of instruction.<sup>64</sup>

Qualified expenses do not include the cost of:

- room and board;
- travel;
- research;
- clerical help; and
- equipment and other expenses that are not required for enrollment or attendance.<sup>65</sup>

## Definitions

### Scholarship and Fellowship Grant

A scholarship is generally an amount paid or allowed to, or for the benefit of, a student at an

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<sup>61</sup> IRC § 117(a)

<sup>62</sup> IRC § 117(b)(1)

<sup>63</sup> IRC § 117(b)(2)(A), Prop. Reg. § 1.117-6(c)(2)(i)

<sup>64</sup> IRC § 117(b)(2)(B), Prop. Reg. § 1.117-6(c)(2)(ii)

<sup>65</sup> Prop. Reg. § 1.117-6(c)(2)

educational institution to aid in the pursuit of studies. The student may be either an undergraduate or a graduate.<sup>66</sup>

A fellowship grant is generally an amount paid or allowed to, or for the benefit of, an individual to aid in the pursuit of study or research.<sup>67</sup>

### Prize and Award

These terms are not defined in the Internal Revenue Code. However, in basic terms, if the payment is based on a past achievement, it is generally considered a prize or an award. If a prize or award won by a student in a contest (e.g., writing contest) does not have to be used for educational expenses, it is not a scholarship or fellowship grant.<sup>68</sup> In such case, the entire amount of the prize is taxable<sup>69</sup> and subject to **IRS FORM 1099-MISC** reporting.<sup>70</sup> Prizes and awards related to employment services (e.g., “Student Employee of the Year”) are wages and reportable on **IRS FORM W-2**.<sup>71</sup>

### Stipend, Allowance, Assistantship, and Traineeship

These terms are not defined in the Internal Revenue Code. To be considered a scholarship or fellowship grant, any amount received need not be formally designated as a scholarship or fellowship grant. Departments should review the purpose of the payment and determine whether the payment will be processed as a scholarship or fellowship grant.

## **Payment for Services not a Scholarship or Fellowship Grant**

Generally, if an individual is required to perform past, present, or future teaching, research, or other services as a condition of receiving the scholarship or fellowship grant, that portion of any amount received that represents such payment for services is taxable as compensation for services rendered.<sup>72</sup> Thus, cash stipends for services aren’t excludible from income as a scholarship or fellowship grant even if the money is used to pay tuition.<sup>73</sup> Services in this context usually arise in one of two ways:

- the recipient either performs services for the educational institution as a condition of receiving the scholarship or fellowship grant; or
- the recipient is required to perform future services for the grantor in return for the educational assistance provided.<sup>74</sup>

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<sup>66</sup> Treas. Reg. § 1.117-3(a), Prop. Reg. § 1.117-6(c)(3)(i)

<sup>67</sup> Treas. Reg. § 1.117-3(c), Prop. Reg. § 1.117-6(c)(3)(i)

<sup>68</sup> *Taxable Income for Students*. Retrieved June 4, 2007, from: [www.irs.gov/individuals/students/article/0,,id=96674,00.html](http://www.irs.gov/individuals/students/article/0,,id=96674,00.html)

<sup>69</sup> *Taxable Income for Students*. Retrieved June 4, 2007, from: [www.irs.gov/individuals/students/article/0,,id=96674,00.html](http://www.irs.gov/individuals/students/article/0,,id=96674,00.html)

<sup>70</sup> *2007 Instructions for Form 1099-MISC*

<sup>71</sup> *2007 Instructions for Form 1099-MISC*

<sup>72</sup> IRC § 117(c)(1), Prop. Reg. § 1.117-6(d)(1)

<sup>73</sup> H Rept No. 99-426 (PL 99-514) p. 101

<sup>74</sup> Harding Jr., Bertrand M. (2008). *The Tax Law of Colleges and Universities*. (Third Edition). Hoboken, New Jersey: John Wiley & Sons, Inc.

Generally, bona-fide scholarships and fellowship grants are relatively disinterested, “no strings” educational grants, with no requirements of any substantial quid pro quo from the recipients.<sup>75</sup> Not all grants that are subject to conditions or limitations represent payment for services. The determination in each case depends on the particular facts and circumstances.<sup>76</sup>

Example 1. A receives a \$5,000 scholarship under a federal program requiring A’s future service as a federal employee. The scholarship represents payment for services. Thus, A would have to include \$5,000 in gross income as wages.<sup>77</sup>

Example 2. C is awarded a fellowship grant to pursue a research project the nature of which is determined by the grantor, University W. C must submit a paper to W that describes the research results. The paper does not fulfill any course requirements. Under the terms of the grant, W may publish C’s results, or otherwise use the results of C’s research. C is treated as performing services for W. Thus, C’s fellowship from W represents payment for services and must be included in C’s gross income as wages.<sup>78</sup>

*Note: Awards received for teaching, research, or other services under the National Health Service Corps Scholarship Program<sup>79</sup> or the F. Edward Hebert Armed Forces Health Professionals Scholarship and Financial Assistance Program<sup>80</sup> are exceptions to this rule.*

### Athletic Scholarships

Generally, the rules affect athletic scholarship payments in the same way they do other scholarship payments. However, participation in sports activities in relationship to an athletic scholarship is not compensatory for services under certain conditions.<sup>81</sup>

A scholarship awarded to a student who expects to participate in the university’s intercollegiate athletic program is not taxable as compensation for services rendered as long as the scholarship cannot be terminated for the following reasons:

- the student cannot participate in the athletic program due to injury
- the student’s unilateral decision not to participate

and the student is not required to engage in any other activity in lieu of participation in a sport.<sup>82</sup>

## **University Reporting Responsibilities**

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<sup>75</sup> Binger v. Johnson, Richard, (1969, S Ct) 23 AFTR 2d 69-1212, 394 US 741, 22 L Ed 2d 695, 69-1 USTC ¶ 9348

<sup>76</sup> IRS Letter Ruling 9526020, IRS Letter Ruling 199908041

<sup>77</sup> Prop. Reg. § 1.117-6(d)(5), Example (1)

<sup>78</sup> Prop. Reg. § 1.117-6(d)(5), Example (3)

<sup>79</sup> IRC § 117(c)(2)(A)

<sup>80</sup> IRC § 117(c)(2)(B)

<sup>81</sup> Harding Jr., Bertrand M. (2008), *The Tax Law of Colleges and Universities* (Third Edition), Hoboken, New Jersey: John Wiley & Sons, Inc.

<sup>82</sup> Rev. Rul. 77-263

Generally, the total amount of scholarships and fellowship grants administered and processed for students each calendar year by the University is reported to the IRS in Box 5 of **IRS FORM 1098-T**.<sup>83</sup> The University also furnishes a copy to the student recipient.

The University has no other reporting requirements with respect to scholarships and fellowship grants, even if the scholarship or fellowship grant is taxable to the recipient because the funds are used to pay for unqualified expenses.<sup>84</sup> The IRS recommends, however, that if the University is aware that some or the entire award is taxable, it so advise the recipient in writing.<sup>85</sup> Different reporting and withholding rules apply for scholarships and fellowship grants to nonresident aliens.

If some or entire amount of the financial support represents employee compensation for past, present, or future teaching, research, or other services as a condition of receiving the grant, such amount is compensation subject to employment tax withholding and reportable on **IRS FORM W-2**.<sup>86</sup> However, in rare cases (generally when the University does not have the right to direct and control how the work is to be performed), these services are independent contractor-type services with the payments treated as fees paid to an independent contractor and reportable on **IRS FORM 1099-NEC**.

## Department Responsibilities

It is imperative that the department administering the financial support determine the appropriate classification of the financial support for tax purposes. Proper classification is important because it directly affects the University's reporting responsibilities. Specifically, departments should determine:

- whether the financial support is a bona-fide scholarship or fellowship grant, or
- whether any portion of the financial support represents compensation for past, present, or future teaching, research, or other services.

Generally, if the primary purpose of the financial support is to further the education and training of the recipient in his or her individual capacity, it is a scholarship or fellowship grant. If, however, the purpose of the financial support provided is to primarily benefit the University (or other grantor), it is compensation for services. To assist in making this determination, departments should review the criteria listed in the chart<sup>87</sup> below and answer all the questions to determine the appropriate classification of the financial support. If uncertainty arises (i.e., it appears that the financial support can be classified as a scholarship or fellowship grant and compensation), departments should contact the Office of Tax Compliance for assistance.

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<sup>83</sup> IRC § 6050S(b)(2)(B)(ii), Notice 2006-72 (Q-8 & A-8)

<sup>84</sup> Treas. Reg. § 1.6041-3(n), IRS Notice 87-31, *2007 Instructions for Form 1099-MISC*

<sup>85</sup> IRS Notice 87-31

<sup>86</sup> Treas. Reg. § 1.6041-3(n), IRS Notice 87-31, *2007 Instructions for Form 1099-MISC*

<sup>87</sup> Portions of this chart retrieved December 5, 2007, from [http://www.controller.jhu.edu/depts/tax/fellgrad\\_admin.htm](http://www.controller.jhu.edu/depts/tax/fellgrad_admin.htm)



To view procedures on how to process financial support made to students, [see Guidelines for Payments Made to SIUC Students](#) for SIUC or see [Guidelines for Payments Made to SIUE Students](#) for SIUE.

(An "X" indicates classification for a "Yes" response.)	Scholarship/ Fellowship Grant	Compensation
<b>How closely is the job controlled?</b> 1. Does the University tell the recipient where, when (e.g., planned time schedules), and how to work?		X
2. Does the University have the right to exercise control or supervision over the sequence of work performed?		X
3. Is the recipient <b>only</b> required to submit progress reports?	X	
<b>Who determines the activities to be performed by the recipient?</b> 4. Does the recipient determine activities (e.g., choosing own subject to research) based on the terms of the scholarship or fellowship grant? (A faculty advisor may assist the recipient.)	X	
5. Does the University determine activities based on its needs (e.g., completing work on a University research grant or teaching a class?)		X
<b>Will benefits be obtained by the University or other grantor?</b> 6. Will the University benefit from any activities (e.g., teaching, research)?		X
7. Will the University or other grantor benefit from the results of the activities (e.g., will the University or other grantor have the right to use the research results or own patents or copyrights)?		X
8. Would an employee have to perform any of the activities of the recipient if the financial support had not been awarded?		X
9. Is the financial support made in consideration of past services or are		

future services to the University or other entity required?		X
<b>Selection for scholarship/fellowship grant:</b>		
10. Was the recipient selected on the basis of experience?		X
11. Was the recipient selected primarily to further education or training?	X	
12. Is the amount of the financial support based upon compensation of employees performing similar activities?		X
<b>Statutory exceptions:</b>		
13. Is this an award received for teaching, research, or other services under the <i>National Health Service Corps Scholarship Program</i> or the <i>F. Edward Hebert Armed Forces Health Professionals Scholarship and Financial Assistance Program</i> ?	X	
<b>IRS private ruling exception:</b>		
14. Is this an award received for teaching, research, or other services under the <i>National Research Service Act</i> sponsored by the NIH?	X	

## Additional Resources

Additional tax treatment information is available in [IRS Publication 970, Tax Benefits for Education](#) and IRS Tax [Topic 421 - Scholarship and Fellowship Grants](#).

# EMPLOYEE AND INDEPENDENT CONTRACTOR CLASSIFICATIONS

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Revision Date: September 14, 2020

Creation Date: November 6, 2013

## Overview

When a worker is hired to perform services for the University, it is imperative that the worker is correctly classified as either an employee or an independent contractor. Misclassification can result in the payment of related employment taxes, penalties and interest to the IRS.

The University has no withholding responsibility pertaining to the services performed by domestic independent contractors. However, if the University pays the individual \$600 or more during a calendar year for his or her services, the University must furnish the individual with an [IRS Form 1099-NEC](#) reporting in Box 1 the total payments made to the individual for his or her services during the year. The Form 1099-NEC must be furnished to the IRS as well as to the independent contractor no later than January 31<sup>st</sup> following the calendar year in which the services were rendered. The individual is responsible for the appropriate federal, state, and self-employment taxes.

The University's withholding and reporting requirements are different for the work completed by employees. For instance, the University is required to withhold, regularly report and remit federal, state, FICA (if applicable), and Medicare taxes for employees. These taxes and the employee's wages must be reported on IRS Form W-2 and furnished to the employee no later than January 31<sup>st</sup> following the calendar year in which the services are provided. The University must also furnish the Social Security Administration with the employee's Form W-2 by January 31<sup>st</sup>.

## Classifications

The IRS classifies workers into four (4) different categories:

- independent contractors
- common-law employees
- statutory employees
- statutory nonemployees.

Common-law rules usually determine if the service provider is an employee or an independent contractor based on the degree of control and independence of the service provider. However, some types of service providers are deemed to be employees or independent contractors by law, despite the applicable common-law rules of the situation. For instance, certain drivers who distribute specific products, full-time life insurance sales agents, and full-time traveling or city salespeople who meet three related conditions under the Social Security and Medicare taxes are required by law to be classified as employees, statutory employees. Likewise, the law

prescribes direct sellers, licensed real estate agents and certain companion sitters who meet specific conditions to be independent contractors, statutory nonemployees. As the University does not generally utilize any of these types of services, the statutory employee and nonemployee categories will not be further discussed.

The IRS generally classifies an independent contractor as a worker that performs services in which:<sup>88</sup>

- the employer controls the end result of the work; but not
- the means and methods of how the work is accomplished.

In contrast, the IRS generally classifies a common-law employee as a worker that performs services in which:<sup>88</sup>

- the employer controls the end result of the work; and
- the means and methods of how the work is accomplished.

## Analysis

The determination of employee or independent contractor is based on all of the facts and circumstances of the arrangement. Generally, no single factor will make the determination. Previously, the IRS set forth a comprehensive list of 20 Common Law Factors in Rev. Rul. 87-41 that had to be addressed when determining whether a worker was an employee or an independent contractor. More recently, however, the IRS has issued guidance governing the “degree of control” that an employer has over a worker to determine the worker’s status. According to the IRS, control falls into three categories: behavioral control, financial control, and the type of relationship of the parties.<sup>88</sup>

Behavioral control is determined by the facts that show whether the business has the right to direct or control how the worker does the task for which the individual was hired.<sup>88</sup> If the employer demonstrates this kind of control over the worker, an employee-employer relationship is likely indicated. The business does not have to exercise the right to direct or control the employee but merely has to possess the right to do so.

Examples of behavioral control include instructions or training given to a worker specifying:<sup>88</sup>

- when and where to do the work
- what tools or equipment to use
- what workers to hire or to assist with the work
- where to purchase supplies and services
- what work must be performed by a specific individual.

The second control analyzed when determining whether a worker is an employee or independent contractor is financial control. Financial control shows whether the hiring company has the right to control the economic aspects of the worker’s job.<sup>88</sup>

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<sup>88</sup> IRS Pub. 15-A, *Employer’s Supplemental Tax Guide*.

Examples of factors considered for financial control include: <sup>89</sup>

- extent to which the worker has unreimbursed business expenses
  - independent contractors usually have more unreimbursed business expenses than employees
- extent of the worker's investment
  - independent contractors usually have more invested financially than employees
- extent to which the worker makes his or her services available to the relevant market
  - independent contractors usually offer their services to the general public more than what an employee would
- how the business pays the worker
  - independent contractors are usually paid fixed dollar amounts for the completion of a job whereas employees are usually paid wages or salaries
- extent to which the worker can realize a profit or a loss
  - independent contractors may realize a profit or loss for services unlike employees who do not recognize a profit or loss on their wages.

The final control analyzed to determine whether a worker is an employee or an independent contractor is the type of relationship that is perceived by the employer and the service provider. The IRS has provided four categories of factors to consider when analyzing the perceived relationship.

The four categories include: <sup>89</sup>

- written contracts describing the relationship the parties intend to create
- whether or not the hiring company provides the worker with employee-type benefits (e.g. insurance, pension plans, vacation pay, or sick pay)
- permanency of the relationship
- extent to which services performed by the worker are a key aspect of the regular business of the hiring company

## **Additional Resources**

For additional information on Independent Contractors and Employees, see [IRS Publication 1779, \*Independent Contractor or Employee\*](#) or [IRS Publication 15-A, \*Employer's Supplemental Tax Guide\*](#).

Before payment is made to a service provider, the hiring department must determine if the service provider should be classified as an employee or independent contractor. Each campus utilizes its own method for determining this classification. Please contact the campus' Human Resources or Procurement Services departments for the applicable method.

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<sup>89</sup> IRS Pub. 15-A, *Employer's Supplemental Tax Guide*.

# HONORARIUM PAYMENTS

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Revision Date: September 14, 2020

Creation Date: May 25, 2016

## Overview

Generally, an honorarium is a one-time payment granted in recognition of a special service or distinguished achievement as a token of appreciation and for which custom or propriety precludes setting a fixed price. Activities in which an honorarium payment may be given include: a special lecture, participation in a workshop or panel discussion, or similar activities. Honorarium payments are considered taxable income to the payee and reportable on Form 1099-NEC, subject to the Form's \$600 threshold.<sup>90</sup> Before rendering payment to the individual, the campus may require the individual to provide a completed [Form W-9](#) confirming the individual's name and Taxpayer Identification Number to ensure the information reported to the IRS on the Form 1099-NEC is correct.

## Honorarium Payment or Wages

If the individual is making a significant contribution to a course or providing on-going services similar to that of an employee, an honorarium payment may not be appropriate as the individual may need to be paid as an employee. The University should review the information in this Tax Guide for Employee Classifications and complete the appropriate campus Independent Contractor Analysis Form to ensure the individual will be paid appropriately. If the payment to the individual should be wages but is incorrectly paid as honoraria, the IRS can assess taxes, penalties, and interest for the campus' failure to correctly withhold from and report the payment.

## Assignment of Income

Sometimes an individual does not want to receive the payment and requests the University (the payor) to give the money to another charitable entity. In such instances, the payment is still taxable and reportable to the individual, as a person cannot avoid tax by assigning his compensation to another individual.<sup>91</sup> This is the case even if the commitment to make the payment to the charity is made before the services are rendered.<sup>92</sup> However, if the services are performed directly and gratuitously for the University, and the University makes all the arrangements, the person performing the services does not have to include in his income the amounts the University receives.<sup>93</sup> Additionally, if the University contracts with the individual's employer for the individual to perform the service for the University, the payment is taxable and reportable to the employer.

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<sup>90</sup> Rev. Rul. 55-431

<sup>91</sup> T. J. PRIMM., 28 BTA 13

<sup>92</sup> Reg § 1.61-2(c)

<sup>93</sup> Rev. Rul. 68-503, 1968-2 CB 44

# HUMAN SUBJECT/PARTICIPANT PAYMENTS

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Creation Date: May 17, 2016

## Overview

SIU may conduct research projects in which it makes payments to human subjects/participants. Such payments may include, but are not limited to, cash or cash equivalents (e.g. gift cards). Payments to human subjects/participants are taxable income to the individuals and may not be excluded as compensation for physical injury or as gifts.<sup>94</sup> Generally, such payments should be reported as Other Income in Box 3 of the Form 1099-MISC, subject to the Form's \$600 threshold.<sup>95</sup> Before rendering payment to the participant, the campus may require the participant to provide a completed [Form W-9](#) confirming the participant's name and Taxpayer Identification Number to ensure the information reported to the IRS on the Form 1099-MISC is correct.

However, in certain circumstances the human subject/participant may be acting as an employee and should be paid as such. For instance, if the individual is performing services an employee normally provides for the University or is acting in a similar manner as an employee, the payment to the payee may need to be reported as wages on Form W-2 rather than as Other Income on Form 1099-MISC. The University should review the information in this Tax Guide for Employee Classifications and complete the appropriate campus Independent Contractor Analysis Form to ensure the appropriate payment and reporting method are utilized.

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<sup>94</sup> O'Connor v. Commissioner, T.C. Memo 2012-317

<sup>95</sup> IRS IMRS Document No. 0700000417

# ROYALTY PAYMENTS

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Revision Date: September 14, 2020

Creation Date: January 9, 2015

## Royalties Paid to Faculty/Creators/Inventors

The University may make payments to faculty and staff in consideration of the faculty or staff member's transferring to the University the patent rights to an invention the employee created during the course of his or her employment. Generally, if the faculty or staff transfers to the University "all substantial rights" in the patent, the payment for such transfer may be treated as nonemployee compensation reportable on Form 1099-NEC.<sup>96</sup> If the employee does not transfer "all substantial rights" in the patent, the payment will be considered additional employee compensation subject to withholding and reportable on Form W-2.

When determining whether the payment is for a bona fide transfer of rights, the first issue to consider is whether the employee was "hired to invent." If the employee was "hired to invent," the payment made to him is considered additional employee compensation since the payment is for services, not the invention. If the employee was not hired to invent, the determination of the payment will be based on all of the facts and circumstances of the case. The courts have determined the presence of certain factors indicate a payment made to an employee/inventor represents a royalty payment for a bona fide transfer of the employee/inventor's property rights in the invention rather than additional employee compensation. To the extent that a college's or university's policies reflect most or all of the following factors, a royalty payment made by the school to an employee/inventor, who was not "hired to invent," may be treated as a royalty payment for a bona fide transfer of the employee's property rights<sup>97</sup>:

- *Fixed royalty payment.* The University's policies and employment agreements should require the University to pay a royalty to the employee for the transferred rights to the invention. Also, the royalty should be paid at a specific rate with no opportunity for the University to later vary the amount of the royalty. The thinking of the court is if the employer retains discretion over whether or how much to pay the employee/inventor, then the payment by the employer can be more readily construed as compensatory in nature because the employer can base the amount of the payment on the quality of the employee's work or other employment-related criteria.
- *Royalty dependent on benefit to employer.* The amount of the royalty paid to the employee should depend on the extent of the use and income received by the University from the invention rather than constitute a lump-sum payment or other payment with no relationship to the benefit received by the University.
- *Continuation of royalty after termination or change in policy.* If the University retains the right to terminate or change its general policy for royalty payments to employees in

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<sup>96</sup> *Vision Information Services v. Commissioner*, 419 F.3d 554

<sup>97</sup> *Harding Jr., Bertrand M.* (2014), *The Tax Law of Colleges and Universities*, (Fifth Edition). Alexandria, Virginia: Bertrand M. Harding, p. 221



return for the transfer of invention rights, an employee whose right to receive royalties, which existed prior to such termination or change, should continue to receive his or her royalties under the original agreement.

- *Continuation of royalties after termination of employment or death.* The employee should continue to receive the royalty even after termination of his or her employment. Additionally, if the employee dies while receiving the royalty, the employee's heirs should continue to receive the payments.

## **Royalties Paid by Issuance of Equity Shares**

The University may receive shares of equity in the licensed company in addition to, or in lieu of, a cash royalty payment. Depending on the University's policies and employment agreements, the University may pay the employee/creator his or her royalty payment with the applicable percentage of equity shares in the licensed company. The payment of a royalty in equity shares creates issues for the University to address which do not arise when the royalty is paid in cash.

The first issue the University must consider is the constructive receipt doctrine. Under this principle, a person is taxed on income when she has the unqualified right to receive it and cannot avoid taxation by choosing not to take possession of the income.<sup>98</sup> Therefore, the University must determine when the employee has the unqualified right to receive the equity in order to report the payment in the correct year.

The next issue relates to the value of the equity to be reported as the royalty payment. Since the royalty payment in equity shares should be treated the same as a cash payment, the equity shares should be valued at their fair market value. However, the valuation date is not necessarily the date on which the inventor/creator physically takes possession of the shares. Generally, the valuation date will be the date the transferor delivers to the University or the University's agent the instructions, certificates, or other information necessary to affect the transfer of the shares to the transferees.<sup>99</sup> If the inventor/creator does not have an unqualified right to receive the equity shares until after this date, the valuation date will most likely be the same date as the constructive receipt date.

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<sup>98</sup> Rev. Rul. 60-31, 1960-1 C.B. 174

<sup>99</sup> 54 T.C. at 1640; Rev. Rul. 81-158

# FRINGE BENEFITS

Revision Dates: October 19, 2015; March 9, 2009; November 24, 2008  
Creation Date: September 24, 2008

## Overview

A fringe benefit is a form of compensation for the performance of services provided in the form of cash or a non-cash benefit to an employee in addition to regular pay.<sup>100</sup> Generally, when an employer provides a fringe benefit to an employee in connection with the performance of services, the fair market value is taxable to the employee<sup>101</sup> and included in the employee's gross income as wages subject to employment tax withholding and reportable on **IRS FORM W-2**.<sup>102</sup> However, several Internal Revenue Code provisions offer specific exclusions from income for certain fringe benefits provided by employers.

## Employer-Provided Vehicles

The University, Foundation, or third party may assign a vehicle to an employee for use in connection with his or her employment with the University. Such vehicles are referred to as employer-provided vehicles.

To the extent a University employee uses an employer-provided vehicle for employment-related duties and the business usage is properly substantiated, the value of the vehicle's use may be excludable from wages as a working condition fringe benefit.<sup>103</sup> However, vehicle use not substantiated by adequate records or sufficient corroborating evidence is considered personal use.<sup>104</sup> Personal use also includes any use while not carrying out University-related business. For instance, the employee's commuting from home to his work location is considered personal use. An employee's personal use of an employer-provided vehicle is considered a taxable fringe benefit and is included in the employee's wages.<sup>105</sup>

### Substantiation Requirements

The IRS requires adequate records or sufficient evidence to corroborate an employee's statement about the business use of employer-provided vehicles. If the employee keeps adequate records or sufficient evidence on which an employer can rely, the employer may exclude the fair market value of the business use of the vehicle and include only the fair market value of the personal use.<sup>106</sup> Employees must substantiate the following elements of each business use of an employer-provided vehicle: the date, the location, the number of miles driven, and the business purpose.<sup>107</sup>

<sup>100</sup> Treas. Reg. § 1.61-21(a)(1), IRS Pub. 15-B, *Employer's Tax Guide to Fringe Benefits*

<sup>101</sup> Treas. Reg. § 1.61-21(a)(3)

<sup>102</sup> Treas. Reg. § 1.61-21(a)(3-4)

<sup>103</sup> Treas. Reg. § 1.132-5(c)

<sup>104</sup> Treas. Reg. § 1.274-5T(3)

<sup>105</sup> Treas. Reg. § 1.61-21(a)(1)

<sup>106</sup> Treas. Reg. § 1.132-5(a),(c)

<sup>107</sup> IRC § 274(d)(4)

Employees may maintain mileage logs, account books, diaries, or similar records to substantiate business use. Employees may use [The Mileage Log Template](#) to record their business miles. The template may be modified as needed. Employees may also be able to record and substantiate their business miles by utilizing applications on their personal electronic devices.

The recording of the mileage must be made at or near the time of the use.<sup>108</sup> Although a contemporaneous mileage log or record (i.e., an entry made at the time the use occurs) is not required, the record must be made when the employee has the full present knowledge of each element of the use (date, location, mileage, business purpose).<sup>109</sup> A mileage log maintained on a weekly basis, which accounts for the use during the week, will generally be sufficient.<sup>110</sup>

Employees who are provided a vehicle by the University, the Foundation, or a third party are responsible for maintaining the mileage logs substantiating their business use of such vehicles. Such employees may be required to submit a [University-Provided Vehicle Fringe Benefit Valuation Statement](#) to the University providing the total miles, business miles, and personal miles driven throughout the reporting period. The University may use this statement to calculate the value of personal miles driven and includible in the employee's wages for the calendar year. The entire value of the use of the vehicle may be includible in the employee's wages for employees who do not timely submit the statement.

### Valuation Rules

Employers are allowed to calculate the value of the personal use of an employer-provided vehicle under the general valuation rule or one of three special automobile valuation rules.<sup>111</sup>

- Automobile Lease Valuation Rule
- Vehicle Cents-Per-Mile Valuation Rule
- Commuting Valuation Rule

The University uses the Automobile Lease Valuation Rule to calculate the value attributed to an employee's personal use of an employer-provided vehicle. This method takes into account the value of the vehicle, maintenance, and insurance provided but not fuel.<sup>112</sup>

### Reporting Period

As a matter of administrative convenience for employers, the IRS allows an optional special accounting period in which to report the value of certain non-cash fringe benefits provided to employees.<sup>113</sup> The University elects to use November 1 through October 31 as its accounting period to calculate the benefit received by employees for personal use of employer-provided vehicles.

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<sup>108</sup> Treas. Reg. § 1.274-5T(c)(2)(ii)

<sup>109</sup> Treas. Reg. § 1.274-5T(c)(2)(ii)(A)

<sup>110</sup> Treas. Reg. § 1.274-5T(c)(2)(ii)(A)

<sup>111</sup> Treas. Reg. § 1.61-21(b)(4)

<sup>112</sup> Treas. Reg. § 1.61-21(d)(3)

<sup>113</sup> Ann. 85-113

### Withholding

Employers have the option not to withhold income taxes on the value attributed to an employee's personal use of an employer-provided vehicle.<sup>114</sup> However, this amount is subject to Medicare tax withholding, if applicable.

### Exceptions to Substantiating and Reporting Requirements

The Treasury has provided exceptions to the substantiating and reporting requirements for certain vehicles prohibited from any personal use or of a nature (design) not likely to be used more than a de minimis amount for personal use.

#### Vehicles Only for Business Use

There is an exception from the substantiating and reporting requirements for vehicles for which the employer prohibits any personal use by the employee.<sup>115</sup> The prohibition must be in a written policy statement.<sup>116</sup> For the exception to apply, all of the following conditions must be met:

- 1) The vehicle is owned or leased by the employer and is provided to one or more employees for use in connection with the employer's trade or business,
- 2) When the vehicle is not used in the employer's trade or business, it is kept on the employer's business premises, unless it is temporarily located elsewhere, for example, for maintenance or because of a mechanical failure,
- 3) No employee using the vehicle lives at the employer's business premises,
- 4) Under a written policy of the employer, neither an employee, nor any individual whose use would be taxable to the employee, may use the vehicle for personal purposes, except for de minimis personal use (such as a stop for lunch between two business deliveries), and
- 5) The employer reasonably believes that, except for de minimis use, neither the employee, nor any individual whose use would be taxable to the employee, uses the vehicle for any personal purpose.<sup>117</sup>

The employer must also be able to demonstrate the use of the vehicle meets the five conditions listed above.<sup>118</sup>

#### Qualified Non-personal Use Vehicles

An exception is also available for qualified non-personal use vehicles as long as the use of the vehicle conforms to specific requirements.<sup>119</sup> Both marked and unmarked police vehicles may qualify for the exclusion.

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<sup>114</sup> IRC § 3402(s)(1)

<sup>115</sup> Treas. Reg. § 1.274-6T(a)(2)

<sup>116</sup> Treas. Reg. § 1.274-6T(a)

<sup>117</sup> Treas. Reg. § 1.274-6T(a)(2)(i)

<sup>118</sup> Treas. Reg. § 1.274-6T(a)(2)(i)

<sup>119</sup> Treas. Reg. § 1.132-5(h)(1)

For the use of a marked police vehicle to qualify for the exception, the vehicle must be owned or leased by the governmental unit, or any agency or instrumentality thereof, and the officer must be required to use the vehicle for commuting because the officer is on call at all times.<sup>120</sup> Additionally, any personal use (other than commuting) of the vehicle outside the limit of the officer's arrest powers must be prohibited by such governmental unit.<sup>121</sup> To be considered clearly marked, it must be readily apparent, through painted insignia or words, the vehicle is a police vehicle.<sup>122</sup> A marking on a license plate is not a clear marking.<sup>123</sup>

An exception is also available for a law enforcement officer's officially authorized use of an unmarked vehicle.<sup>124</sup> To qualify for this exception, any personal use must be officially authorized by the governmental agency or department owning or leasing the vehicle and employing the officer.<sup>125</sup> Additionally, any such personal use must be incident to law-enforcement functions, such as being able to report directly from home to an emergency situation or crime site.<sup>126</sup>

A law enforcement officer is an individual who is employed on a full-time basis by a governmental unit responsible for the prevention or investigation of crime involving injury to persons or property (including apprehension or detention of persons for such crimes), who is authorized by law to carry firearms, execute search warrants, and to make arrests (other than merely a citizen's arrest), and who regularly carries firearms (except when it is not possible to do so because of the requirements of undercover work).<sup>127</sup>

## Additional Resources

Additional information is available in [IRS Publication 15-B, Employer's Tax Guide To Fringe Benefits](#).

The University's [Vehicle Use Policy](#) is located on the [CMS website](#) pursuant to the [State Vehicle Use Act](#).

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<sup>120</sup> Treas. Reg. § 1.274-5(k)(3)

<sup>121</sup> Treas. Reg. § 1.274-5(k)(3)

<sup>122</sup> Treas. Reg. § 1.274-5(k)(3)

<sup>123</sup> Treas. Reg. § 1.274-5(k)(3)

<sup>124</sup> Treas. Reg. § 1.274-5(k)(6)(i)

<sup>125</sup> Treas. Reg. § 1.274-5(k)(6)(i)

<sup>126</sup> Treas. Reg. § 1.274-5(k)(6)(i)

<sup>127</sup> Treas. Reg. § 1.274-5(k)(6)(ii)

# EMPLOYER-PROVIDED CLOTHING OR CLOTHING ALLOWANCE

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Creation Date: February 2020

The University may provide clothing, or a clothing allowance, to certain employees. The value of the clothing, or the clothing allowance, provided to employees should be considered taxable income to the employee unless a specific Internal Revenue Code exclusion applies.

## Exclusion from Gross Income

Employer provided clothing may be excluded from gross income under certain circumstances. The following may be used as a basis for determining whether employer provided clothing may be excluded from gross income:

- De Minimis Benefit
- Working Condition Fringe Benefit

## De Minimis Benefits Exclusion

The term “de minimis fringe” means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.<sup>128</sup>

Three provisions must be considered when determining whether providing clothing to employees qualifies as de minimis:

### 1) **Accounting for it Would be Unreasonable or Administratively Impracticable**

Whether or not the department is tracking who receives the provided clothing should be considered. If a department is keeping track of which employees receive the clothing it would be difficult to argue that accounting for it is impracticable. If, however, clothing of various sizes are placed on a table in the general office area and employees are allowed to pick one up, this could qualify as a nontaxable provision of clothing.

### 2) **Value of Clothing**

The IRS has previously ruled that items with a value exceeding \$100 could not be considered de minimis. This threshold should be used as gauge for determining whether the provided clothing qualifies for de minimis treatment.

### 3) **Frequency**

Frequency is not a term that has been defined by the IRS. The section on De Minimis in IRS [Publication 15-B](#) provides some examples that may be used as a guide in making a determination on how to define frequency.

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<sup>128</sup> IRC §132(e)

Cash and cash equivalent fringe benefits, no matter how little, are never excludable as a de minimis benefit.<sup>129</sup> Therefore, clothing allowances provided in the form of cash or cash equivalents cannot be excluded from tax as a de minimis benefit.

### Working Condition Fringe Benefit Exclusion

Clothing, or a clothing allowance, may be provided by an employer to an employee on a tax-free basis if it meets the working condition fringe benefit requirements.

When considering whether employer provided clothing, or a clothing allowance, meets the working condition fringe benefit requirements, the following two conditions must be met:

1. The clothing is specifically required as a condition of employment.
2. The clothing is not suitable for everyday wear.

It is not enough that the employee wear distinctive clothing; the employer must specifically require the clothing as a working condition. Nor is the test met because the employee does not, in fact, wear the clothes away from work. The clothing must not be suitable for taking the place of regular clothing. For example, if the employer provides a polo shirt emblazoned with the organization's logo, this would be considered suitable for everyday wear; even if the employee would not choose to wear it in place of regular clothing. Protective clothing such as safety boots, safety glasses, hard hats and work gloves are not considered to be suitable for general wear by the IRS.<sup>130</sup>

Per Revenue Ruling 70-474, the cost of uniforms in the case of police officers, firemen, letter carriers, nurses, etc. who are required to wear distinctive types of uniforms while at work and which are not suitable for ordinary wear are deductible.

If a cash payment provided for a clothing allowance qualifies as a working condition fringe benefit, the employee must meet any substantiation requirements that apply to the deduction. An employee must be required to verify that they payment is actually used for qualifying clothing expenses and return any unused portion of the payment.

## **Additional Resources**

Additional information is available in [IRS Publication 15-B, Employer's Tax Guide To Fringe Benefits](#).

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<sup>129</sup> IRS Publication 15-B (2018)

<sup>130</sup> IRS Quick Reference Guide for Employers

# STUDENT FICA EXCEPTION

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Creation Date: February 24, 2016

## Overview

The Federal Insurance Contributions Act (FICA) is composed of two taxes: Social Security tax and Medicare tax. Generally, the employer and employee are each responsible for half of the FICA tax assessed on the employee's wages. However, the Internal Revenue Code provides specific exceptions to the tax for certain types of services.<sup>131</sup> One such exception applicable to the University is the Student FICA Exception. This exception is for services performed in the employ of a school, college, or university, or an affiliated § 509(a)(3) organization if such services are performed by a student who is enrolled and regularly attending classes at such school, college, or university.

The IRS has established a set of safe harbor guidelines typically used to determine if the employee qualifies for the student FICA exception.<sup>132</sup> If an employee fails to meet the requirements of the safe harbor, the employee may still qualify for the student FICA Exception using the facts and circumstances test. However, establishing qualification under the facts and circumstances test may be an uphill battle as the IRS generally gives substantial weight to safe harbors and only rarely will conclude a facts and circumstances test is met when the safe harbor is not.<sup>133</sup>

## Safe Harbor Guidelines

The safe harbor guidelines provide clear, definitive requirements for determining if an employee who is enrolled and regularly attending classes at the university qualifies for the student FICA exception. If all the requirements are met, the employee qualifies for the exception.

The safe harbor requirements are as follows:

### Half-Time Requirement

The employee must be enrolled at least on a half-time basis as an undergraduate, graduate, or professional student.<sup>134</sup> The half-time undergraduate status is defined by the Department of Education regulation at 34 CFR § 674.2.<sup>135</sup> The half-time graduate or professional student status is defined as an enrolled graduate or professional student who is carrying at least a half-time academic workload as determined by the institution under its standards and practices.<sup>136</sup>

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<sup>131</sup> IRC §3121(b)

<sup>132</sup> Rev. Proc. 2005-11

<sup>133</sup> Harding Jr., Bertrand M. (2014), *The Tax Law of Colleges and Universities*, (Fifth Edition). Alexandria, Virginia: Bertrand M. Harding, p. 196

<sup>134</sup> Rev. Proc. 2005-11, §7.01

<sup>135</sup> Rev. Proc. 2005-11, §8.02

<sup>136</sup> Rev. Proc. 2005-11, §8.04



In a student's last semester of a course study, the student will be considered half-time, even if the individual is enrolled in less than half the number of credit hours required of full-time students, if the student is enrolled in the number of credit hours needed to complete the requirements for obtaining a degree, certificate, or other recognized educational credential offered by the institution. Such degree, certificate, or other credential must require at least two semesters to complete.<sup>137</sup>

The determination of the student's enrollment status should be made at the end of the drop-add period and may be adjusted thereafter at the institution's option. For payroll periods ending before the drop-add period, the determination may be based on the number of hours being taken at the end of the registration period for the semester.<sup>138</sup>

Additionally, if an individual's services qualify for the student FICA exception during the academic term, then all services performed during all payroll periods of a month or less which fall wholly or partially within the academic term qualify for the student FICA exception.<sup>139</sup>

#### *Institution of Higher Education*

The employee must be employed by an institution of higher education. Such institutions include any public or private nonprofit school, college, or university or affiliated 509(a)(3) which meets the following criteria: the primary function is the presentation of formal education; normally maintains a regular faculty and curriculum; and normally has a regularly enrolled body of students in attendance where its educational activities are regularly carried on.<sup>140</sup>

#### *Cannot be a Full-Time Employee*

The employee must not be a full-time employee. Such status is based upon the employer's standards and practices. However, an employee whose normal work schedule is 40 or more hours per week will always be considered a full-time employee.<sup>141</sup>

An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An employee's work schedule during academic breaks is not considered in determining whether the employee's normal work schedule is 40 hours or more per week. The determination of an employee's normal work schedule is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect.<sup>142</sup>

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<sup>137</sup> Rev. Proc. 2005-11, §7.02

<sup>138</sup> Rev. Proc. 2005-11, §7.03

<sup>139</sup> Rev. Proc. 2005-11, §7.04

<sup>140</sup> Rev. Proc. 2005-11, §8.04

<sup>141</sup> Rev. Proc. 2005-11, §6.01

<sup>142</sup> Treas. Reg. § 31.3121(b)(10)-2(d)(3)(iii)

### Cannot be a Professional or Licensed, Professional Employee

The employee must also not be a professional or licensed, professional employee.<sup>143</sup> A professional employee's work consists of advanced or specialized knowledge, requires consistent discretion and judgment, and is intellectual or varied rather than routine, manual, or physical.<sup>144</sup> A licensed, professional employee is a professional employee who holds a license which is required under state or local law to work in the field.

### Cannot be Eligible for Benefits

Finally, the employee cannot be eligible for certain employment benefits to be eligible for the safe harbor, unless the benefit is mandated by state or local law.<sup>145</sup> Being eligible for certain employment benefits suggests the individual is an employee and not a student. The employee is not eligible for the safe harbor if the individual is eligible for:

- 1.) Vacation, sick leave, or paid holiday benefits;
- 2.) To participate in any retirement plan described in § 401(a) of the Code established or maintained by the institution, or would be eligible to participate if age and service requirements were met;
- 3.) To receive an allocation of employer contributions other than contributions described in § 402(g) of the Code under an arrangement described in § 403(b) of the Code, or would be eligible to receive such allocations if age and service requirements were met, or if contributions described in § 402(g) of the Code were made by the employee;
- 4.) To receive an annual deferral by nonelective employer contributions under an eligible deferred compensation plan described in § 457(b), or would be eligible for such annual deferrals if plan requirements were met, or if contributions by salary reduction were made by the employee to a plan described in § 457(b);
- 5.) For reduced tuition (other than qualified tuition reduction under § 117(d)(5) of the Code provided to a teaching or research assistant who is a graduate student) because of the individual's employment relationship with the institution; or
- 6.) To receive one or more of the employment benefits described under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), and 137 (adoption assistance) because of the individual's employment relationship with the institution.<sup>146</sup>

### Cannot be Postdoctoral Students, Postdoctoral Fellows, Medical Resident or Medical Interns

The safe harbor specifically excludes postdoctoral students, postdoctoral fellows, and medical residents or medical interns from qualifying for the exception.<sup>147</sup>

### 5-Week Rule

The student FICA exception does not apply to services performed when the employee is not enrolled and attending classes during school breaks of more than five weeks, which includes

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<sup>143</sup> Rev. Proc. 2005-11, §6.02

<sup>144</sup> Treas. Reg. § 31.3121(b)(10)-2(d)(3)(v)(B)(1)

<sup>145</sup> Rev. Proc. 2005-11, §6.03-.04

<sup>146</sup> Rev. Proc. 2005-11, §6.03

<sup>147</sup> Rev. Proc. 2005-11, §8.03(3)

summer breaks of more than five weeks.<sup>148</sup> However, during normal breaks of 5 weeks or less, the student FICA exception may continue to apply as long as the individual qualified for the student FICA exception on the last day of classes or examinations preceding the break and is eligible to enroll in classes for the first academic period following the break.<sup>149</sup>

## Treasury Regulations Test

The Treasury Regulations test is comprised of two components: school, college, or university test and the student status test. The employee must meet the conditions of both tests to qualify for the student FICA exception. The school, college, or university test is the same test as required in the Safe Harbor (described above). The student status test is a facts and circumstances test based on the relationship of the employee with the employing organization.<sup>150</sup>

### Student Status Test

To qualify for the student status, the Treasury Regulations require the employee to be enrolled and regularly attending classes at the university and his services to be incident to and for the purpose of pursuing a course of study at the university. The latter determination is based on the employee's relationship with the university: the educational aspect must be predominate as compared to the service aspect for the employee to have the status of student. Each aspect is based on all of the relevant facts and circumstances. However, generally, the percentage of time as an employee must be less than the percentage of time as a student in order for the educational aspect to prevail.<sup>151</sup>

The educational aspect is generally evaluated based on the employee's course workload. A relevant factor in such evaluation is the employee's course workload relative to a full-time course workload at the university. The closer the employee's course workload is to a full-time course workload the more the educational aspect is supported.<sup>152</sup>

The service aspect is based on the facts and circumstances related to the employee's employment at the university. The employee's normal work schedule and hours worked are relevant factors in evaluating the service aspect. As the employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely the service aspect is predominate. However, the services of a full-time employee (based on the employer's standards and practices but always anyone whose normal work schedule is 40 hours or more per week) are not incident to and for the purpose of pursuing a course of study. Also, the status of a professional or licensed, professional employee generally suggests the service aspect is predominate. Another factor considered is whether the employee is eligible to receive one or more employment benefits. Each benefit's specific characteristics determine its weight in

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<sup>148</sup> Rev. Rul. 72-142, Rev. Rul. 74-109

<sup>149</sup> Rev. Proc. 2005-11, §7.05

<sup>150</sup> Treas. Reg. § 31.3121(b)(10)-2(d)

<sup>151</sup> Treas. Reg. § 31.3121(b)(10)-2(d)

<sup>152</sup> Treas. Reg. § 31.3121(b)(10)-2(d)

suggesting the service aspect is predominate. For instance, more weight is given to a benefit typically reserved for only employees while a benefit mandated by law is given less weight.<sup>153</sup>

### **Additional Resources**

For additional information on the Student FICA Exception see the IRS' website, [Student Exception to FICA Tax](#).

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<sup>153</sup> Treas. Reg. § 31.3121(b)(10)-2(d)

# HOTEL OPERATOR'S OCCUPATION TAX

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Creation Date: April 1, 2014

## Overview

Illinois' Hotel Operators' Occupation Tax is imposed on receipts from the occupation of renting, leasing, or letting rooms to individuals occupying such accommodations for less than 30 consecutive days. As of April 1, 2014, the Hotel Operators' Occupation Tax is 6 percent of 94 percent of the total gross receipts.

The Hotel Operators' Occupation Tax is not imposed on gross receipts from the following types of accommodations:

- Individuals occupying the accommodations for more than 30 consecutive days
- Students attending summer camps and programs operated by the University and for which the University issues credit or other recognition, regardless of the length of the program
- University departments using such accommodations for University purposes

### Are the "extras" included in Total Gross Receipts?

Total gross receipts includes any separate and specific charge for the use of bedding or other facilities furnished in connection with the use of a room as living quarters or for sleeping or housekeeping accommodations. However, receipts from selling food, beverages or other tangible personal property not in any way reasonably connected with or attributable to the renting, leasing or letting of rooms for use as living quarters or for sleeping or housekeeping accommodations are not included in total gross receipts.

## Additional Resources

For additional information on the Hotel Operators' Occupation Tax Act, see [35 Illinois Compiled Statutes 145](#), the [IDOR Regulations at 86 Ill. Adm. Code 480](#), [IDOR's Web site](#), and [IDOR Publication 106 Allowable Deductions for IDOR-Collected Hotel Taxes](#).

The Carbondale and Edwardsville campuses file separate Forms RHM-1, Hotel Operators' Occupation Tax Return. The individuals listed below prepare the respective Forms RHM-1 for the campuses. Please contact the appropriate individual for dates and specifications for reporting information related to the Hotel Operators' Occupation Tax.

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Brian Kerley  
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Mail Code 6812  
536-2623  
[bkerley@siu.edu](mailto:bkerley@siu.edu)

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Lea Tompkins  
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# SALES AND USE TAXES

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Creation Date: April 1, 2014

## Illinois

Illinois sales tax is comprised of several different taxes to include the Retailer's Occupation Tax and its complementary Use Tax. The Retailer's Occupation Tax (ROT) is imposed on persons engaged in the business of selling tangible personal property to buyers for use or consumption.<sup>154</sup> The Use Tax is imposed on the privilege of using in the state any tangible personal property that is bought anywhere at retail from a retailer.<sup>155</sup> The Use Tax complements the Retailers' Occupation Tax in that a retailer need not remit any Use Tax collected from the purchaser to the extent that the retailer is required to pay and does remit Retailers' Occupation Tax on gross receipts from the same transaction.<sup>156</sup> In effect, the retailer is reimbursed by the purchaser from the Use Tax collected at the time of purchase.

### Exemptions

Under Illinois law, each sale of tangible personal property is considered to be taxable unless there is a specific exemption for the purchaser or transaction.

### Sale for Resale

The sale of tangible personal property to a purchaser for the purpose of resale is not subject to sales tax. The seller should obtain from the purchaser the purchaser's active registration number or active resale number and a Certificate of Resale as documentation that the sale is for resale. Failure to present such documentation creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sales for resale or that a particular sale is a sale for resale.<sup>157</sup>

### Intangible Property

Only sales of tangible personal property are subject to sales tax. Therefore, the tax does not apply to receipts from sales of intangible personal property.<sup>158</sup> For instance, information or data that is downloaded electronically, such as downloaded books, musical recordings, newspapers or magazines, does not constitute the transfer of tangible personal property. These types of transactions represent the transfer of intangibles and are thus not subject to sales tax.<sup>159</sup> However, canned (prewritten) computer software is considered tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media.<sup>160</sup>

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<sup>154</sup> ILCS 35 § 120/2

<sup>155</sup> ILCS 35 § 105/3

<sup>156</sup> ILCS 35 § 105/8

<sup>157</sup> Ill. Admin. Code 86 §130.210

<sup>158</sup> Ill. Admin. Code 86 §130.120(a)

<sup>159</sup> Ill. Admin. Code 86 §130.2105(a)(3)

<sup>160</sup> Ill. Admin. Code 86 §130.1935; IDOR GIL ST 10-0005

### Exempt Entities

Purchases made by qualified organizations, as determined by the Illinois Department of Revenue (“IDOR” or “Department”), may be exempt from sales taxes in Illinois. The IDOR will issue each organization it deems appropriate a sales tax exemption number signifying that the organization may make purchases for its use tax free.<sup>161</sup> The organization must give this number to a merchant in order to make tax-free purchases. Examples of exempt organizations may include: state, local, and federal governments, not-for-profit organizations that are exclusively charitable, religious, or educational, certain senior citizen organizations, county fair associations, not-for-profit organizations that are operated primarily for arts or cultural purposes, and certain licensed day care centers.

## **Sales by Exempt Entities**

### Governmental Bodies

The State of Illinois or any local governments in Illinois, or any agency or instrumentality of any such governmental body, incurs sales tax when it engages in the selling of tangible personal property at retail to the public other than in the performance of a governmental function. As an example, the Department’s Regulations provide that a park district or other governmental body incurs sales tax from the operation of a public stand since such sales are not in performance of its governmental function. Whereas, the sale of motor vehicle license plates by the State of Illinois is not subject to sales tax since the sales to the public involve the performance of a governmental function.<sup>162</sup>

### Nonprofit Entities

Sales made by exclusively charitable, religious and educational organizations and institutions may be exempt from sales tax in very limited instances. These instances include sales to members, noncompetitive sales, and occasional dinners and similar activities.<sup>163</sup>

### Sales to Members

Sales by exclusively charitable, religious and educational organizations and institutions to its members or students *primarily for the purposes of the organization* may be exempt from sales tax. Examples include the sales of Bibles by a church to its members, and uniforms, insignia and Scouting equipment by a Scout organization to its members. If any of the items are sold to a nonmember, all sales will be subject to sales tax. Additionally, the selling of school books and supplies by schools are not considered to be primarily for the purpose of the school. Therefore, sales tax is incurred when schools sell books or supplies to students. It is key that the item being sold is primarily for the purposes of the selling organization.<sup>164</sup>

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<sup>161</sup> Ill. Admin. Code 86 §130.2007

<sup>162</sup> Ill. Admin. Code 86 §130.2055

<sup>163</sup> Ill. Admin. Code 86 §130.2005

<sup>164</sup> Ill. Admin. Code 86 §130.2005(a)(2)

### Noncompetitive Sales

Sales by exclusively charitable, religious and educational organizations and institutions may also be exempt from sales tax if such selling is noncompetitive with business establishments. When determining if the sale is noncompetitive, the following factors must be met: transactions are conducted by members of the entity (not by any franchisee or licensee), all proceeds must go to the selling entity, transaction must not be a continuing one but held either annually or a reasonable small number of times within a year, and the dominant motive of the transferees of the items sold must be the making of a charitable contribution while the transfer of property merely incidental. Additionally, the nature of the particular item sold, the character of the sale, and the real practical effect upon punitive competition are considered when determining if such sales are noncompetitive. Examples of noncompetitive sales include *infrequent* sales of cookies, doughnuts, calendars, and Christmas trees. Sales of hats, greeting cards or other items for which the dominant motive of the purchase is acquisition of the property rather than the making of a donation will be subject to sales tax even if the sale occurs only once a year.<sup>165</sup>

### Occasional Dinners and Similar Activities

Occasional dinners, socials or other similar activities which are conducted by exclusively charitable, religious or educational organizations or institutions are not subject to sales tax, even if such activities are open to the public. Such events may include occasional dinners, ice cream socials, fun fairs, carnivals, rummage sales, bazaars, bake sales, and the like. However, "occasional" means not more than twice in any calendar year. Where more than two events are held in any calendar year, the organization or institution may select which two events held within that year will be considered exempt. Once the organization or institution has made the selections, the selections cannot be changed. *All other events* in that year will be considered taxable. Additionally, this exemption does not extend to "occasional" sales by exclusively charitable, religious or educational organizations or institutions of hats, greeting cards, cookbooks, flag kits and other similar items because these are not "occasional dinners, socials or similar activities" within the meaning of the Act, and the selling of these kinds of items at retail even on an occasional basis does generally place the selling organization in substantial competition with business establishments.<sup>166</sup>

## **Special Issues Related to Schools**

### Dining Facilities

A school does not incur sales tax on its sales from a cafeteria or other dining facility which is conducted on the school's premises and confines its selling to the students and employees of the school. In any instance in which the dining facility is opened up for the use of other persons, all sales that are made at such facility while opened to the public are taxable.<sup>167</sup>

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<sup>165</sup> Ill. Admin. Code 86 §130.2005(a)(3)

<sup>166</sup> Ill. Admin. Code 86 §130.2005(a)(4)

<sup>167</sup> Ill. Admin. Code 86 §130.2005(b)(4)(A)



The Illinois Department of Revenue has allowed schools that sell meal cards to students living in university housing to make tax-free sales to such students in central food facilities open to the public. Such sales may be made tax-free only if there is a mechanism for identifying and documenting, at or before the time of sale, the nontaxable sales of food to students living in university housing and enrolled in a meal plan. The mechanism for identifying and documenting such information must consist of something more than simply showing an identification card. These mechanisms must consist of systems that provide both an auditable and verifiable record of food sales to each of those students. Additionally, the sale must be made by the school itself and not a lessee.<sup>168</sup>

#### *Clothing, Dormitory Supplies and Miscellaneous Items*

Schools incur sales tax when they sell sweaters, sweatshirts, gym shoes, jackets, and other items of clothing to students or others. Sales tax is also incurred when schools sell furniture, rugs, or other dormitory supplies. The same is true when schools sell soft drinks, candy, peanuts, popcorn, chewing gum, and the like to students or members of the public where the sales occur in a book store, through vending machines or other areas open to the public.<sup>169</sup>

#### *University Purchases*

The Illinois Department of Revenue has issued Exemption Identification Numbers, "E" numbers, to both the Carbondale, Edwardsville, and Springfield campuses. The "E" number signifies that purchases of tangible personal property made by the campus for its own use are exempt from sales and use tax. Organizations granted an "E" number cannot authorize the use of that number to other individuals or organizations. The buyer must be the organization itself, not simply a member or officer of the organization. Sales made to an individual member of an exempt entity or to a purchaser purportedly buying an item for an exempt entity are generally taxable.<sup>170</sup> Purchases using University issued PCards are considered to be made by the University.

Additionally, the tangible personal property purchased tax-free must be in furtherance of the exempt organizations purpose.<sup>171</sup> If the tangible personal property purchased is not used in furtherance of the exempt organization's organizational purpose, the purchaser may owe Use Tax.<sup>172</sup>

Campus Procurement Departments can provide current Illinois Tax Exemptions Certificates upon request.

#### *Reporting of University Sales*

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<sup>168</sup> IDOR GIL ST-110108

<sup>169</sup> Ill. Admin. Code 86 §130.2005(b)(4)(D)-(E)

<sup>170</sup> IDOR GIL ST 98-0177

<sup>171</sup> IDOR GIL ST 12-0044

<sup>172</sup> IDOR PLR ST 09-0009

Each campus department or unit selling tangible personal property subject to sales tax is responsible for collecting the appropriate tax from the purchaser and reporting the sale(s) to Accounting Services (Carbondale Campus) or Administrative Accounting (Edwardsville Campus).

The appropriate tax rate will depend upon the item sold and the location of the sale. Illinois has two fundamental (base) tax rates. The fundamental rate for general merchandise and items required to be registered is 6.25%. The fundamental rate for qualifying food, drug, and medical appliances is 1%. Qualifying food items are those not prepared for immediate consumption, qualifying drug items include prescription medicines and nonprescription items that have medicinal value, and qualifying medical appliances include items that directly replace a malfunctioning part of the human body. Additionally, depending upon the location of the sale, the actual sales tax rate may be higher than the fundamental rate because of home rule, non-home rule, water commission, mass transit, park district, county public safety, public facilities or transportation, and county school facility tax.

To obtain the most current tax rates and tax rates for other locations, please visit the website [www.Sale-tax.com](http://www.Sale-tax.com).

The Carbondale and Edwardsville campuses file separate Forms ST-1, Sales and Use Tax Return. The individuals listed below prepare the respective Forms ST-1 for the campuses. Please contact the appropriate individual for dates and specifications for reporting information related to Illinois sales and use taxes.

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Brian Kerley  
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Lea Tompkins  
Administrative Accounting  
RH 0110  
650-3276  
[ftompki@siue.edu](mailto:ftompki@siue.edu)

*Special Events – Third Party Vendors on Campus*

Generally, all sales of tangible personal property are subject to sales tax in Illinois. When outside vendors sell tangible personal property on campus, such vendors are responsible for collecting and remitting the appropriate sales taxes to the Illinois Department of Revenue. The Department has a special form, Form IDOR-6-SETR, Special Event Tax Collection Report and Payment Coupon, to report and remit sales taxes incurred during sales at fairs, festivals, flea markets, craft shows and other similar activities. The forms may be obtained by contacting the Department's Special Events Coordinator by emailing [Rev.SpecialEvents@illinois.gov](mailto:Rev.SpecialEvents@illinois.gov) or calling 1-847-294-4475. It is recommended that the campus department or unit promoting, organizing, or providing the retail selling space contact the Special Events Coordinator before the event to obtain these forms to make available to the vendors.

Campus departments or units that promote, organize, or provide retail selling space for concessionaires or other types of sellers at fairs, art shows, flea markets, or other similar events on campus are required to file a report with the Department by the 20<sup>th</sup> day of the month

following the month during which the event was held. The report must include the following information for each vendor:

- name of the vendor's business
- name of the person or persons engaged in the vendor's business
- permanent address of the business
- Illinois business tax (IBT) number of the business
- dates and location of the event

The report should be sent to: Special Events Unit  
Illinois Department of Revenue  
PO Box 19035  
Springfield, IL 62794-9035

## **Additional Resources**

For additional information on Illinois sales and use taxes see [35 Illinois Compiled Statutes 120/1 to 120/14](#) and [IDOR Regulations at 86 Ill. Adm. Code 130](#) for Retailer's Occupation Tax, [35 Illinois Compiled Statutes 115/1 to 115/21](#) and [IDOR Regulations at 86 Ill. Adm. Code 140](#) for Service Occupation Tax, [35 Illinois Compiled Statutes 110/1 to 110/21](#) and [IDOR Regulations at 86 Ill. Adm. Code 160](#) for Service Use Tax, [35 Illinois Compiled Statutes 105/1 to 105/22](#) and [IDOR Regulations at 86 Ill. Adm. Code 150](#) for Use Tax, [IDOR Publication 113 Retailer's Overview of Sales and Use Tax and Prepaid Wireless E911 Surcharge](#), and [IDOR's Sales and Use Tax Website](#).

## **Other States**

### University Purchases

Although the University has received exemption from sales and use tax in Illinois, this exemption does not necessarily extend to other states. Generally to receive exemption from sales and use taxes in states other than Illinois, the University/campus must apply to the state for such exemption or complete the states' blank tax exemption certificate. Some states do not allow non-resident entities to receive tax exemption status while others may limit the items to which the exemption applies. Please contact the campus Procurement Department for state exemption information and instruction for University purchases made in states other than Illinois.

### University Sales

Every state has its own laws and regulations regarding sales tax. Therefore, when making sales in other states, campus departments must meet the filing requirements of that state. Some states have special forms or tax returns for nonresident entities making one time or special event sales in the state. Such forms can be obtained from the state's website or through the special event coordinator of the state.

# FORM AND INSTRUCTION APPENDIX

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To view a form or its instructions, click on one of the links provided below.

- **IRS FORM W-2, *WAGE AND TAX STATEMENT***  
**INSTRUCTIONS FOR FORM W-2**
- **IRS FORM 990, *RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX***  
**INSTRUCTIONS FOR FORM 990 AND 990-EZ**
- **IRS FORM 990-T, *EXEMPT ORGANIZATION BUSINESS INCOME TAX RETURN***  
**INSTRUCTIONS FOR FORM 990-T**
- **FORM IL-990-T, *EXEMPT ORGANIZATION INCOME AND REPLACEMENT TAX RETURN***  
**INSTRUCTIONS FOR FORM IL-990-T**
- **IRS FORM 1098-T, *TUITION STATEMENT***  
**INSTRUCTIONS FOR FORM 1098-T**
- **IRS FORM 1099-MISC, *MISCELLANEOUS INCOME***  
**INSTRUCTIONS FOR FORM 1099-MISC**