

THE UNIVERSITY OF WISCONSIN SYSTEM

UNRELATED BUSINESS INCOME

REVIEW GUIDELINES

The University of Wisconsin System is tax exempt both as a charitable educational organization and as an instrumentality of the State. The University's stated purpose is providing instruction, research, and public service. Public service, however, does not by itself provide the basis for the University's tax exemption. Therefore, each activity which is public service oriented must be evaluated to determine whether an instructional or research purpose is also being served.

Three elements must be present for an activity to be considered unrelated to the University's tax exempt purpose of instruction and research: (1) the activity must be a 'trade or business', (2) it must be 'regularly carried on', and (3) it must not contribute substantially to the University's exempt purpose.

- (1) Trade or Business - Generally, a trade or business for unrelated business income tax purpose is an activity which is carried on for the production of income from the sale of goods or performance of services [Reg. Sec. 1.513-1 (b)].
- (2) Regularly Carried On - The unrelated business income tax applies only to a business activity which is regularly carried on as distinguished from commercial transactions which are sporadic or infrequent [Sec. 512 (a)(1)]. Short term activities are not 'regular' if a nonexempt business would conduct them on a year-round basis. Intermittent, casual or sporadic activities are generally not regular. However, year-round activities are regular even if they are conducted only one day a week. Seasonal activities conducted in season are also regular [Reg. 1.513-1(c)(2)].
- (3) Not Contribute Substantially to Exempt Purpose - To be related to the University's exempt purpose, there must be a substantial casual relationship, i.e., the activity must contribute importantly to the accomplishment of the exempt purpose. Particular emphasis is placed on the size and extent of the activity. Thus, if an activity is conducted on a scale larger than reasonably necessary to carry out the exempt purpose, it is more likely to be treated as unrelated [Reg. Sec. 1.513-1 (d)(2)].

Even if an activity meets the definition of an unrelated trade or business, it can avoid being taxed if (1) substantially all the work of the activity is performed by unpaid volunteers, (2) the activity is carried on primarily for the convenience of students, faculty, staff or patients, or (3) the activity consists of the sale of donated merchandise.

- (1) Uncompensated Volunteers - Any activity in which substantially all (probably 85%) of the work of the trade or business is performed without compensation is exempt from tax. However, in assessing the contribution made by volunteers, the University must consider such factors as the monetary value of the respective services rendered, the number of hours worked, the intrinsic importance of the volunteer work performed and the degree of reliance placed upon volunteers [Sec. 513 (a)(1)].

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- (3) Selling of Donated Merchandise - Any unrelated activity engaged in the selling of merchandise, substantially all (probably 85%) of which was received as gifts or contributions is exempt from tax regardless of whether the labor to operate the activity is paid or volunteered [Sec. 513 (a)(3)].

The IRS code also allows for the following special exemptions from tax under certain circumstances:

- (1) Advertising - Advertising activities may be taxable even if they are carried on within a larger complex of other endeavors which are substantially related to the exempt purpose of the University. To be considered exempt from tax, the advertising must contribute importantly to the University's exempt function, i.e., as part of an instructional program or when the advertising serves an 'informational function' rather than as a means of stimulating demand for products [Sec. 513 (a)(1)].
- (2) Hospital Services - Certain services, i.e., data processing, purchasing, warehousing, billing and collection, food, laboratory, personnel, etc., performed by an exempt hospital for another exempt hospital may be considered related activities. However, the services must be provided at a fee that does not exceed actual costs, furnished solely to hospitals servicing not more than 100 inpatients and must be related to the recipient hospital's exempt function [Sec. 513 (e)].

In addition to the exemptions detailed above, the code contains several modifications that have the effect of exempting from tax passive investment income (e.g., rents and royalties) under certain circumstances unless it is derived from debt financed property, in which case it is taxable.

- (1) Rents - the rules for rents vary depending on whether they are derived from real (i.e., land or buildings) or personal (i.e., equipment) property or from a mixed lease of both real and personal property [Reg. Sec. 1.512(b)-1(c)].
 - a. All real property rents are exempt from tax.
 - b. Personal property rents are exempt from tax only if there is a mixed lease and the rents attributable to the personal property are an 'incidental' part (not more than 10%) of the total rents received under the lease.
 - c. Rents dependent on profits or income derived by the University from the real property do not qualify for exemption from tax unless they are based on the fixed percentage of gross receipts or sales. Rents based on the percentage of net profits are taxable.
 - d. Services - Payments from external individuals or organizations for the use or occupancy of rooms or other space where personal services are also provided do not constitute rents from real property and are taxable.
- (2) Royalties - The royalty exemption from tax includes overriding royalties and royalty income received from licenses by the University as the legal and beneficial owner of patents assigned to it by inventors [Reg. Sec. 1.512(b) - 1(b)].

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Summary of Interpretations

Unless there is a specific provision to the contrary, the UW System will make the following interpretations in determining whether or not an activity is related:

1. The sale of educational materials to other schools, whether high schools or colleges, are considered educationally related and therefore, exempt.
2. Generally sales to those who are neither faculty, staff nor students are unrelated. However, if these sales amount to less than 15% of the total sales or usage, the sales/usage would be considered not material and not regularly carried on. The primary purpose would be either educationally-related or for convenience of faculty, staff or students. For these purposes, alumni are considered to be general public.

The issue to be addressed is primary purpose, primary use, primary users, etc. Consideration must be given to whether or not we actively solicit outside participation or sales.

3. Lab testing will be considered related if it is unique or unavailable in the community. Lab testing will also be related if it provides clinical experience for students.
4. The UW System will support the position taken by the National Association of College Stores, Inc., i.e. all items sold in college and university stores are for the convenience of faculty, staff and students. The pricing structure is such that miscellaneous items are purchased primarily for convenience. In addition, these miscellaneous items make up a very small percentage of total sales. Bookstores primarily offer those items which are educationally related.
5. If an item is being sold on a chargeback basis, with price set to cover costs, it will be our position that those activities have no profit motive and therefore, are not businesses.
6. If a campus is leasing a facility to another state agency, we feel the state has an obligation to maximize its facilities and we must cooperate with this obligation.

