

# Understanding Tax Implications in Higher Education

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# Learning Objectives

At the end of this session, you will be able to

- Explain tax complexities within institutions of higher education
- Assist in identifying tax risks
- Identify potential next steps in minimizing risk exposure

# Presenters

**Karen A. Gries, CPA**

Principal

karen.gries@CLAconnect.com

**Amy Chapman, CPA**

Principal

amy.chapman@CLAconnect.com

# Agenda

2017 Tax Reform

Unrelated Business Income

Other Risk Issues

Conclusion / Questions



# 2017 Tax Reform

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# 2017 Tax Reform Implications to Higher Ed

1

**Transportation Fringe Benefits Treated  
as Unrelated Business Income**

2

**UBTI Calculated as Separate Trade or  
Business**

3

**Compensation Excise Tax**

4

**Excise Tax on Investment Income**

# Interim Guidance for Exempt Organizations

Notice 2018-55  
University Excise Tax  
on Investment  
Income

Notice 2018-67  
Unrelated Business  
Income Separate Line  
of Business Reporting

Notice 2018-99 &  
2018-100 Qualified  
Transportation Fringe  
Benefits (QTFB)

Notice 2019-09 Excise  
Tax on Compensation

*Treasury and IRS to issue proposed regulations for each provision*



# Qualified Transportation Fringe Benefits

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# Qualified Transportation Fringe Benefits as UBI

- Effective for amounts paid after December 31, 2017, organizations subject to UBI must increase UBTI by their expenses of providing certain fringe benefits
- Fringe benefits include:
  - Expenses for commuter highway vehicles, transportation transit passes, and qualified parking
- Income inclusion includes both employer paid direct expenses and employee pre-tax deferrals

## Notice 2018-99

- Allows organizations to use any reasonable method including the one deemed reasonable in the notice
- What is unreasonable?
  - Using the value of employee parking to determine allocable expense
  - Allocating no expense to reserved parking

# Notice 2018-99

- Expenses to be include as UBI:
  - Parking lot attendant and security
  - Repairs, maintenance and landscaping
  - Cleaning and removal of snow, ice, leaves, and trash
  - Utility costs
  - Rent or lease payments or a portion of rent or lease payments
  - Insurance, property taxes, interest, etc.
- Expenses do not include depreciation

## Notice 2018-99 - Payments to Third Parties

- Employer amounts up to \$265 per employee per month is treated as UBI
- Amounts paid greater than \$265 per employee per month is additional taxable income to the employee and not treated as UBI
  - Total amount excluded from taxable income includes both employer direct payments plus employee pre-tax deferral

## Notice 2018-99 – Owned or Leased Facilities

- STEP 1 - **Cost** of reserved employee spots = UBI
  - Allocation of costs based on reserved/total spots
  - Organizations may up to March 31, 2019, change the parking arrangement retroactive to January 1, 2018 and eliminate UBI
- STEP 2 - Applicability of public use exception for remaining spots
  - If more than 50% of the remaining spots are typically used by the general public, no additional UBI
    - ◇ General public includes customers, visitors, vendors, students, congregants, etc.



## Notice 2018-99 – Owned or Leased Facilities

- STEP 3 - Expenses of reserved nonemployee spots
  - Amounts are not deemed to be UBI
- STEP 4 – Remaining use/expenses typically employee spots
  - Allocated based on typical usage during normal business hours on a typical day

# QTFB Complexities

- What amount to include as UBI when employee pre-tax deferral exists for owned or leased facility?
- Allocation of expenses associated with sponsorships or other arrangements providing employee transportation
- Payments to third-parties providers based on usage
- Others....



# Unrelated Business Income Separate Line of Business Reporting

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## UBI Separate Line of Business

- Effective for tax years beginning after December 31, 2017, UBTI is computed separately for each business
- Organizations may no longer aggregate activities to arrive at taxable
  - Net operating losses (NOLs) from a business may not offset other profitable activities
  - NOLs which are unable to be used in current year are carried forward until the activity produces positive UBI

## Notice 2018-67

- Reasonable, good faith interpretation must be used until additional guidance is issued
- Use of NAICS is considered good faith interpretation
- Guidance issued for investment activities
- Qualified transportation fringe benefits is not treated as a separate unrelated trade or business

## Notice 2018-67 – Partnership Investments

- Interim guidance for aggregating UBTI from partnerships
  - De minimis test – EO holds no more than 2% of partnership profits interest and capital interest, combining all related interests **or**
  - Control test – EO holds no more than 20% of the partnership interest and does not have control or influence over the partnership, combining all related interests
    - ◇ Related interests includes: interests held by disqualified persons, supporting organization, or controlled entity
  - Transition rule applies for partnership interests acquired prior to August 21, 2018, EO permitted to treat each partnership interest as a single trade of business, even though more than one activity is conducted by the partnership

# Separate Lines of Business Complexities

- What constitutes a separate line of business?
- How are expenses allocated to each activity?
- With investments, does the institution have resources for the tracking of the partnership investment including related parties? Does the organization conflict of interest disclosure accumulate the appropriate information?



# Excise Tax on Compensation

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# Excise Tax on Compensation

- Effective for tax years beginning after December 31, 2017, an “applicable tax-exempt organization” is subject to a 21% excise tax on
  - Remuneration over \$1m paid to a covered employee
  - Excess parachute payments paid to a covered employee

# Applicable Tax-Exempt Organization (ATEO)

- Exempt from tax under IRC Section 501(a)
- Has income excluded from tax under IRC Section 115(1)
- Governmental entities
  - Governmental unit (including a state college or university) that do not have an IRS determination letter is not an ATEO
  - Governmental entity that is separately organized from a state may meet the requirements of section 115(1) and be considered an ATEO
  - Even if the governmental entity is not an ATEO, it may be liable for the excise tax if it employs a covered employee and is “related organization”

## Related Organizations

- A person or governmental entity is considered a related organization to the ATEO if it controls or is controlled by the ATEO, as defined by section 512(b)(13) – applies a more than 50% control test
- A taxable entity or governmental entity that is a related organization to the ATEO
- Excise tax is calculated based on compensation made in the calendar year ending with or within the ATEO's or related organizations' tax year
- Excise tax is allocated among the entities

# Covered Employees and Compensation

- Covered employee
  - Five highest-compensated employees in the current year or a covered employee in any preceding tax year beginning after December 31, 2016
  - Limited service exception excludes employees if the ATEO paid less than 10% of the employee's total remuneration for services to the ATEO and all related organizations
    - ◇ Once a covered employee, always a covered employee
- Remuneration
  - Wages generally means Form W-2 Box 1
  - Excludes licensed medical professionals for medical services
  - Includes amounts paid by related organization that is the employer of the covered employee

# Excess Parachute Payments

- Compensatory payment to a covered employee if:
  - The payment is contingent on an employee separation from employment with the employer and
  - Aggregate present value of the payment exceeds three times the base amount, which is the average annual compensation over the preceding 5-years
- Notice 2019-009 Amount is a parachute payment
  - Only if the payment is contingent on involuntary separation from service

# Excess Compensation Complexities

- Avoid fluctuations in compensation
- Consider modification to vesting of deferred compensation, severance, or bonus provisions
- Review separation from service payments to avoid excess parachute payments
- Review shared employment agreements



# Excise Tax on Investment Income

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# Excise Tax on Investment Income

- For tax years beginning after December 31, 2017, an “applicable educational institution” is subject to a 1.4 excise tax on net investment
- Net investment income is computed similar to private foundations
  - Interest, dividends, rents, royalties, and similar amounts **plus**
  - Capital gains **less**
  - Investment expenses and other expenses of generating the income
- Assets and income of related entities are attributed to the educational institution



## Excise Tax on Investment Income

- For the purpose of calculating gains, Notice 2018-55 states an intent to allow a step-up in basis for property held on December 31, 2017
  - Position may be relied upon until proposed regulations are issued
- Capital gains and losses may be netted across related entities

# Next Steps in Tax Reform Compliance

Understand tax provisions and monitor guidance and regulatory developments

Review positions and address impact of new taxes

Develop an implementation plan

Consider tax planning strategies

Engage in the advocacy and regulatory process



# Unrelated Business Income Reporting

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# Unrelated Business Income Compliance

- Facility rentals
- Sponsorships
- Athletic department activities
- Outside events
- Alternative investments



# Other Tax Risks Facing Institutions

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# Additional Tax Compliance

- Compensation/Fringe Benefit Reporting
  - Accountable vs. nonaccountable plan rules
- Housing Benefits
  - Housing benefits are taxable unless provisions are met
    - ◇ Business premises
    - ◇ Convenience of employer
    - ◇ Condition of employment
  - Ministerial housing exclusion

# Additional Tax Compliance

- Athletic Apparel
  - FMV is considered to be taxable income of the employee unless:
    - ◇ Required to be worn as a condition of employment
    - ◇ Apparel is not suitable for everyday use
  - FMV not cost is taxable as fringe benefit

## Additional Tax Compliance

- Gifts, Prizes and Awards
  - Typically, both cash and noncash items are reported as taxable income to the individual
- Contribution/Right to Purchase Athletic Tickets
  - Charitable contribution deduction is not allowed for payments made in exchange for athletic event seating rights



# Additional Tax Compliance

- Alternative investments
  - Partnership and s-corp reporting
  - Requires detailed analysis of individual investment
    - ◇ Unrelated business income compliance
    - ◇ Foreign filings
    - ◇ State and local filing requirements



# Questions?

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Thank You!

