TEGE Exempt Organizations Council

Tax Reform – Open Issues

Unrelated Business Income and Trusts

March 2018

Today's Topics

Purpose

The purpose of this call and these materials is to help inform interested members of the federal government as to tax issues and questions for exempt organizations as it relates to the Tax Cuts and Jobs Act of 2017. These are intended to inform, but not to express an opinion as to the details of the guidance to be issued.

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Unrelated Business Income

Exempt Organization - UBI

Definition of a Trade or Business

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6).

Open issues:

- What constitutes a separate trade or business?
  - Are investments (such as alternative investments) a single activity if part of an investment portfolio?
    - Endowments, private foundations, and pensions often have significant diversified investment portfolios that may include 100's of limited partnerships. Other exempt organizations may also have diversified investment portfolios.
    - Even under current IRC 469 passive activity loss rules, losses from one passive activity can offset the gains from another passive activity. Similarly, capital losses from one investment can offset capital gains from separate investments.
  - Are healthcare activities (lab, pharmacy, etc.) a single healthcare activity?
    - Would the single activity include both those owned and operated directly as well as those flowing through from various partnerships (e.g. operated on a joint basis)?

Exempt Organization - UBI

Definition of a Trade or Business

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6).

Open issues:

- What constitutes a separate trade or business?
  - Are all personal property leasing activities aggregated as a single trade or business?
  - Are all debt-financed leases / sales of property considered a single trade or business?
  - Are personal services and personal property rentals from the same rental activity a single trade or business?
  - Are individual gaming activities conducted during the year at different intervals a single gaming trade or business?
  - Are all advertising activities (e.g., website, print ads, etc.) part of the same trade or business?
- Can losses from an activity be offset against the §512(b)(7) income?

Exempt Organization - UBI

Definition of a Trade or Business

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6). Guidance will likely not be available before estimated tax payments are due.

Open issues:

- Will transition relief be available to give organizations adequate time to comply with any newly-issued guidance?
- Will organizations be subject to penalties for underpayment of estimated taxes prior to the issuance of additional guidance?
- Will the IRS delay enforcement pending release of guidance?

Exempt Organization - UBI

Definition of a Trade or Business

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6). Guidance will likely not be available before estimated tax payments are due.

Open issues:

- Until a period of time after guidance is released, may organizations use any reasonable approach to defining trade or business for purposes of these rules?
  - Should treatment be similar to how the 501(r) regulations were approached, or existing 469 passive loss rules and/or section 446 accounting method rules, in which similarities in business and interdependence of activities (among other items) are considered in group activities as a single trade or business?
- How much discretion will an organization have in determining separate trades or businesses?
  - Will the Service respect taxpayers' classifications?

Exempt Organization - UBI

Credits

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6). Guidance will likely not be available before estimated tax payments are due.

Open issues:

- Should tax credits be applied at the entity level or allocated to separate trades or businesses?
- If allocated, how should they be allocated, particularly if some credits may not be associated with a specific UBI activity but are creditable against UBI taxes?

Exempt Organization - UBI

Net Operating Loss Considerations

Exempt organizations do not currently have the tools necessary to properly delineate between separate trades and businesses for purposes of IRC § 512(b)(6). New net operating loss rules for exempt organizations were enacted.

Open issues:

- What are the ordering rules for utilization of net operating losses?
  - Are the separate activity losses generated after 2017 or the pre-2018 losses applied first?
- Similar to the passive activity rules under §469, can an unused trade or business loss offset income from another trade or business upon disposition of the activity?

Exempt Organization - UBI

Section 163(j) Business Interest Expense Limitations

Section 163(j) imposes limits on the deduction of net business interest expense. These limits are applied at the entity level. Further, the interest expense of corporations are deemed to be business interest rather than investment interest.

Open issues:

- Will the business interest expense limit rules of 163(j) be applied at the legal entity level as contemplated by section 163(j) regardless of the separate silo's for different trades or business for UBI purposes?
- Will the business interest expense limitations be applied taking into account solely unrelated business income?
  - This could result in no deduction for interest expense as debt financed percentages go down (with payments, for example), then the income may be exempt from UBI (such as real property rental income)
- Will business interest expense carryforwards be used (subject to limitations) before or after post 2017 loss carryforwards are applied by trade/business? What about the interrelationship with pre-2018 NOL carryforwards?

Exempt Organization - UBI

General unrelated business income deductions and income not associated with a trade or business

Certain expenses (indirect expenses) are deductible but not identified with a particular trade or business, such as 990T tax preparation and UBI tax planning fees. Further, some income is per se UBI and not necessarily a trade or business.

Open issues:

- How should organizations account for general unrelated expenses?
  - Should indirect unrelated business expenses be allocated ratably across separate activities or applied to the total after the activities are combined?
- How are per se UBI items treated vis-à-vis the separate trade or business silos?
  - 512(b)(13) causes certain income from controlled organizations to be UBI
  - The transportation fringe benefit (e.g. parking) among others is per se UBI income
  - Should all or part of these items of income be allocated to the other trades or businesses?

Exempt Organization - UBI

General unrelated business income deductions – state and local income taxes

State income taxes are generally calculated at the entity level. Some states may conform to federal in the future, but there will be states that do not conform.

Open issues:

- How should organizations deduct state/local income taxes?
  - Are these to be deducted against any resulting UBI for the year?
  - If these create a loss, how should the loss for these taxes be carried forward?
    - Practically speaking, state taxes are normally not significant. Many organizations deduct state taxes on a cash basis. With the separate silo's of income/loss by trade or business, this could create a loss of deduction if the taxes are paid in a year in which there is a loss.

Exempt Organization - UBI

General unrelated business income deductions – charitable contribution deduction

The interrelationship among items with separate limitations is unclear vis-à-vis the limitations on losses by trade or business for UBI purposes. Charitable contributions have historically been subject to limitation – 10% for corporations.

Open issues:

- Should the charitable contribution deduction be determined at the legal entity level rather than separate trade or business level? This should be the same, but for when there are loss carryforwards on a separate trade or business involved.

Trusts

Exempt Organization Trusts

Qualification as a Business Trust

Business trusts may not be subject to the potential $10K limit on the deduction of state and local income taxes and state/local real estate taxes, as well as the denial of miscellaneous itemized deductions. Investment manager fees, for example, are one category of common miscellaneous itemized deductions. Non-business trusts are subject to these limitations.

Open issues:

- Are business trusts exempted from the individual limits on state/ local taxes and miscellaneous itemized deductions?
- Could the regulations be modified to also include private foundations and pension plans as business trusts?

Exempt Organization Trusts

Miscellaneous Expenses

Tax Cuts and Jobs Act Sec. 11045(a) creates IRC Sec. 67(g) that suspends all miscellaneous itemized deductions in Code Sec. 67(a). This provision appears to be related to 2% itemized deductions for individual taxpayers. Code Sec. 67(e) states that trusts are allowed to take any costs paid or incurred in connection with the administration of the trust and would not have been incurred if the property was not held in trust.

Open issues:

- Clarification is requested whether tax preparation, legal, and trustee fees are still deductible as expenses incurred despite the entity being a trust.
  - For 990T purposes (against separate trade/ business or generally)
  - For IRC 4940 net investment income purposes of a private foundation

Exempt Organization Trusts

State and local taxes

TCJA modifies the state and local etc. tax deduction rules of IRC section 164 to limit the deduction of taxes under IRC 164(a)(1), (2) and (3) and 164(b)(5) to $10K (except foreign income taxes). However, the statute also provides for certain deductions (real and personal property taxes under 164(a)(1) and (2)) for purposes of a trade or business or for IRC 212 purposes. In addition, foreign real estate taxes appear to be carved out of the 164(a)(1) deduction as are state and local income taxes from full deduction under the 212 and trade or business exceptions pursuant to 164(b)(6)(B).

Open issues:

- Is this a technical error in the statute that would put a tax exempt trust, including a pension trust, at a significant disadvantage to exempt organization's formed as corporations?
- Clarification (form instructions?) as to the applicability, if any, of the $10K limit on state etc. tax deductions. Specifically, are the following deductible in full against UBI and against IRC 4940 net investment income, as applicable, or are they subject to the $10K limitation regardless of investment purpose?
    - 164(a)(1) provides for deduction for state, local, and foreign real property taxes.
    - 164(a)(2) provides for deduction for state, and local personal property taxes.
    - 164(a)(3) provides for deduction for state, local and foreign income, war taxes and excess profit taxes.
    - 164(b)(5) provides for deduction of general sales taxes.

Exempt Organization Trusts

199A passive income deduction

New Code section 199A provides for a potential 20% pass-through deduction for taxpayers other than corporations. Some non-profits and all pensions are trusts. These rules are quite complex and include a series of calculations of greater of/ lesser of calculations and then limits that may or may not apply depending on W-2 wage income. For purposes of allocating W-2 wages to trusts, the domestic production activities rules are referenced. Further, these calculations are performed at the taxpayer level, requiring pass through entities to provide the necessary information. The pass-through entity may not be aware of whether the tax exempt organization is a trust as its tax status is that of tax exempt organization. Further, the deduction is limited based on taxable income.

Open issues:

- A road map or calculator tool of how the deduction might apply to tax exempt trusts would be very useful.
- Clarification if amounts within the calculation are solely those attributable to reported unrelated trade or business activities or to all activities of the pass through entity since the amount of the deduction is in part limited by 20% of adjusted taxable income.
- Clarification on how these calculations may interrelated with the separate silo calculations for trade or business activities for UBI purposes.
- Clarify whether the calculation of qualified business income is after the business interest expense limitations, as applicable

Exempt Organization Trusts - Private Foundation

Business Interest Expense Attribute Flowing through from Partnerships

Context:

Business interest expense incurred within a partnership is limited at the partnership level that generates the interest expense in the tax year the expense is incurred. Any excess business interest expense though is a carryforward and tracked at the partner level. With a tax exempt organization, business interest may be incurred and generate unrelated business income but as the debt gets paid down, the private foundation partner may have less unrelated business taxable income and more of the partnership income that is excluded from UBI but instead reported as net investment income. At point of sale of the investment, the private foundation partner may or may not have unrelated business income from the sale of the partnership interest.

Open issues:

Will the excess business interest expense ever be deductible against net investment income? Or otherwise usable by the private foundation to offset taxable income?

Note – this topic is included as a placeholder for completeness. The topic was covered in the private foundation section.

Exempt Organization Trusts

Alternative Minimum Exemption Amounts

The Tax Cuts and Jobs Acts temporarily increases alternative minimum tax exception for individuals. TCJA Section 12003(a) modifies IRC Code Sec. 55(d)(4) for the increases in the AMT exemption amounts for individuals, however the bill indicates that the exemption for trusts is "without regard to the substitution" for married filing joint of surviving spouse but does not refer to the exemption amount that appears in IRC section 55(d)(1)(D) which is the current section applicable to trusts and estates.

Open issues:

- Is the AMT exemption amount for trusts $78,750 or $22,500?
- Is such amount then indexed for inflation?

Exempt Organization Trusts

Interrelationship of Various Deduction Limitations

Trust deductions are limited in ways that do not apply to corporations. For example, trusts are subject to the passive activity loss rules, in addition to the UBI loss limitations by trade or business. Further, non-business trusts are also subject to the state, local and foreign income tax and state/ local property tax deduction limitation of $10K and the denial of the deduction of miscellaneous itemized deductions. The interrelationship of the rules can be confusing to the exempt organization preparing their returns.

Open issues:

- In what order are the various limitations applied and how do they interrelate?
  - Business interest expense is limited at the entity level – so first to underlying pass-through entity with excess limitation available at partner level
  - Passive activity loss limitations
  - State, and local income tax deduction limit of $10K (as some such costs may be included in K-1 income that is subject to the passive activity loss rules)
  - Charitable contribution deduction (including pass through vs direct charitable contribution)

Partnership return instructions

K-1 information for exempt organization partners

Even before the TCJA, K-1s received by exempt organization partners frequently do not contain sufficient information for exempt partners to complete their returns. This is particularly true for partnerships that invest in lower tier partnerships. In part this is because the lower tier partnership does not know that there is a tax exempt organization up the chain.

Open issues:

- Partnership K-1s should be required to provide all information necessary for a tax exempt partner to prepare its return both when the partner is an exempt organization as well as when the partner is a partnership (unless they definitively know that there is no upper tier exempt organization partner)
    - This is particularly true for information for purposes of computing foreign tax credits.
- Consider whether to have 2 boxes for exempt organizations on K-1s – one for exempt organization corporation and one for exempt organization trust. There are more differences in the information needed as a result of the TCJA than in the past.

Thank you for the opportunity to share our feedback.

TEGE Exempt Organizations Council

Tax Reform Questions

Private Foundations and Universities

March 7, 2018

Today's Topics

- Purpose
- Private Foundations
  - Grants to Donor Advised Funds
  - Philanthropic Enterprise Act
  - Executive compensation excise tax re: private foundations
  - International and UBI Issues
- Universities
  - Executive Compensation Excise Tax re: universities
  - Endowment Excise Tax
  - Charitable Gifts with Athletic Seating Rights

Purpose

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Private Foundations

Private Foundations

Uses for Donor Advised Funds by Private Foundations

Currently, private foundations may establish donor advised funds (DAFs) at qualified sponsoring organizations, and distributions from private foundations to these DAFs will be considered qualifying distributions for purposes of IRC section 4942. However, Treasury and IRS have expressed concern over the following potential abuses:

- **Continued "Parking" of Money**: Because there are no distribution requirements for donor advised funds, money contributed to a DAF by a private foundation may sit in the DAF indefinitely without further distribution to charitable organizations;
- **Use of DAFs to Avoid "Tipping" of Smaller Charitable Organizations**: Under current law, 100% of distributions from DAFs to charitable grantees may be counted as public support to the grantee organization for purposes of the public support test. A private foundation (or individual donor) can therefore provide substantial support for smaller charitable organizations through DAFs without causing the grantee organization to fail its public support test. (This issue is also discussed in Notice 2017-73).

Open Issues:

- Can the provisions described in IRC Section 4942(g)(3) requiring further distribution of certain qualifying distributions within a certain time period be applied to distributions from private foundations to donor advised funds to address the concerns about "parking" money?
- If regulations are proposed to restrict the use of DAFs by private foundations, can certain exceptions be included for acceptable uses of DAFs by private foundations?
- Certain acceptable uses may include 1) to facilitate disaster funding and other grant activity that may be outside the scope of a private foundation's stated mission or geographic area; 2) to collect funding from multiple partners for collaborative charitable projects; 3) to benefit from the sponsoring organization's knowledge, research and experience with respect to grantmaking (for private foundations with little or no staff); 4) as a preliminary step to PF termination; 5) for year-end paperwork or acknowledgement timing issues; 6) for contributions to new organizations that are engaging in a capital campaign but are not yet ready to accept funds directly; and 7) to fulfill a funding commitment during a good market (leveling process).

Private Foundations

Exception from Excess Business Holdings Tax for Independently-Operated Philanthropic Business

Section § 4943(g) (a.k.a., the *Newman's Own* exception) allows a private foundation to hold 100% of a business's voting stock if:

- **Non-Purchased Ownership**: The foundation acquired its 100% interest by means other than by purchase (e.g., by gift);
- **All Profits to Charity**: Within 120 days of the end of the business's taxable year, the foundation receives all of the business's annual net operating income (defined to offset for certain reductions, such as reserves for working capital and other business needs); and
- **Independent Operation**: The business is operated in an independent manner, which entails that: (a) the business's directors, officers, employees and contractors are not substantial contributors (as defined under Section 4958 principles) to the private foundation (nor family members of substantial contributors, as determined under Section 4958(f)(4)); (b) at least a majority of the foundation's board of directors are not directors or officers of the business or family members of a substantial contributor; and (c) there are no loans from the business to a substantial contributor to the private foundation nor to any family member of such a contributor.

Certain deemed private foundations are not eligible for this exception (e.g., DAFs and supporting organizations).

Open Issues:

- What are reasonable reserves for working capital? What are "other business needs"? How are these categories identified/documented?
- Under the independent operation requirement, substantial contributors and their family members appear to be able to serve as "members" of the private foundation and elect the private foundation's board of directors, right?
- Is 120 days really enough time for businesses to calculate their Chapter 1 taxes following the end of their taxable years and to determine their net operating incomes?

Private Foundations

Executive Compensation Excise Tax

Section 4960 imposes an excise tax equal to the corporate tax rate (21% under the conference agreement) on remuneration in excess of $1 million and on excess parachute payments paid by an organization exempt from tax under 501(a), to any of its current or prior (beginning after December 31, 2016) five highest-paid employees.

Private foundations frequently receive personal services (within the meaning of Section 4941) from the family office of the private foundation's founders. The employees providing personal services track their time and the private foundation reimburses the family office for the employees' time spent on foundation matters. The reimbursement is directly correlated to the employees' salary from which an hourly reimbursement rate is determined (assume the private foundation has separately determined that the salary rate is reasonable for the services provided).

Open Issues:

- If any of these employees would be among the five highest-compensated individuals of the private foundation and their remuneration is greater than $1M (total remuneration from the family office), is such an employee considered a "covered employee" for purposes of Section 4960?
- Could the family office (usually structured as an LLC which is not otherwise subject to the tax on excessive compensation) be liable for some of the Section 4960 tax?
- Does the answer hinge on whether the family office is or is not a "related organization"?
- Is compensation paid by related parties exempt from the excise tax if the services are donated and not reimbursed by the foundation?

Note: other executive compensation excise tax issues will be addressed in a separate session.

Private Foundations

International Provisions of the 2017 Tax Act

Many private foundations own a greater than 10% interest in a controlled foreign corporation for investment purposes or as program related investments.

- TJCA created Section 965 to recognize accumulated deferred foreign income created before 1/1/2018 and be recognized as Subpart F income on foundation's tax return. In addition, the provision works through criteria where the additional income is subject to either a 8% or 15% rate.
- TJCA also added code Section 951A for shareholders of CFCs to include their global intangible low-taxed income (GILTI) in gross income.
- Subpart F income is treated as a dividend unless insurance income pursuant to 512(b)(17)

Open Issues:

- For the provisions under Sections 965 and 951A, how should the income be treated for private foundations?
- Will deemed repatriations be exempt from UBI as investment income? A dividend under 512(b)?
- If a private foundation has deemed repatriation, will it be subject to the 4940 excise tax and the 4940 excise tax rate as opposed to the GILTI 15.5% and 8% rates?
- Is there a requirement to report this on a Form 990PF as a book tax difference to start the statute?

Private Foundations

Non-Operating Foundations Do Not Undertake Active Trades or Businesses

Section 512(a)(6) now provides that if an organization has "more than 1 unrelated trade or business", unrelated business taxable income ("UBTI") must first be computed separately with respect to each trade or business (although prior year NOLs may be included in the calculation). UBTI for the year is the sum of the amounts (**not less than zero)** for each separate unrelated trade or business.

Most traditional, non-operating foundations do not engage in any active programs or activities aside from administering grants to qualifying recipients. Hence, they would never conduct an unrelated trade or business activity directly. The term "trade or business" has generally been defined to mean any activity carried on for the production of income from selling goods or performing services. See e.g., Reg. 1.513-1(b). Most traditional, non-operating foundations do not lease properties, sell goods or services or compete with commercial enterprises. Instead, if they generate any UBTI, they do so through passive activities, which are generally excluded from tax unless they are debt-financed or otherwise subject to UBI.

Open Issues:

- Will "trade or business" be defined for purposes of Section 512(a)(6) to exclude passive sources?
- Will a non-operating foundation's investment activities be considered as a single trade or business activity (i.e., in the aggregate) even though only some components of the foundation's investment portfolio may generate UBI?
    - To put it another way, how will income from pass-through entities be treated? As part of a single investment activity? Or taxed on an investment-by-investment basis?
- How much discretion does the organization have in determining what income-producing activity is a trade or business?

Private Foundations

Business Interest Expense Attribute Flowing through from Partnerships (163(j))

Business interest expense incurred within a partnership is limited at the partnership level that generates the interest expense in the tax year the expense is incurred. Any excess business interest expense though is a carryforward and tracked at the partner level. With a tax-exempt organization, business interest may be incurred and generate UBTI but as the debt gets paid down, the private foundation partner may have less UBTI and more of the partnership income that is excluded from UBTI but instead reported as net investment income. At point of sale of the investment, the private foundation partner may or may not have UBTI from the sale of the partnership interest.

Open Issues:

- Will the excess business interest expense ever be deductible against net investment income?
- Or otherwise usable by the private foundation to offset taxable income?

Universities

Universities

Executive Compensation Excise Tax

Section 4960 imposes an excise tax equal to the corporate tax rate (21% under the conference agreement) on remuneration in excess of $1 million and on excess parachute payments paid by an organization exempt from tax under 501(a), an exempt farmer's cooperative described in section 512(b)(1), a political organization described in section 527, or a state or local governmental entity with excludable income under section 115(1), to any of its current or prior (beginning after December 31, 2016) five highest-paid employees.

Open Issues:

- What instances does the excise tax apply to public universities, if any?
- Does the excise tax apply to public universities that have a ruling indicating its income is excluded under section 115(1)?
- Will there be a procedure to enable a state college or university to relinquish its Section 501(c)(3) or 115 ruling so that Section 4960 will not apply?

Note: other executive compensation excise tax issues will be addressed in a separate session.

Universities

Excise Tax on Endowment Funds

Section 4968 imposes an excise tax on the investment income of eligible educational institutions which: (1) have at least 500 tuition-paying students; (2) more than 50 percent of the students of which are located in the United States; and (3) the aggregate fair market value of the assets of which are at least $500,000 per student as of the end of the preceding taxable year (excluding assets used directly in carrying out the organization's exempt purpose).

Open Issues:

- How will the organization determine the amount of assets used in carrying out the organization's exempt purpose? Will this be determined under principles similar to Regs. 53.4942(a)-2(c)(3)?
- Can assets and investment income be excluded from the calculation if the assets and income are not intended or available for the use in the organization's educational activities? For example, assume an organization operates a museum open to the public and in the same legal entity also operates a school which is an eligible educational institution. Can assets and investment income that are only intended and available for the museum's activities and operations be excluded from the 4968 calculations?
- How is financial aid treated for purposes of counting "tuition-paying students"? What about loans? What about other required fees and charges that are not payments in respect of instruction?

Universities

Excise Tax on Endowment Funds (cont'd)

Open Issues:

- With respect to assets and investment income from related organizations and supporting organizations:
  - How are assets and investment income attributed to educational organizations from supporting organizations that support multiple educational institutions?
  - Will there be a supporting organization diminimus exception for supporting organizations that support multiple organizations both educational and non-educational where the educational organization support is small?
  - Are assets and investment income from related organizations (including supporting organizations) included in the calculations if the assets and income are not intended or available for the use or benefit of the educational organization?
- Calculation, reporting and payment of tax
  - Is income excluded from the excise tax to the extent the income is subject to tax under Section 11 or Section 511?
  - When is the tax due?
  - On what form is the tax computed and reported?
  - Is the excise tax subject to estimated payment requirements?

Universities

Disallowance of Charitable Contribution Deduction (170(l))

No charitable contribution deduction is allowed for a donor who, in return for a contribution to or for the benefit of an institution of higher education, receives the right to purchase tickets for seating at an athletic event in the institution's athletic stadium.

Open Issues:

- What constitutes a "right" to purchase tickets? Is it a right that is legally enforceable under state law?
- If a donor receives "priority points" that serve to rank the donor for seat selection purposes vis-à-vis other donors, do the priority points represent a "right to purchase tickets for seating" that will cause the donor's entire contribution to be nondeductible?
- If the donor's receipt of priority points triggers a charitable contribution deduction disallowance, would the result be the same if the donor receiving the points does not otherwise have a right to purchase tickets, for example, because only members of the university's athletic foundation are able to purchase tickets and the donor is a non-member, or because the donor does not accumulate enough points to enable the donor to purchase a ticket?

Thank you for the opportunity to share our comments.

TEGE Exempt Organizations Council

Tax Reform – Open Issues

International and Executive Compensation

March 16, 2018

Purpose

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Today's Topics

- Purpose
- International
  - 951A Current inclusion of GILTI
  - 59A Base Erosion Tax (BEAT)
  - Administrative burden of international tax forms
  - Bank Secrecy Act, Foreign Agent Registration Act, Bank Examiners Manual

- Executive Compensation

Exempt Organization - UBI

Section 951A –Current Year inclusion of global intangible low-taxed income (GILTI)

- Section 951A (GILTI): The inclusion required by section 951A is not treated as subpart F income except (see section 951A(f)) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959 , 961, 962, 993(a)(1)(E), 996(f)(1) , 1248(b)(1) , 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D) , and 6655(e)(4).
- **Open issues:**
  - The list above does not include Section 512(b)(17). How will GILTI be characterized for a tax-exempt entity?
  - Is it possible to apply past IRS precedents (Sub F PLRs and rulings) relevant?
  - Accordingly, the UBTI status of GILTI must be tested, but how?
  - Corporate shareholders are allowed a 50% deduction, how would this be handled at the tax exempt level and reporting?
  - Are there opportunities to delay implementation until this is better understood and the IRS does not receive a range of interpretations in upcoming filings?

Exempt Organization - UBI

International. Section 59A – Base Erosion Anti-Abuse Tax (BEAT)

- Section 59A (BEAT): Payments that are treated as full inclusion subpart F income or as GILTI appear as if they may also be fully subject to the BEAT, even though there may be no net tax benefit for payments subject to full inclusion and only a reduced tax benefit for payments included in GILTI. Although the threshold of deductible payments to foreign affiliates that is necessary for the BEAT to become a positive tax liability is so high as to exclude most exempt organizations, there will be some that do get pulled into it.

Open issues:

- Some of the same questions that exist for GILTI – such as the failure to include Section 512(b)(17) – exist for BEAT and how it will be characterized for a tax-exempt entity(?)
- Is it possible to apply past IRS precedents (Sub F PLRs and rulings) relevant?
- Like GILTI, the UBTI status of BEAT may need to be tested, as well?
- Are there opportunities to delay implementation until this is better understood and the IRS does not receive a range of interpretations in upcoming filings?

Exempt Organization –

Administrative burden of international tax forms

Subpart F income for most tax exempt organizations have no tax impact. However, there is an administrative burden regarding subpart F reporting by tax-exempt organizations that does not appear to serve a tax purpose. Further, with the international tax reform provisions, the administrative burden will increase substantially, in part because subpart F income is reported on a Form 5471. There is no current exception for tax exempt organizations from this filing requirement.

Of the 501(c)(3) organizations, private foundations are affected by subpart F income for net investment income tax purposes. However, public charities, as well as pension plans, VEBAs and other exempt organizations are not.

Open issues:

With the new transition tax, GILTI and BEAT – there are new and more complex calculations of subpart F income. Many non-profits are passive investors in a diversified portfolio of investments which include international investments. As a result, they may have subpart F income to report on a Form 5471. Historically, this has been burdensome but manageable. However, with the new and even more complex calculations, particularly for GILTI, this will be particularly burdensome on non-profits. Note: for GILTI, the actual calculation of the inclusion depends on the shareholder entity type as the "rate" is part of the calculation. Accordingly, we anticipate that partnerships will provide all the gross numbers included in a calculation of the GILTI income inclusion but will not provide the actual income inclusion amount, leaving the tax-exempt organization to determine this for themselves.

At the same time, 926's and 8865's similarly appear to have no tax impact for non-profits but do raise considerable administrative burdens and costs, as well as the administrative burden on the IRS of collecting all of these forms.

Please consider administrative relief from these filing requirements for non-profits that do not have a tax consequence associated with their international investments.

Exempt Organization – Operating Environment

Bank Secrecy Act, Foreign Agent Registration Act, Bank Examiners Manual

- While we review tax reform with an exempt organizations lens, we want to mention other regulatory issues that affect exempt organizations working internationally. We hope spotlighting these issues will minimize further unintended consequences to charities as regulations are written.
- **De-Risking:** Access to financial services is difficult for civil society organizations that must conduct international financial transactions to operate overseas where their work is needed most. Financial institutions may delay, or refuse to make, transfers between organizations. Sometimes, nonprofit organizations (NPOs) are turned away as customers or have their accounts closed. *De-risking could change depending on the Bank Secrecy Act Legislation being considered by Congress this year.*
  https://www.cof.org/sites/default/files/documents/files/International-Issues-IRS-Guidance-2017-2018.pdf
- **Open issues:**
  - Is there written guidance by TE/GE that charities working overseas can point to regarding the importance of financial access for charities? https://www.treasury.gov/resource-center/terrorist-illicit-finance/Pages/protecting-index.aspx, http://files.acams.org/pdfs/2016/Derisking-Final.pdf

Compensation and Fringe Benefits

Compensation Excise Tax

Act Section 13602(IRC §4960) – regarding universities

Section 4960 imposes an excise tax equal to the corporate tax rate (21% under the conference agreement) on remuneration in excess of $1 million and on excess parachute payments paid by an organization exempt from tax under 501(a), an exempt farmer's cooperative described in section 512(b)(1), a political organization described in section 527, or a state or local governmental entity with excludable income under section 115(1), to any of its current or prior (beginning after December 31, 2016) five highest-paid employees.

The new provision applies to organizations that have income excluded from taxation under Code Section 115(1) but does not reference state or local governmental units or "integral parts" thereof.

Open issues:

- Guidance that provides state college and universities are excluded as it appears the above omission appears to indicate that the excise tax does not apply to such entities.
- What instances does the excise tax apply to public universities, if any?
- Does the excise tax apply to public universities that have a ruling indicating its income is excluded under section 115(1)?
- Will there be a procedure to enable a state college or university to relinquish its Section 501(c)(3) or 115 ruling so that Section 4960 will not apply?

Compensation Excise Tax-Compliance

Act Section 13602(IRC §4960)- generally from a compliance perspective

Subjects a tax-exempt organization to a 21% excise tax on compensation in excess of $1 million paid to any of its covered employees for the tax year

Open issues:

- Due dates for remittance, filing, estimates, and penalties. Is the excise tax deductible to the extent compensation is allocated to UBI activities? Potential to report and remit on controlled group basis?
- On what form is the excise tax paid? Given first quarter estimates are due soon for calendar year taxpayers, exempt organizations need to know how to pay in. Further, this may be difficult to determine early in year (person leaves, will top 5 be same as prior year or have more people, etc.)
- How are the 5 highest compensated employees determined? The new provision does not define the " 5 highest compensated employees."
- The statute also appears to use the fiscal year of the organization in determining the "high 5." Compensation information used for this purpose may not be how the organization tracks or reports its compensation (as defined for this excise tax). Can guidance provide relief so that in determining the "high 5," remuneration can be determined based on a measuring period other than the fiscal year of the organization such as the calendar year as is currently done for 990 Part VII and Schedule J purposes?
- What is the impact of a change in employer within a controlled group?

Compensation & Fringe Benefits

Act Section 13602(IRC §4960)- continued

Subjects a tax-exempt organization to a 21% excise tax on compensation in excess of $1 million paid to any of its five highest-paid employees for the tax year

Open Issues:

- Is the "covered employee" determination made on an entity-by-entity basis? Although the statute does not include an explicit controlled group or affiliated group rule, it does not appear that the intent of the statute was to require large exempt organizations with multiple exempt entities within their organizational structure to separately track and pay an excise tax on covered employees of each entity. We note that Section 162(m) also does not include a controlled group rule, but the regulations provide that the deduction limitation rule is applied on the basis of an affiliated group of corporations.
- How is "remuneration" determined under the related organization rule in the case of an employee is employed and paid by both a tax-exempt entity and a related taxable entity? In this case, is the remuneration paid by the taxable organization included for purposes of allocating the excise tax between the tax-exempt and taxable entities, only for purposes of determining who is a covered employees, or not at all. Taxable organizations are subject to a current and deferred compensation tax regime applicable to taxable employers; it would follow that a taxable organization should not also be subject to the excise tax that is designed to be imposed only on applicable tax-exempt organizations.

Compensation Excise Tax-Compliance (continued)

- **Potential Solutions:**
  - Compensation period – follow the calendar year of a fiscal year organization as utilized on Form 990, Part VII, Section A for ease of administration and consistency.
  - Excess compensation excise tax- Allow annual remittance on a controlled basis through the use of parent organization's filing of a Form 720 for the April 30 filing deadline. The Form 720 will need revision of Part I, the space under line 97 vaccines is labeled reserved for future use.
  - Allow the deductibility on Form 990-T of excise tax on excess compensation for individuals whose compensation is allocated to a UBI activity using the same % allocation for salary to UBI.
  - Determination of related party and controlled group- use the current Form 990 Glossary definitions of these terms.

Compensation-Covered Employee

- **Open issues:**

  Clarification on if a covered employee includes-(i)an employee of an organization other than the applicable tax exempt organization; (ii) who provides services to the applicable tax exempt organization; (iii) who track time spent providing services to the applicable tax exempt organization; (iv) whose time is reimbursed by the applicable tax exempt organization on a basis that is pro-rata of the individual's salary paid by the employer; (v) is the family office of a private foundation's founder a related organization.

- **Potential Solutions:**

  Guidance clarifies each statutory employer, common law employer, payroll agent etc. situations and how related parties figure into the aggregation of compensation for purposes of determining highest compensated plus where the excise tax liability resides in each situation. Perhaps a chart similar to that created for 990 Part VII purposes.

Compensation, Remuneration

- **Open Issues:**
  - Remuneration does not include remuneration paid to a licensed medical professional for the performance of "medical services." The term "medical services" is not defined. Does "medical services" include remuneration for services that are not directly related to providing patient care such as medical director, intern and resident programs oversight or teaching?
  - If the medical professional provides medical and other services will the compensation paid have to be allocated between the services to determine whether they are covered employees for purposes of the "high 5" requirement.
  - Are individuals who perform medical services considered in determining the highest 5 for a tax year but not considered for purposes of the excise tax itself?

Compensation, Remuneration- continued

- **Potential Solutions:**
  - Because of the regulatory oversight required- defining medical services to include medical directorships and positions that teach and oversee residents in a patient delivery setting.
  - Providing allocation for medical and non-medical services be determined based on contractual or employment agreement documents for the individual.

Compensation & Fringe Benefits

Act Section 13702 & 13703 (IRC Sections 512 & 513)

Value of providing their employees with transportation fringe benefits and on-premises gyms and other athletic facilities by treating the funds used to pay for such benefits as UBTI.

Perils: Including as UBI fringes is not equal footing to disallowing deductibility of similar fringes to taxable entities. It is likely for many exempt organizations, taxation of these fringes will cause the first occurrence for the organization of a Form 990T filing.

Open Issues:

- Compliance perspective: UBI silo purposes provide guidance on how will fringes can be allocated to one or more UBI activities. Written guidance is needed regarding due dates for remittance, filing, estimates, and penalties; guidance for FYE how to report on 2017 form 990-T.

- Athletic Facilities-Will formal guidance be provided on employer provided on-site workout facilities. Some commentators have stated that IRC Section 274 will still remain effective for on-site employer workout facilities, and, therefore, there is no actual income inclusion for on-site workout facilities..

Fringe Benefits – Employer Provided Parking

- **Open Issues:**
  - Clarification regarding whether taxation is only to the extent of amounts excluded under a qualified fringe benefit as provided under IRC Section 132(f).
  - Clarification regarding whether parking facilities open free of charge to customers or public and employees on equal basis are subject to this provision (see concepts similar to Notice 94-3, Q 10).
  - Clarification determining value of the benefit: is cost to park or value? How is value determined, based on what is charged in in the particular lot or does it include similarly situated or close proximity third party lots.
  - Language of Sec 512(a)(7) states that "Unrelated business taxable income of an organization shall be increased". Confirm that this does not mean that this does not cause the use of such parking facilities to necessarily be unrelated use for purposes of determining private business use for tax exempt bond financed facilities (see Sec 145(a)(2)(A)).
  - Treatment of dual use facilities for UBI inclusion amount– mixed customer or patient/employee use - how to allocate costs? Note some employees may not use parking at their employer's premises (walk, buses, car pools). Plus may have shifts where same spot is used by multiple employees during the course of a 24 hour period.
  - Guidance as to computation of value if choose to include in employee's income- leased property where lease does not break out parking garage or lot cost, if certain employees (sliding scale by wage level) or lessors are charged different rates to park.
  - Intersection of these amounts with new provisions in Sec 512(a)(6) SPECIAL RULE FOR ORGANIZATION WITH MORE THAN 1 UNRELATED TRADE OR BUSINESS.

Fringe Benefits – Employer Provided Parking (continued)

- **Potential Solutions:**
  - For free parking that is not monitored as to who parks for free, employees or general public, can there be a de minimus rule based on concept that there is no incremental cost or foregone revenue, therefore no taxable benefit?
  - New taxable fringe benefits be allocated among the UBI activities based on allocable proportion of employees involved in that UBI activity to total employees.
  - Relief from underpayment of estimated taxes for transition year.
  - Relief from bond financed property tainting from the new taxable parking fringe benefit.

Fringe Benefits- Mass Transit

Act Section 13702 & 13703 (IRC Sections 512 & 513) -continued

Exempts entities on the values of providing their employees with transportation fringe benefits for mass transportation by treating the funds used to pay for such benefits as UBTI

Perils: Mass transit should not discouraged for obvious reasons such as environmental, safety, and traffic. In addition, mass transit benefit generally benefit lower wage earners.

Open Issues:

- Mass transit applicability & valuation issues:
  - If mass transit benefits are provided under a salary reduction plan within the guidance of IRC Section 132(f) and 274 is UBI still an issue?
  - What if an agreement with municipality requires mass transit passes to be provided to employees?
  - Employer collects transit pass charges from employees on wage based sliding scale.
  - Mass transit system bills the university a per-ride charge which may differ from fares. Transit system does not report employee versus student rides. Dual status persons, part-time employee of university and student.
  - Would university provided campus and housing transportation provided free of charge to employee and student riders be a transportation fringe. If so, how valued.

Fringe Benefits- Mass Transit (continued)

- **Potential Solutions:**
  - Limit applicability of the provision to mass transit provided through salary reduction fringe benefit plan.
  - University provided bus transportation to students, employees and faculty should be exempt from UBI.

Observation – some organizations are actually withdrawing bus passes and other transportation benefits under IRC section 132 due to this UBI provision. Unfortunately, these bus passes typically benefit low income employees.

Thank you for the opportunity to share our feedback.