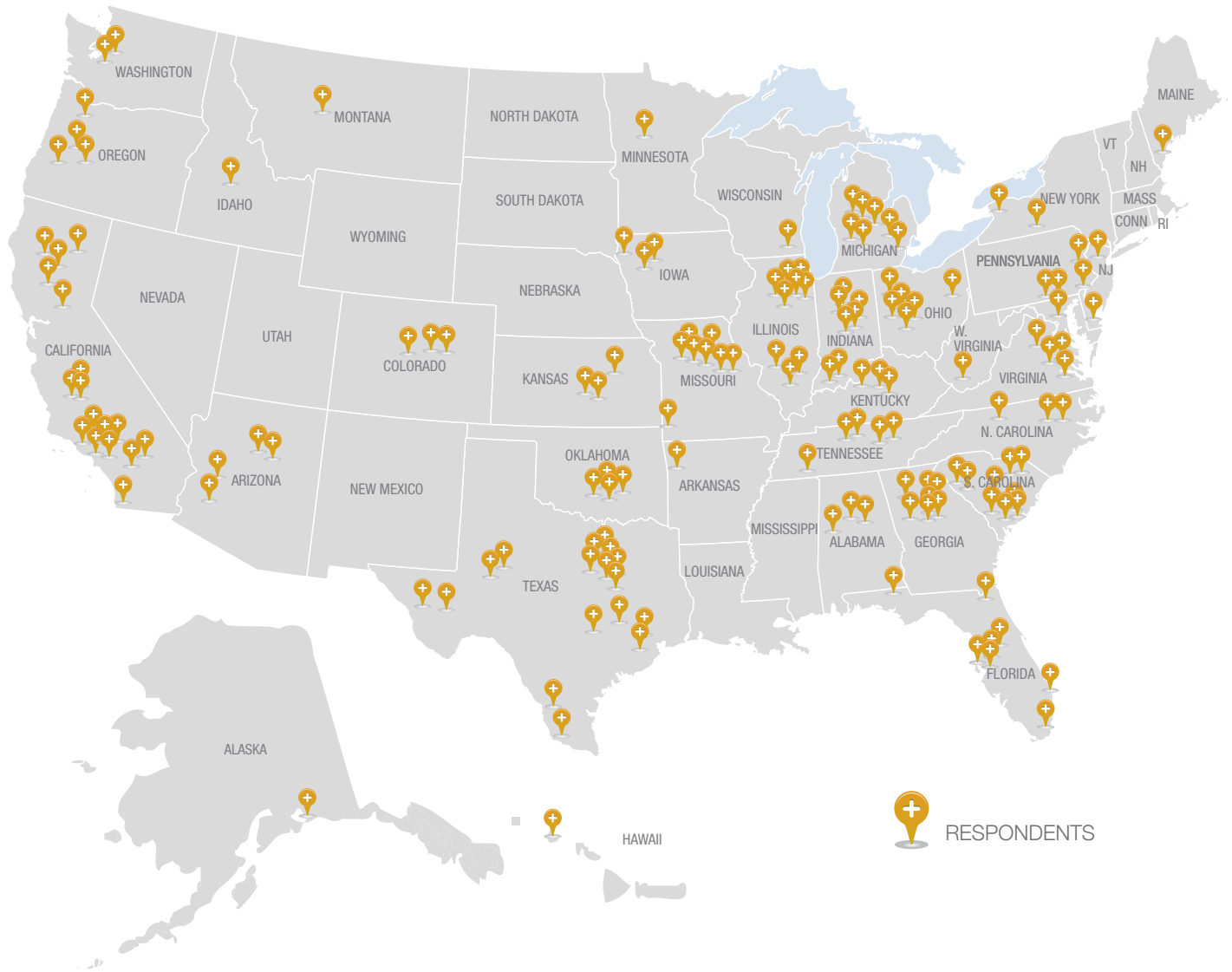


# 2011 Higher Education Tax Reporting Trends Project

FALL 2011



*AgapeFest*, Cover photo courtesy of Greenville College



We are very pleased to present the 2011 edition of CapinCrouse LLP's annual *Higher Education Tax Reporting Trends Project*. We would like to start by sincerely thanking the 155 colleges, universities, and seminaries who participated in the study. Participating institutions were located in 36 states (and Washington, D.C.) across the U.S., from Florida to Maine, Alaska, and Hawaii.

The current enrollment of the 155 participating institutions of higher education averaged 1,522, with the largest having just over 14,900 students and the smallest having an enrollment of 15.

We separated the respondents into three categories:

	Category A	Category B	Category C
Enrollment	1,700+	500-1,700	Under 500
Respondents	49	47	59

Among the survey participants, 38 organizations do not file Form 990. Of those, nine are under a "group exemption" from the IRS. Four of the Form 990 non-filers fell into Category A, 10 were in Category B, and 24 were in Category C.



*His Girl Friday*, photo courtesy of Cornerstone University

## INTRODUCTION

Welcome to the second edition of CapinCrouse's annual *Higher Education Tax Reporting Trends Project*. This unique statistical review includes financial, tax, and demographic data compiled from our 2011 college, university, and seminary web survey, and from reviews of the 2009 Return of Organization Exempt from Income Tax (Form 990) filed by 117 of the respondents.

Our goal is for this report to be a useful reference guide when preparing and reviewing your 2010 Form 990 (for the tax years ended in 2011). While we recognize that no two higher education institutions are exactly alike, **the editorial and statistical information contained here should help your accounting team gain a better understanding of tax reporting and the manner in which peer institutions answer line items on the annual Form 990.**

Our web survey asked seven questions, including whether the institution has a state-issued collegiate license plate, receives income from a telecommunications tower rental agreement, hangs "sponsorship" banners in its sports venues, or provides a residence for its president. We also asked about radio stations that broadcast to the public, whether a merger/acquisition had been contemplated, and if overhead costs were allocated among the three functional expense categories.

Of the 155 institutions that completed the web survey, 38 historically do not file Form 990, for a variety of reasons. We used [www.guidestar.org](http://www.guidestar.org) to review the 2009 Form 990 filings for the

117 organizations that do file. In our overview, we looked at each institution's foreign bank and financial account (FBAR) filing and the reporting of government grants, as well as whether they used a paid preparer to complete the 990 and broke out accounting and other professional fees on the functional expense statement (Part IX, Line 11).

We made a slight change in formatting the statistical data this year and dropped the ceiling for Category C schools to 500 students, rather than the 700 used in the 2010 report. This added a few institutions to Category B (500 – 1,700 students).

Our objective is for the data in this report to help with your future tax compliance filings and assist you in training and informing your board, management group, and accounting team. We are always happy to answer any questions you may have and to discuss how these industry-wide tax reporting trends may be affecting your institution.

We also welcome comments and suggestions on how we might improve the content or presentation of this report in future editions. Please direct your comments or questions to [collegetax@capincrouse.com](mailto:collegetax@capincrouse.com).

Thank you for allowing us to serve your audit, tax, and consulting needs. We appreciate your continued support.

— The CapinCrouse Not-for-Profit Tax Team





*Silent Night*, photo courtesy of Taylor University

## WEB SURVEY

	Responses to Question	Total Survey	Category A Universities	Category B Universities	Category C Universities
What is your current enrollment? (average)	155	1,522	3,605	1,020	193
Does your college (or alumni association) have a state-issued collegiate license plate?	155	22.6%	51.1%	23.4%	1.7%
Does your institution receive revenue from a cell phone company for tower or equipment space rental?	153	24.8%	41.7%	23.9%	11.9%
Does your school have sponsorship banners or signs hanging / posted at any of your sports venues?	155	43.2%	67.4%	53.2%	15.3%
Does your institution provide a house for your president to live in?	154	37.7%	51.1%	42.6%	19.0%
Does your school have a radio station that broadcasts to the public?	155	19.4%	42.9%	12.8%	5.1%
Has your school considered or completed a "merger" with another organization within the past three years?	154	13.6%	8.2%	17.0%	15.5%
Does your organization allocate overhead costs between the three functional expense categories?	153	68.6%	77.1%	78.3%	54.2%

## FORM 990

Does your school file Form 990?	117	75.5%	89.8%	78.7%	59.3%
Does your college pay a preparer to complete Form 990? (if you file)	117	70.9%	55.5%	78.4%	82.9%
Did your institution report "FBAR" accounts?	117	18.0%	31.1%	13.5%	5.7%
Did you report "fundraising events" on Form 990?	117	35.0%	46.7%	37.8%	17.1%
Did your institution report Government Grants on Form 990?	117	65.8%	84.4%	75.7%	31.4%
Did you break out Accounting and other professional fees?	117	82.1%	95.6%	70.3%	77.1%

## EXECUTIVE SUMMARY

For the 2011 edition of the *Higher Education Tax Reporting Trends Project*, we processed responses from 155 institutions in our web survey. Of these schools, 117 filed Form 990. The web survey asked the following “Yes” or “No” questions:

- Does your college (or alumni association) have a state-issued collegiate license plate?
- Does your institution receive revenue from a cell phone company for tower or equipment space rental?
- Does your school have sponsorship banners or signs hanging/posted at any of your sports venues?
- Does your institution provide a house for your president to live in?
- Does your school have a radio station that broadcasts to the public?
- Has your school considered or completed a “merger” with another organization within the past three years?
- Does your organization allocate overhead costs between the three functional expense categories?

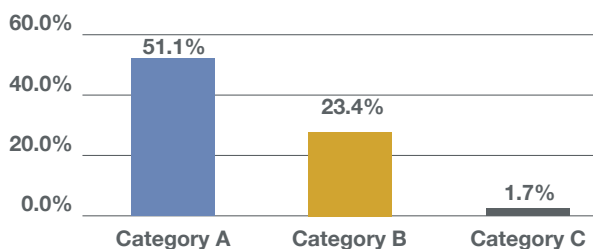
In addition, we reviewed the 117 Form 990s filed by the survey participants. (Thirty-eight do not file the form, for a variety of reasons.) We looked at these items:

- Does your school file Form 990?
- Does your college pay a preparer to complete Form 990?
- Did your institution report “FBAR” accounts?
- Did you report “fundraising events” on Form 990?
- Did your institution report Government Grants on Form 990?
- Did you break out Accounting (and other professional fees)?

The responses to these queries are summarized on Page 1. We had almost twice as many respondents in 2011 as we did for the 2010 report.

An overview of each of the items looked at for the 2011 report is below.

### State-issued Collegiate License Plates

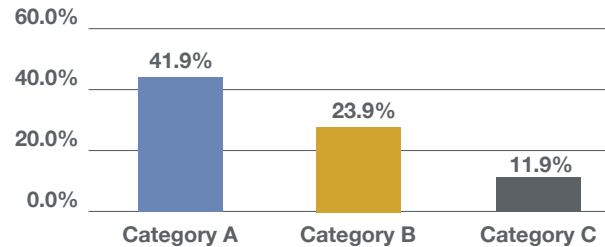


As we traveled around the country this year helping various colleges, universities, and seminaries analyze their unrelated business activities, we noted that several received funding from college license plates. In several states, the process to apply for and be granted one of these plates is well established and not difficult. Our research shows that 44 states have some type of specialty license plate program that allows not-for-profit groups, including higher education institutions, to establish a license plate with their name or logo on it. The barrier to entry can be high, though. In most instances, states

require the applying college to accumulate orders of between 50 and 500 vehicle owners before establishing the plate for production. In some states the plate is ordered or requested through the school, while in others the vehicle owner is able to choose the collegiate plate when they acquire or renew their car tags. Also, the amount of funding, if any, that the school receives varies from state to state.

Overall, if you don't have a state license plate for your school it is probably worth looking into. A state license plate featuring your institution's name and logo is a great public awareness opportunity and may even net your college, university, or seminary some nice funding in the process.

### Cell Phone Tower or Equipment Space Rental

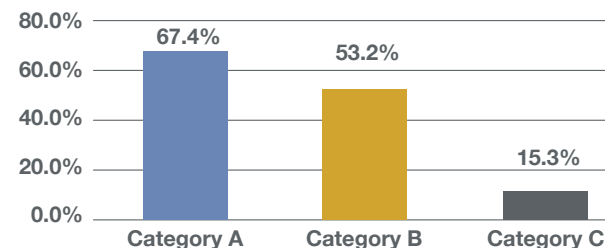


Historically, there have been three types of cell phone tower rental scenarios available to not-for-profit organizations.

In the first scenario, the organization rents land to a cell phone company. That company installs its own tower, generally with a fence around it, and maintains everything, with the organization providing no services. The second scenario is the same as the first, except that the land is debt-financed. In the third scenario, the organization owns, maintains, and services a radio, media, or telecommunications tower and rents equipment space on the tower to one or more cell phone companies.

Generally, the first scenario won't be subject to unrelated business income tax (UBIT), but the other two will. There are many codicils, nuances, exceptions, and facts that can change the UBIT determination, so this is not set in stone. This year we've seen many different “what if” scenarios regarding UBIT and cell phone tower rentals: What if your college is not in a heavily populated area and your students would not have cell/PDA coverage if you didn't contract with a provider? What if the cell phone company rents space in the steeple of your chapel? What if you have board-approved plans to utilize the debt-financed property in the next 10 years? All of these matters, and many more, come into play when you analyze the taxability of cell phone tower rentals.

### Sponsorship Banners Posted in Sports Venues

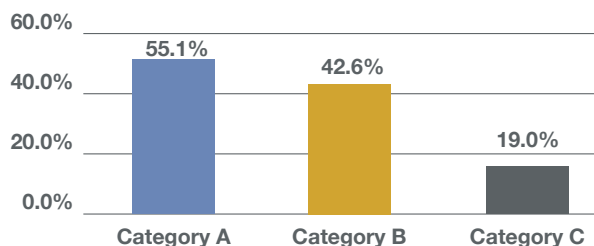


In our tax team's visits to over 25 campuses in the past year, we've visited gymnasiums, aquatic centers, baseball stadiums, and soccer fields searching for "advertising" verbiage on sponsorship banners or signs hung in these venues.

Wording on banners — and for that matter, in program acknowledgments — is generally considered "corporate sponsorship" if it acknowledges the "sponsor" rather than advertising their products or services. In over 95% of the cases we observed, the banners appeared to make the grade as acknowledgements that resulted from "qualified sponsorship payments."

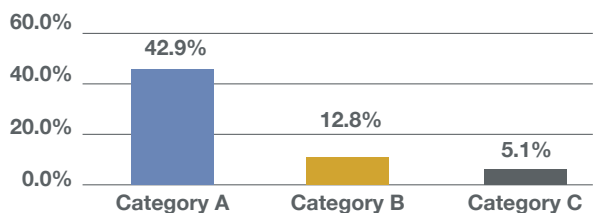
In a sponsorship arrangement, the key question is whether the payment is a contribution to the higher ed institution ("qualified sponsorship payment") or the purchase of advertising. Advertising wording includes an "inducement to buy" or "comparative language." But it doesn't stop there. The concept of a "substantial return benefit" for the sponsor also comes into play. Advertising is one substantial return benefit. Another can occur when the sponsor receives something valued at greater than 2% of the payment, such as season tickets to sporting events. This is a complicated area. With the IRS looking very closely at the unrelated business activities of colleges and universities, we encourage every institution to monitor the full spectrum of potential unrelated business income sources.

### Housing Provided for President



This is an interesting area of tax law. Generally, higher education institutions that provide housing for their presidents or other executives appear to be excluding the value of that housing from compensation based upon the tenets in Internal Revenue Code section 119, but the application of those requirements can be tricky. More than a third of the 155 respondents in our survey (37.7%) reported that they provided a residence for their president. For the residence to be excluded from compensation, the three "hurdles" of section 119 must be met. This means that the residence must be: 1) for the convenience of the employer; 2) a condition of employment; and 3) "on the business premises." Note that there are several nuances and interpretations possible in all three. There also are special reporting requirements for Form 990, Part VII and Schedule J that need to be considered.

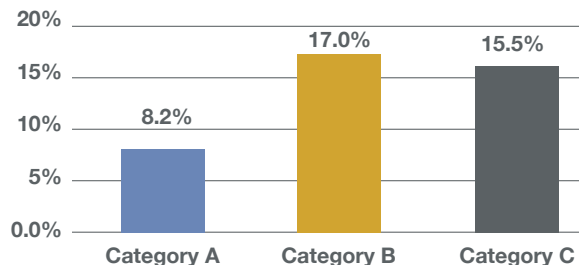
### Radio Station that Broadcasts to the Public



Dave did a stint as a college radio DJ about 100 years ago, so he's somewhat biased when it comes to this subject. He admits that he thinks every college, university, and seminary should have some type of radio presence — a voice! So while there have been numerous articles over the past few months mourning the "decline of college radio," Dave was surprised that more campuses in each category did not report that they operate a radio station. Overall, less than 20% of our respondents answered "Yes" to this question. Only about 43% of Category A, 13% of Category B, and 5% of Category C institutions reported that they have content out on the radio airwaves.

As we dug a little deeper and talked to some of the participating institutions, we got some interesting comments. At least three of the participants are in the process of selling their stations, but a few others are considering establishing a radio presence in the near future. The full spectrum of radio includes colleges operating a for-profit station; institutions powering out Christian tunes via an exempt, but regional, station; low-power stations designed to cover the campus only; and Internet stations that can be enjoyed by a worldwide audience. No matter what type of broadcasting you may do, college radio could provide information and entertainment to your students, a connection with your community, a taste of your college to potential students, and maybe, just maybe, some needed revenue through properly designed "qualified sponsorship payments."

### Considered or Completed a Merger in the Past Three Years



Right up front, let us say that "merger" is something of a misnomer, given the scope of recent accounting pronouncements. But "Pooling of Interests and Acquisitions" didn't have much snap as a title. This question arose from conversations we've had over the past few years with institutions that came to us with tax questions about possible "mergers." We've heard about some interesting opportunities in this arena, and several of our survey respondents said they had considered or completed mergers with other schools.

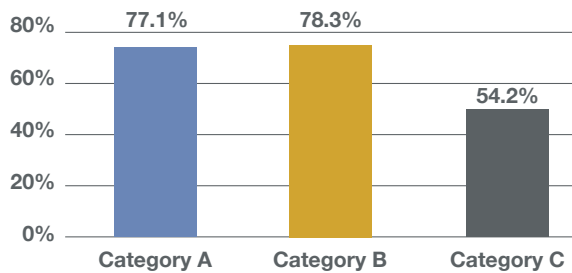
What about a scenario where your college merges with a well-established missions or relief organization, for example? In this tough economy, contributions from the public are down. But if a college and a relief organization "merged" there could be several benefits, such as:

- A defined, established network for student mission trips
- Additional donors for the college's endowment or foundation
- Hands-on experience for various areas of study (ministry, accounting, management, etc.)
- More exposure to potential students

We're just brainstorming here, but with the current economic situation in the U.S. and students who want to make a difference, there may be some amazing "merger/acquisition" opportunities out there for your institution!



## Allocation of Overhead Costs Between Program, Management & General, and Fundraising



After last year's *Tax Reporting Trends* report was published, numerous colleges asked us about this question. Our intent was to see whether institutions included overhead costs only under "Management and General" on the Functional Expense section of Form 990 (Part IX, Column C), or whether they allocated various overhead expenses between the three functional categories.

Ultimately, a lot more could be read into the issue than what we were asking. For instance, were we talking about just occupancy-type costs or were other costs to be included? Also, some institutions allocate for their audited financial statements but do not file a Form 990. But after some clarification, we believe the percentages represented here are solid. Again, this information came from the web survey responses of 153 respondents (two did not answer), not from our review of Form 990, Part IX.

### Form 990 Review of Data

Of the 155 participants in this year's report, 117 filed Form 990s:

- Category A: 45**
- Category B: 37**
- Category C: 35**

After completing our review, we are concerned that Form TD F 90-22.1 (FBAR) may not be receiving the attention it deserves. If you are required to file Schedule F, Part I, you should look very closely at whether FBAR filing is required. We'll talk about this in detail later in this report.

Another area we looked at was "fundraising events." The Form 990 instructions define these events as: "dinners and dances, door-to-door sales of merchandise, concerts, carnivals, sports events, auctions, casino nights (in which participants can play casino-style games but the only prizes or auction items provided to participants are noncash items that were donated to the organization), and similar events not regularly carried on that are conducted for the primary purpose of raising funds."

Overall, only 35% of the 2011 *Tax Reporting Trends* participants reported conducting these events on Form 990, Part VIII, Line 8 and (if applicable) Schedule G, Part II. Given the current economy, if you are in the 65% not holding "events" these days it may be time to start considering them.

In addition, about 66% of the institutions in our survey who filed Form 990 included an amount for "Government Grants" on Part VIII, Line 1e. There seems to be some confusion about what amounts should be included here. The specific instructions say:



*Roots of Giving*, photo courtesy of Point Loma Nazarene University

A grant or other payment from a governmental unit is reported here if its primary purpose is to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public rather than to serve the direct and immediate needs of the governmental unit. In other words, the payment is recorded on line 1e if the general public receives the primary and direct benefit from the payment and any benefit to the governmental unit is indirect and insubstantial as compared to the public benefit.

The following are examples of governmental grants and other payments that are treated as contributions and reported on line 1e:

- Payments by a governmental unit for the construction or maintenance of library or museum facilities open to the public.
- Payments by a governmental unit to nursing homes to provide health care to their residents.
- Payments by a governmental unit to child placement or child guidance organizations under government programs to better serve children in the community.

A high number of Form 990 filers in each category are correctly breaking out accounting and other professional fees on Form 990, Part IX, Line 11a-g. The overall percentage was 82%.

If your institution does not break out professional fees, you should be aware that the IRS considers your Form 990 to be incomplete or inaccurate. If you check boxes to say an independent audit was completed and do not show accounting fees on Part IX,

Line 11c, that is an obvious inaccuracy. Likewise, if you show a healthy amount of investment income (we know, we know... it's the economy...) on Form 990, Part VIII, Line 3 and don't enumerate investment management fees on Part IX, Line 11f, an IRS auditor may deem you to be subject to penalties for an untimely, inaccurate, or incomplete return.

The data in this report is designed to help as you analyze and evaluate your institution's financial performance and endeavor to prepare Form 990. And as always, the CapinCrouse Tax Team is available to answer any questions you may have about these and other issues confronting colleges, universities, and seminaries today.

## WHAT IS THE IRS UP TO?

The IRS is currently involved in many initiatives and projects of interest to the higher education community. But there are three you should be following with particular interest.

### College and University Compliance Project (CUCP)

This project started with a questionnaire sent to 400 colleges in late 2008. An interim report was released in May 2010, and it included a great deal of good information. The IRS is currently auditing over 30 of the project participants, and expects to issue a final report when all the audits are complete. At a recent conference, an IRS Exempt Organization official stated that "a few of the audits are complete and all of them are winding down." We expect the final report to contain information that will be enlightening and of great value to the accounting teams at colleges, universities, and seminaries. We will report those findings to you when the report is released.

The two main areas being looked at in the CUCP audits are unrelated business income tax (UBIT) and executive compensation. On the UBIT side, the IRS is focusing on "very, very large losses" reported on Form 990-T for years. The IRS tends to view these activities as not being engaged in for profit, and thus the Service is apparently working to disallow the losses in the calculation of unrelated business income.

In the area of executive compensation, the IRS is looking closely at occurrences of excess benefit transactions. The focus is two-fold. First, they are looking at whether the "benefit" to the disqualified person is greater than the "benefit" to the institution, which is considered unreasonable compensation. And second, they are looking at whether all "benefits" are reported.

### Employment Tax Compliance Initiative

The IRS has also begun conducting audits of employment tax issues under a National Research Program (NRP). The NRP will cover three years: 2008, 2009, and 2010. For each year, 2,000 entities will be selected at random to be audited, for a total of 6,000 audits. The IRS has stated that at least 500 in each year will be exempt organizations. The audits will include worker classification, fringe benefits, executive compensation (including section 409A deferred compensation), employee expense reimbursement plans, and non-filers. Those five areas, however, are only guidelines, and randomly selected employers should expect revenue agents to examine everything thoroughly to uncover hidden employment tax issues.

The information requested for the initiative is vast. If your institution is selected, you'll receive Form 4564 (Information Document Request). In some cases we've seen one Form 4564; in others we've seen up to nine. The requested information includes all

W-2s, 1099-MISCs, Forms 941 for all four quarters in a given year, and employee benefit plan manuals, procedures and handbooks. In addition, the IRS asks for accounts payable data including vendor listing files, disbursements records, a copy of your general journal, and a list of your organization's highly paid employees with all "non-payroll related payments made to those employees," including cash and non-cash payments.

But wait, there's more — the IRS also wants copies of bank and investment records for all accounts open during the given tax year, including "monthly statements, deposit tickets, check register, cancelled checks, letters, loans, etc."

In addition, you will need to provide copies of all board meeting minutes and copies of any contracts with employee unions and executives, plus all contracts with outside contractors. Finally, you are to provide copies of your annual report, audited financial statements, and any letters to management from independent auditors or internal auditors for the year in question.

There also appears to be a special Form 4564 for colleges and universities. It has the heading "Non-citizen working students and faculty," and requests that you provide "a listing of your employed international (alien) students, research scholars, faculty, staff" and various data about these employees. Some of the requested data includes copies of contracts, country of origin, and type of visa for each.

Being part of the on-site Employment Tax Compliance Initiative can cause some disruption to your accounting team, and require a large investment of time. All higher education institutions should review the areas of focus in this initiative to ensure that, if questioned, you can support your decisions. Complete and accurate records, as well as sound policies and procedures, should help make any examination less stressful and time-consuming and reduce the potential tax exposure.

### 403(b) Plan Compliance Initiative – Higher Education Institutions

You should also be aware of a featured project that the IRS's Employee Plans Compliance Unit (EPCU) is in the process of starting. According to the description,

This project focuses on higher education organizations sponsoring Internal Revenue Code (Code) section 403(b) plans and their satisfaction of Universal Availability (UA) non-discrimination rules and new plan document requirements. The project builds upon a similarly focused 403(b) pilot project involving K-12 public schools. For purposes of this project, higher education organizations refers to academies, universities, colleges, seminaries, institutes of technology, and other collegiate level organizations, such as vocational and trade schools that award academic degrees or professional certifications.

The project will be conducted by sending "information request packages" to 300 higher education institutions. The packages include Form 886-A, a 21-question survey that will allow the EPCU to begin examining the 403(b) plan processes at the randomly selected institutions. You can learn more at <http://www.irs.gov/retirement/article/0,,id=238459,00.html>.



## FOREIGN BANK AND FINANCIAL ACCOUNT (FBAR) REPORTING

Among the tax questions we've heard most frequently this year, many have been related to foreign bank and financial account reporting, or "FBAR." The Bank Secrecy Act may require your institution or some of your executives to report foreign financial accounts to the IRS annually. This information is reported by filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). Note that this form must be in the hands of the IRS – not just postmarked – by June 30 each year. Failure to file may lead to a \$10,000 fine.

Now just as an aside, couldn't they have come up with a better form number? What about Form 3227? (That's "FBAR" on the phone dial.) Wait, there's already one of those, used by the Department of Homeland Security. It's entitled "Certificate of Disposition of Imported Merchandise." (That's kind of related!)

Or, what about a simple Form 922? It looks like Australia has one of those, but we don't. Maybe we can start a petition... or not.

In all seriousness, though, there has been a good bit of misdirection on the FBAR rules over the past few years. The rules have changed slightly three times since 2009. As a rule of thumb, any individual or organization with a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account, may be required to file — unless they meet one of the exceptions.

The IRS website gives the following "statement of purpose" for the TD F 90-22.1 form:

The FBAR is required because foreign financial institutions may not be subject to the same reporting requirements as domestic financial institutions. The FBAR is a tool to help the United States government identify persons who may be using foreign financial accounts to circumvent United States law. Investigators use FBARs to help identify or trace funds used for illicit purposes or to identify unreported income maintained or generated abroad.

### Final Regulations

After several false starts, deadline postponements, opportunities for public comment, and lots of misinformation on the Internet, the IRS issued final regulations (and updated instructions to the "TD F" form). On February 24, 2011, the Treasury Department published final regulations that amended the then-existing FBAR regulations. The final regulations became effective on March 28, 2011, and apply to FBARs required to be filed with respect to foreign financial accounts maintained in calendar year 2010 and for FBARs required to be filed with respect to all subsequent calendar years. Note that even if your tax year is a fiscal year, FBAR reporting is based on the calendar year.

### Who Must File an FBAR?

United States persons are required to file an FBAR if:

1. The United States person had a financial interest in or signature authority over at least one financial account located outside of the United States; and
2. The aggregate value of all foreign financial accounts exceeded \$10,000 at any time during the calendar year to be reported.

"United States person" means United States citizens; United States residents; entities including, but not limited to, corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States.

The Form TD F 90-22.1 Instructions provide this definition of "financial account:"

A financial account includes, but is not limited to, a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution (or other person performing the services of a financial institution). A financial account also includes a commodity futures or options account, an insurance policy with a cash value (such as a whole life insurance policy), an annuity policy with a cash value, and shares in a mutual fund or similar pooled fund (i.e., a fund that is available to the general public with a regular net asset value determination and regular redemptions).

### Exceptions to the Reporting Requirements

Exceptions to the FBAR reporting requirements can be found on page 6 of the instructions to Form TD F 90-22.1. There are filing exceptions for the following United States persons or foreign financial accounts:

1. Certain foreign financial accounts jointly owned by spouses;
2. United States persons included in a consolidated FBAR;
3. Correspondent/nostro accounts;
4. Foreign financial accounts owned by a governmental entity;
5. Foreign financial accounts owned by an international financial institution;
6. IRA owners and beneficiaries;
7. Participants in and beneficiaries of tax-qualified retirement plans;
8. Certain individuals with signature authority over, but no financial interest in, a foreign financial account (see below);
9. Trust beneficiaries; and
10. Foreign financial accounts maintained on a United States military banking facility.

Check the Form TD F 90-22.1 Instructions (on the same .pdf file as the form) for further details regarding the exceptions listed above, including "correspondent/nostro accounts."

Regarding "signature authority, but no financial interest" (number 8 above): Individuals who have signature authority over, but no financial interest in, a foreign financial account are not required to report the account in the following situations:

1. An officer or employee of a bank that is examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Administration is not required to report signature authority over a foreign financial account owned or maintained by the bank.
2. An officer or employee of a financial institution that is registered with and examined by the Securities and Exchange Commission or Commodity Futures Trading Commission is not required to report signature authority over a foreign financial account owned or maintained by the financial institution.
3. An officer or employee of an Authorized Service Provider is not required to report signature authority over a foreign

financial account that is owned or maintained by an investment company that is registered with the Securities and Exchange Commission. Authorized Service Provider means an entity that is registered with and examined by the Securities and Exchange Commission and provides services to an investment company registered under the Investment Company Act of 1940.

4. An officer or employee of an entity that has a class of equity securities (or American depository receipts) listed on any United States national securities exchange is not required to report signature authority over a foreign financial account of such entity.
5. An officer or employee of a United States subsidiary is not required to report signature authority over a foreign financial account of the subsidiary if its United States parent has a class of equity securities listed on any United States national securities exchange and the subsidiary is included in a consolidated FBAR report of the United States parent.
6. An officer or employee of an entity that has a class of equity securities (or American depository receipts in respect of equity securities) registered under section 12(g) of the Securities Exchange Act is not required to report signature authority over a foreign financial account of such entity.

As you can see, that doesn't really clear things up and a lot more digging is often required.

### Reporting and Filing Information

Even if the foreign financial account does not produce taxable income, a person who holds a foreign financial account may have a reporting obligation. Also, there are other forms that require FBAR-related "box checking." Examples can be found on Schedule B of Form 1040; Form 990, Part IV, Line 4; the "Other Information" section of Form 1041; Schedule B of Form 1065; and Schedule N of Form 1120. Checking these boxes as appropriate and filing the FBAR (Form TD F 90-22.1) satisfies the account holder's reporting obligation.

You do not file the Form TD F 90-22.1 (FBAR) with your federal income tax return. There is not a provision for an extension for the FBAR form. (In recent years the IRS has granted some special "administrative" extensions for certain filers, though.) And receiving an extension to file your federal income tax return(s) does not extend the due date for filing an FBAR. The IRS must receive the FBAR on or before June 30 of the year following the calendar year being reported.

On July 18, 2011, FinCEN announced that it has developed an electronic filing system that will accept the FBAR form. E-filing is a quick and secure way for individuals to file FBARs. Filers will receive an acknowledgement of each submission. This is great news for FBAR filers – especially the last-minute types among us!

On May 31, 2011, the Financial Crimes Enforcement Network (FinCEN) issued a notice that extended the deadline for filing the 2010 Form TD F 90-22.1 for some officers or employees that have signature authority over, but no financial interest in, the foreign financial accounts of entities controlled by their employers. The administrative extension for those qualifying is until June 30, 2012.

Finally, the IRS reiterates that "account holders who do not comply with the FBAR reporting requirements may be subject to civil penalties, criminal penalties, or both."

## THE COMING APOCALYPSE? STATE REGULATION OF DISTANCE LEARNING PROGRAMS

Has your college, university, or seminary's management team reviewed and discussed the implications of the new rule from the U.S. Department of Education (USDOE) on the state regulation of distance learning programs?

Before we get into the serious stuff, we wanted to share the Dictionary.com definition of "distance learning:"

**Distance learning** (noun): education in which students receive instruction over the internet, from a video, etc., *instead of going to school*. [emphasis ours]

The USDOE considers distance learning "going to school," however, and has placed more focus on it. On October 29, 2010, the Department released the following new regulation for higher education institutions as § 600.9(c) State authorization:

If an institution is offering postsecondary education through distance or correspondence education to students in a State in which it is not physically located or in which it is otherwise subject to State jurisdiction as determined by the State, the institution must meet any State requirements for it to be legally offering postsecondary distance or correspondence education in that State. An institution must be able to document to the Secretary the State's approval upon request.

To boil it all down, the USDOE will no longer allow Title IV funds to be paid to an institution of higher education for students enrolled in "distance learning" programs, unless the institution has been licensed/approved to offer or deliver postsecondary distance or correspondence learning programs in the state where their students reside. In a "Dear Colleague" letter, the USDOE wrote that "a student that is enrolled in an educational program offered by an institution cannot use Title IV, HEA program funds for that program if the institution the student is attending does not have State authorization in the State in which the student resides." These licensure/approval processes can be slow, cumbersome, and costly.

Institutions are expected to comply **in each state in which they "operate"** by July 1, 2011. USDOE officials have stated that if an institution possesses proof that they are applying in a state by July 1, they will consider it "good faith" that the institution is in compliance for the 2011 – 2012 year. We are waiting for the official release of this statement. (See "Clarification of Enforcement," below.)

Recently, the USDOE released a letter that stated:

Under the State authorization regulations, a student that is enrolled in an educational program offered by an institution cannot use Title IV, HEA program funds for that program if the institution the student is attending does not have State authorization in the State in which the student resides. This is true for all educational programs, including distance education. As explained within the preamble to the October 2010 regulations, if a State fails to timely comply with the State authorization requirements at 34 C.F.R. §§ 600.9(a), and (b), for programs other than distance education, an institution may obtain extensions until July 1, 2013, to secure compliance with these State authorization requirements.

On Tuesday, July 12, 2011, a federal judge ruled that the Department of Education's edict on state registrations for distance learning programs was not valid. In her ruling, the judge stated that the USDOE had not taken the time to ask colleges what they thought of the plan. A USDOE spokesperson said that the Department was reviewing its options based upon the judge's decision.

We've spoken to CFOs at several colleges and the feedback is that this is not over. One CFO said that their university had applied to 32 states and they'd gotten three types of responses: 1) a form to fill out with instructions, 2) a letter saying that the state was working on new regulations and would be in touch, and 3) "What?"

On April 20, 2011, the USDOE issued a notice announcing that it would not initiate the enforcement against institutions before July 1, 2014, as long as the school was making a "good faith effort" to comply. (See "Evidence of Good Faith Efforts" below.)

The April 20 letter contains a section that states:

**Clarification of Enforcement.** With regard to the State authorization provisions at 34 C.P.R. § 600.9(c), *The Department will not initiate any action to establish repayment liabilities or limit student eligibility for distance education activities undertaken before July 1, 2014, so long as the institution is making good faith efforts to identify and obtain necessary State authorizations before that date...* [emphasis ours]

...If a State has no applicable regulation or law, then no action on the part of the institution is required. Where States are in the process of establishing new requirements or creating application procedures, institutions acting in good faith would be expected to seek authorization under the new requirements or procedures only after they are established. Monitoring evolving State requirements should be made easier by the many associations, States, and institutions that are sharing on the Internet their analyses of individual State authorization requirements and processes.

However, the Department will review carefully instances where an institution may not be acting in good faith, such as where documents show an institution knew of a State requirement and willfully refused to comply with it.

### Evidence of Good Faith Efforts

The April 20 letter says that:

Evidence of good faith efforts by institutions could include any one or more of the following items:

- Documentation that an institution is developing a distance education management process for tracking students' place of residence when engaged in distance education.
- Documentation that an institution has contacted a State directly to discuss programs the institution is providing to students in that State to determine whether authorization is needed.
- An application to a State, even if it is not yet approved.
- Documentation from a State that an application is pending.

It's somewhat unclear, though, when your "good faith efforts" must begin. Certainly, they must be completely in place by July 1, 2014, but it would appear that these "good faith efforts" must have begun by July 1, 2011. So the important question is, what is your institution doing about it?

### Distance Learning in the CapinCrouse 2010 Tax Reporting Trends Report

We didn't ask about distance learning programs in this year's *Higher Education Tax Reporting Trends Project*. But for the 2010 edition, published last fall, we asked, "Does your college conduct a web-based 'distance learning' program?" Out of 79 respondents, 64.6% answered in the affirmative.

The enrollment-based categories we used last year were slightly different from the ones we used this year. In the 2010 report, the higher education institutions in Category A had more than 1,700 students, while Category B institutions had between 700 and 1,700 students, and Category C had less than 700 students.

Among Category A respondents, 81.5% indicated that they had a web-based distance learning program, while 61.5% of Category B and 50.0% of Category C institutions answered "yes."

### State Authorization

**The need for state licensure/approval is determined by the laws and regulations of each state, which vary significantly across the country.** (The term "licensure/approval" is used because states use a variety of terms — such as "license," "authorize," "certify," "approve," "accredit," and "register" — for the act of regulating institutions in their state.) The CapinCrouse Tax Team is available to help your institution comply with these complex and time-consuming regulations, which vary from state to state.

For instance, Florida requires approval of all independent institutions. They note that "An out-of-state institution is considered 'independent' even if a public institution in its home state."

The Florida statutes state that:

Operating in this state means any of the following: (a) Maintaining for any purpose related to offering a degree, diploma, or credit a physical location in this state, a mailing address in this state, a telephone or facsimile number in this state, or a mail forwarding service or telephone answering or relay service in this state or advertising any such presence; or (b) By any means or device, facilitating in this state any part of a scheme to offer a degree, diploma, or credit, or any activity connected with the administration, promotion, recruitment, placement, instruction, fee collection or receipt, or any other function of a purported independent postsecondary educational institution, other than periodic and customary contact with the institution's own alumni.

The Florida application process takes four to six months and requires submission of a complete application and documentation, followed by review by staff and follow-up. The application fee is based on projected enrollments and ranges from \$500 for enrollments of under 100 to \$5,000 for enrollments over 10,000; plus \$2,000-\$3,000 based on degree level and \$200 per degree program.

Florida does have a statutory exemption for "religious colleges" that is fairly restrictive. It requires an annual sworn affidavit that confirms that, among other things, the name of the institution includes a religious modifier or the name of a religious patriarch, saint,



person, or symbol of the church and that the institution offers only educational programs that prepare students for religious vocations as ministers, professionals, or laypersons in the categories of ministry, counseling, theology, education, administration, music, fine arts, media communications, or social work.

As another example, California regulates “all private postsecondary education institutions with a physical presence in California.” Accreditation is not required, but approval to operate is. The state defines “distance education” as the transmission of instruction to students at a location separate from the institution. The application is made by submitting a fairly self-explanatory two-page form, and the application fee is \$5,000 for initial approval, \$3,000 for a new branch of approved institutions, and \$750 for approval to operate by means of accreditation. Approval is granted for a term of five years. “Religious schools” are exempt. In California, a “religious school” is defined as:

An institution owned, controlled, and operated and maintained by a religious organization lawfully operating as a nonprofit religious corporation pursuant to Part 4 (commencing with Section 9110) of Division 2 of Title 1 of the Corporations Code, that meets all of the following requirements: (a) The instruction is limited to the principles of that religious organization, or to courses offered pursuant to Section 2789 of Business and Professions Code and, (b) The diploma or degree is limited to evidence of completion of that education.

Further, in California “religious schools” must offer degrees and diplomas only in the beliefs and practices of the church, religious denomination, or religious organization, and shall not award degrees in any area of physical science.

Finally, a cursory look at Indiana’s requirements show that their state regulations are relevant to distance education programs offered by Indiana institutions only. That can be deceiving, however. The regulations state that triggers for physical presence include:

- Local media advertisement
- Having a recruiter physically in state
- Doing cold calls to Indiana residents
- Having a physical location or computer server in the state

The Indiana regulations do say that an online school faculty member who lives in the state is not a trigger. The Indiana application fee is \$2,000 for out-of-state and \$1,000 for in-state, with various add-on fees ranging from \$50 to \$500 each.

### **Relief on the Way?**

Several organizations are putting together a reference chart to help higher education institutions understand what is required on a state-by-state basis. There’s also a push to develop a “uniform” application that may be adopted by some or all states.

In June 2011, the Education Committee of the House of Representatives passed a bill designed to overturn the USDOE’s rule. It is unlikely the bill will pass the full House or the Senate, however. The bill sponsor stated that it was Washington’s responsibility to “be cautious of federal regulations and policies that could create new hurdles for administrators, professors, and students.”

### **Creating a Plan of Attack**

This is a lively issue. Now that the new USDOE regulations have gone into effect as of July 1, 2011 (with a grace period for institutions

that are making a “good faith effort” to comply in all states in which they operate), it is imperative that all higher education institutions offering distance learning programs construct a plan of attack.

One concern is that many Christian colleges, universities, and seminaries may think they are exempted as a “religious school” in many states when they actually are required to be licensed/ approved. It’s important to note that state religious exemptions can be very restrictive.

Ultimately, many schools may have to make a cost/benefit decision as to whether it makes sense to offer distance learning courses to students in some states. As one CFO put it, “It really is a state issue with only a small federal issue that looks like it might go away. Unfortunately the state regulations have not gone away.” Our team can help you through this process by meeting with your team, constructing a state-by-state requirement grid, and coaching you through the application process.

## **RAISING FUNDS THROUGH SPECIAL EVENTS**

As we mentioned earlier, only 35% of the higher education institutions who participated in the *2011 Tax Reporting Trends Project* reported on Form 990 that they held “special fundraising events.” (Category A = 47%, Category B = 38%, and Category C = 17%.) This surprised us. As colleges seek funding, they should consider establishing an annual event that can start providing revenue now and grow into a strong, long-term source of funds.

The key is that it takes planning. In addition to the logistics required to pull off a successful event, you need to consider the potential tax ramifications.

The 2010 Form 990 instructions define “fundraising event” as: Includ[ing] dinners and dances, door-to-door sales of merchandise, concerts, carnivals, sports events, auctions, casino nights (in which participants can play casino-style games but the only prizes or auction items provided to participants are noncash items that were donated to the organization), and similar events not regularly carried on that are conducted for the primary purpose of raising funds.

The definition goes on to say that fundraising events do not include:

1. The conduct of a trade or business that is regularly carried on;
2. Activities substantially related to the accomplishment of the organization’s exempt purposes (other than by raising funds);
3. Solicitation campaigns that generate only contributions, which may involve gifts of goods or services from the organization of only nominal value, or sweepstakes, lotteries, or raffles in which the names of contributors or other respondents are entered in a drawing for prizes of only nominal value; and
4. Gaming.

The revenues, contributions, and expenses from these events are reported on Form 990, Part VIII, Line 8. If the amount is more than \$15,000, it is also reported on Schedule G, Part II.

### **What You Need to Know Before Planning Events**

In these challenging economic times, it is important — if not imperative — to come up with innovative ways to raise funds. Go ahead and innovate, but be aware that the playing field has changed recently.

There are two areas to be aware of as your team plans new fundraising events. First, watch out for unrelated business income and the corresponding filings and taxes for that income. Second, make sure your team and board of directors are well versed on the new Form 990, specifically the new Schedule G instructions.

Traditionally, fundraising events at higher education institutions have involved donor banquets, golf tournaments, “travel tours,” and pre-game sports events. Some innovative institutions have been holding Frisbee golf tournaments, Hawaiian luau banquets, Monopoly tournaments, 100k run/walks, and more. We’ve even been talking about working with some of our university foundations to host all-day continuing education events. Think about it — 300 people in a room paying \$250 for the day garners \$75,000, with minimal expenses if your institution has a good venue in which to hold the seminar.

When it comes to special fundraising events, though, the most common source of unrelated business income tends to be from “inadvertent” advertising income. Generally, the most lucrative element of event fundraising comes from corporate sponsorships. The problem occurs when sponsorship revenue crosses the line into advertising income.

At not-for-profit colleges, universities, and seminaries, corporate sponsorship income is accounted for as a charitable contribution. But advertising revenue, by definition, is unrelated business income and subject to taxes at rates of up to 35%. If your not-for-profit organization receives gross UBI of \$1,000 or more in a given year, you are required to file Form 990-T and pay the related taxes.

Remember, you may have to file a Form 990-T even if you are not required to file a Form 990. The wording in the determination letter for institutions that don’t file Form 990 almost always includes verbiage to that effect.

### **Corporate Sponsorship vs. Advertising**

So what exactly is the difference between a corporate sponsorship and advertising? With a corporate sponsorship you may display the sponsor’s logo, use their name, and give their address, website, and phone number — and that’s about it. If you present comparative language, an inducement to buy a product, or discounts, the income you receive from a “sponsoring” company will likely be deemed advertising and subject to taxes. For more data on corporate sponsorships, see <http://www.irs.gov/pub/irs-regs/td8991.pdf>.

### **The New Form 990 and Special Events**

The other challenge for special events in the coming months is the new Form 990, specifically Schedule G – Supplemental Information Regarding Fundraising or Gaming Activities. Prior to 2008, special events were reported on Form 990, Part I, Line 9 and required a “five-column” reporting format on an attached statement. With the new Form 990, if you have more than \$15,000 in gross income from special events or gaming, or both, you are required to report more information than before. Schedule G, Part II requires detailed reporting for your top two fundraising events and collective reporting for all other fundraising events. You are also now required to show, on Schedule G, the breakout of amounts expended for “cash prizes,” “non-cash prizes,” rent/facility costs, and other direct expenses for each event.

If that sounds complicated, wait until you see what you need to report in Schedule G, Part III if you engage in fundraising events that the IRS classifies as “gaming.” There are columns on the

form for bingo, pull tabs/instant bingo/progressive bingo, and other gaming. What, you may ask, is “other gaming”? The IRS’s glossary for the new Form 990 offers this definition:

..[gaming] includes (but is not limited to): bingo, pull tabs/instant bingo (including satellite and progressive bingo), Texas Hold-Em Poker and other card games, raffles, scratch-offs, charitable gaming tickets, break-opens, hard cards, banded tickets, jar tickets, pickle cards, Lucky Seven cards, Nevada Club tickets, casino nights, Las Vegas nights, and coin-operated gambling devices. Coin-operated gambling devices include slot machines, electronic video slot or line games, video poker, video blackjack, video keno, video bingo, video pull tab games, etc.

If your events fall under this definition, you are required to answer nine special, multi-part questions about these activities, including the name of your “gaming manager” and the compensation and services provided to him or her. The instructions for Schedule G can be found at <http://www.irs.gov/pub/irs-pdf/i990sg.pdf>. But if gaming events are held as part of a fundraising event that must be reported on Schedule G, Part II, you may not have to complete Schedule G, Part III.

Finally, we thought it would be interesting to look for a correlation between colleges that conduct special events and those that report a higher number of volunteers on Form 990, Part I, Line 6. Presuming that having more volunteers is a good thing, you’d think organizations holding special events would report more volunteers. Our analysis did not show that, but it could be due to misunderstanding regarding the reporting of volunteers.

Overall, it appears to be a great time to hold special fundraising events. So go ahead and get cracking on innovating, planning, and rounding up help. The more innovative and fun your team can be, the more additional funds you can probably raise to secure the future of your institution. Just be aware that there are pitfalls and work with informed accounting managers to avoid them.

## **THE NEW SCHEDULE F, PART IV**

Since the introduction of the “new” Form 990, many organizations have struggled with Schedule F, Statement of Activities Outside the United States. And the 2010 Schedule F has a little surprise attached: the new Part IV! It is an interesting addition and has muddied the Schedule F waters even more. Basically, Part IV is a six-question query similar to Form 990, Part V, which we like to call “All the IRS Forms You Should Have Been Filing But Probably Weren’t.” Filers answer “Yes” or “No” to six questions concerning various other IRS forms.

The entire instructions to Schedule F, Part IV are as follows:

All Schedule F (Form 990) filers must complete Part IV, lines 1-6. If the organization answers “Yes” to any of lines 1-6 because it engaged in the activities described on that line during the tax year, it may need to file the form referenced on that line. To determine whether an organization is required to file any of the IRS forms referenced on lines 1-6 (i.e., Forms 926, 3520, 3520-A, 5471, 5713, 8621, or 8865), see the instructions for those forms.

Given that this section is new and that many colleges, universities, and seminaries file Schedule F, here are the IRS’s “purpose statements” for each of the forms in question:



Israel Tour, photo courtesy of Columbia International University

### **Question 1: Form 926 – Return by a U.S. Transferor of Property to a Foreign Corporation**

According to the instructions, this form is to be used to “report certain transfers of tangible or intangible property to a foreign corporation required by section 6038B.” Internal Revenue Code section 6038B concerns the transfer of property to a foreign corporation by a U.S. citizen or resident, a domestic corporation, or a domestic estate or trust — just like the form title says!

### **Question 2: Form 3520 – Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts**

U.S. persons and the executors of estates of U.S. decedents are required to file Form 3520 to report:

- Certain transactions with foreign trusts,
- Ownership of foreign trusts under the rules of sections 671 through 679, and
- Receipt of certain large gifts or bequests from certain foreign persons.

Note that a separate Form 3520 must be filed for transactions with each foreign trust.

### **Question 2: Form 3520-A – Annual Information Return of Foreign Trust with a U.S. Owner**

This form is the annual information return of a foreign trust with at least one U.S. owner. The instructions say that “the form provides information about the foreign trust, its U.S. beneficiaries, and any U.S. person who is treated as an owner of any portion of the foreign trust.”

### **Question 3: Form 5471 – Information Return of U.S. Persons with Respect to Certain Foreign Corporations**

This form is used by “certain U.S. citizens and residents who are officers, directors, or shareholders in certain foreign corporations.” The IRS notes that “the form and schedules are used to satisfy the reporting requirements of sections 6038 and 6046, and the related regulations.”

### **Question 4: Form 8621 – Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund**

The form instructions state:

Generally, a U.S. person that is a direct or indirect shareholder

of a PFIC must file Form 8621 for each tax year in which that U.S. person:

- Recognizes gain on a direct or indirect disposition of PFIC stock,
- Receives certain direct or indirect distributions from a PFIC, or
- Is making an election reportable in Part I of the form.

Please note that you must file a separate Form 8621 for each PFIC in which stock is held. See the “Chain of ownership” section in the Form 8621 instructions for specific requirements.

The instructions also explain that:

A foreign corporation is a PFIC if it meets either the income or asset test described below.

1. Income test. 75% or more of the corporation’s gross income for its taxable year is passive income (as defined in section 1297(b)).
2. Asset test. At least 50% of the average percentage of assets (determined under section 1297(e)) held by the foreign corporation during the taxable year are assets that produce passive income or that are held for the production of passive income.

### **Question 5: Form 8865 – Return of U.S. Persons with Respect to Certain Foreign Partnerships**

The instructions say to “use Form 8865 to report the information required under section 6038 (reporting with respect to controlled foreign partnerships), section 6038B (reporting of transfers to foreign partnerships), or section 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests).”

### **Question 6: Form 5713 – International Boycott Report**

The Form 5713 instructions say to use this form to report:

- Operations in or related to boycotting countries and
- The receipt of boycott requests and boycott agreements made.

The most recent list of “boycotting countries,” dated November 2010, includes Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates, and the Republic of Yemen.

Please note that we’re only giving you a brief overview of the forms in this section. There are numerous exceptions and limitations to filing each. You should work closely with a qualified tax counsel to determine your institution’s specific filing requirements.

## **LEARN MORE AT OUR COMPLIMENTARY WEBCASTS**

CapinCrouse regularly offers webcasts on current tax issues for colleges and universities, including recent changes and updates. You can learn more and register for these free, informative sessions at <http://www.capincrouse.com/events/webcasts/>.

And as always, please do not hesitate to contact us with questions or to discuss any of the issues raised in this report and how they affect your organization. We are here to help you!



## About CapinCrouse

With more than 700 not-for-profit organizations and 1,500 tax clients, CapinCrouse is the country's leading accounting and advisory firm primarily serving the Christian not-for-profit community.

Since 1972, CapinCrouse has been serving not-for-profit entities including megachurches, institutions of higher education and secondary schools, and international missions agencies by providing a full range of audit, review, tax, and advisory services.

CapinCrouse is dedicated to helping our clients operate with financial integrity so they can dedicate themselves to fulfilling their mission.

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