Higher Education Tax Update

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Contents

2017 Tax Reform Overview

Provisions of the 2017 Tax Cuts and Jobs Act (the name of which was changed to “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018” at the eleventh hour by the Senate Parliamentarian) are expected to have a significant impact on charitable giving, among other changes that will affect nonprofit organizations.

The provisions that most affect institutions of higher education are as follows:

Excise Tax on Some Private Colleges and Universities – There is a 1.4% excise tax on the net investment income (to be defined) of private colleges and universities that are “applicable educational institutions” (AEIs) — generally meaning the school has at least 500 students and 50% of its students are located in the U.S. The threshold computation applies to AEIs with an aggregate fair market value of assets of at least $500,000 per student at the end of the preceding taxable year. (This does not include those assets that are used directly in carrying out the institution’s exempt purpose.)

Each Unrelated Business Activity Stands Alone with Respect to Profit/Loss – A deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction. There is a transition rule that says net operating losses arising in a taxable year before January 1, 2018, that are carried forward to a future taxable year are not subject to this rule.

Excess Compensation – There is a 21% excise tax in excess of $1 million paid to a covered employee (i.e., one of the five highest compensated employees of the organization) by an applicable tax-exempt organization when there is no substantial risk of forfeiture of the rights to such remuneration (as defined at IRC Section 457(f)(3)(B)C). There are several limitations and exemptions to this rule.

College Athletic Event Seating Rights – Historically, special rules applied to certain payments to institutions of higher education in exchange for which the donor/payor who met certain criteria received the right to purchase tickets or seating at an athletic event. Specifically, the donor/payor could treat 80% of a payment as a charitable contribution. The new law includes a denial of this deduction for periods after December 31, 2017.

UBIT on Certain Fringe Benefits – Unrelated business taxable income (UBIT) includes any expenses paid or incurred by a tax-exempt organization for qualified transportation fringe benefits, a parking facility used in connection with qualified parking, or any on-premises athletic facility, provided such amounts are not deductible under Section 274.

Repeal of Advance Refunding Bonds – Interest on advance refunding bonds (i.e., refunding bonds issued more than 90 days before the redemption of the refunded bonds) is taxable. Interest on current refunding bonds continues to be tax-exempt. The provision is effective for advance refunding bonds issued after 2017.

Whew! Finally, the provision that made “logo and name” licensing fees automatically (“per se”) unrelated business income did not make it out of the Senate. Thus, we escaped without this rule in the new law.

Tax Reform: On-premises Athletic Facilities = UBIT

Section 13703 of the new law contains a provision whereby the market value of providing exercise facilities (and specific other fringes) to staff and faculty would be considered unrelated business income and required to be reported on Form 990-T.

Excerpts from this section of the new law state:

> Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)).

Tax Reform: On-premises Athletic Facilities = UBIT (continued)

And:

> The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for onpremises athletic facilities.

Ouch. That sounds like a whole lot of new UBIT reporting for colleges. However, higher education institutions may have an out on this because current IRC section 132(j)(4) defines on-premises athletic facilities as gyms or other athletic facilities located on the employer's premises, operated by the employer, and substantially all the use of which is by employees of the employer, their spouses, and their dependent children.

Tax Reform: Moving Expense Deductions Suspended

Sections 11048 and 11049 of the new law suspend the exclusion from income tax for qualified moving expense reimbursements AND the deduction for moving expenses through December 31, 2025 (except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military).

Thus, IRC section 217 has been amended by adding the following new subsection at the end:

> (k) SUSPENSION OF DEDUCTION FOR TAXABLE YEARS 2018 THROUGH 2025.

Institutions should be careful about promises made to current, new, and future employees with regard to moving expenses. Also, any policies and procedures based on the suspended provisions should be updated to conform with current tax law.

Tax Reform: Athletic Tickets Deduction Suspended

College Athletic Event Seating Rights – Historically, special rules applied to certain payments to institutions of higher education in exchange for which the donor/payor who met certain criteria received the right to purchase tickets or seating at an athletic event. Specifically, the donor/payor could treat 80% of a payment as a charitable contribution. The new law includes a denial of this deduction for periods after December 31, 2017.

Specifically, the new law states:

> SEC. 13704. REPEAL OF DEDUCTION FOR AMOUNTS PAID IN EXCHANGE FOR COLLEGE ATHLETIC EVENT SEATING RIGHTS.
>
> (a) IN GENERAL.—Section 170(l) is amended—
>
> by striking paragraph (1) and inserting the following:
>
> ''(1) IN GENERAL.—No deduction shall be allowed under this section for any amount described in paragraph (2).'', and
>
> (2) in paragraph (2)(B), by striking ''such amount would be allowable as a deduction under this section but for the fact that''.
>
> (b) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2017.

Tax Reform: Private College/University Endowment Excise Tax

Excise Tax on some Private Colleges and Universities – There is a 1.4% excise tax on the net investment income (to be defined) of private colleges and universities who are "applicable educational institutions" (AEIs) — generally meaning the school has at least 500 students and 50% of its students are located in the U.S. The threshold computation applies to AEIs with an aggregate fair market value of assets of at least $500,000 per student at the end of the preceding taxable year. (This does not include those assets that are used directly in carrying out the institution's exempt purpose.)

Until the eleventh hour, the provision followed the Senate bill and stated, "… at least 500 tuition-paying students." This was changed between the original House vote and the final Senate vote.

The new law contains the following definition:

> The term 'applicable educational institution' means an eligible educational institution (as defined in section 25A(f)(2))—
>
> > (A) which had at least 500 students during the preceding taxable year,
> > (B) more than 50 percent of the students of which are located in the United States,
> > (C) which is not described in the first sentence of section 511(a)(2)(B) (relating to State colleges and universities), and
> > (D) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution's exempt purpose) is at least $500,000 per student of the institution.
>
> STUDENTS. - For purposes of paragraph (1), the number of students of an institution (including for purposes of determining the number of students at a particular location) shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).

Tax Reform: What did not make it in?

Political Campaign Activity – The current "Johnson Amendment," which prohibits any political activity by 501(c)(3) organizations, is not affected.

Private Foundation Taxes –The current 1% or 2% structure for taxes on investment income of private foundations is not changed from current law.

Tuition Reduction/Remission Rules Not Affected – Qualified tuition reductions will remain non-taxable.

Employer-Provided Educational Assistance Intact – The Section 127 provision for the non-taxability of certain employer educational assistance is not repealed.

Housing for the Convenience of the Employer – The House bill contained a provision to provide limits on the amount that could be excluded from an employee's income for employer-provided housing. This provision is not in the final bill.

UBIT on Research Activities – The House bill included a modification that subjected income from research activities whose results were not publicly available to unrelated business income taxes. The final bill does not include this provision.

Donor-Advised Fund Reporting – The final bill does not incorporate the House provision to increase reporting and disclosure of donor-advised funds.

Tax Reform: What did not make it in? (continued)

Private Activity Bonds – The House bill included a provision to make interest on private activity bonds taxable. This provision is not included in the final bill.

Inflation Adjustment for Charitable Mileage Deduction – The House proposed a provision to repeal the statutory charitable mileage rate and provide instead that the standard mileage rate used for determining the charitable contribution deduction shall be a rate which takes into account the variable costs of operating an automobile. This is not included in the final bill.

Repeal and Replacement of The Affordable Care Act – Not Really

Throughout most of 2017, President Trump and Republican lawmakers continued to pursue and act upon a widespread 2016 campaign pledge to "repeal and replace Obamacare." Several plans and attempts failed to get the requisite number of votes in both houses of Congress during the year.

The new tax law has altered the playing field by reducing the amount of the individual responsibility payment, enacted as part of the Patient Protection and Affordable Care Act (also called the Affordable Care Act, or ACA), to zero.

Formerly, under the ACA individuals were required to be covered by a health plan that provided at least minimum essential coverage or be subject to a tax (also referred to as a penalty) for failure to maintain the coverage (commonly referred to as the "individual mandate"). Minimum essential coverage included government-sponsored programs (including Medicare, Medicaid, and CHIP, among others), eligible employer-sponsored plans, plans in the individual market, grandfathered group health plans and grandfathered health insurance coverage, and other coverage as recognized by the Secretary of Health and Human Services (HHS) in coordination with the Secretary of the Treasury. The tax was imposed for any month that an individual does not have minimum essential coverage unless the individual qualified for an exemption for the month.

As we look ahead, proposals remain on the horizon. Many give more power to the states in the healthcare and insurance arena. One plan, the Cassidy-Collins bill, retains several ACA provisions (i.e., no pre-existing condition limits and kids up to 26 years old can stay on their parents' plan) and allows "options" for states. Another option is to continue with the ACA — minus the individual mandate, of course.

Repeal of The "Johnson Amendment" – No!

The "Johnson Amendment" is a 1954 law that restricts 501(c)(3) organizations — including colleges and churches — from directly or indirectly participating in political campaign activities. In fact, it was the impetus for the verbiage in IRC section 501(c)(3) that states, "… and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

President Trump has repeatedly vowed to repeal this restriction. At the 2017 National Prayer Breakfast, the President said he wanted to "get rid of and totally destroy the Johnson Amendment" so that "representatives of faith [could] speak freely and without fear of retribution."

The House tax reform bill (H.R. 1) contained a provision that was to modify the present-law rules relating to political campaign activity by section 501(c)(3) organizations for the following purposes:

1. section 501(c)(3) tax-exempt status;
2. qualifying as an eligible recipient of tax-deductible contributions for income, gift, and estate tax purposes; and
3. application of the excise tax on political expenditures by section 501(c)(3) organizations.

Repeal of The "Johnson Amendment" – No! (continued)

> For such purposes, an organization shall not fail to be treated as organized and operated exclusively for a purpose described in section 501(c)(3), nor shall it be deemed to have participated in, or intervened in any political campaign on behalf of (or in opposition to) any candidate for public office, solely because of the content of any statement that: (A) is made in the ordinary course of the organization's regular and customary activities in carrying out its exempt purpose; and (B) results in the organization incurring not more than de minimis incremental expenses.

However, this provision was excluded from the final law.

Advertising vs. Qualified Sponsorship Payments Update

One of the IRS Exempt Organizations (EO) "Issue Snapshots" deals with "QSP's" — qualified sponsorship payments under IRC section 513(i). On the whole, this snapshot (released on September 29, 2016) contains a great summary of the relevant code sections and somewhat lives up to its "preface information" of:

> Advertising or Qualified Sponsorship Payments? *Determining whether corporate sponsorship payments received or solicited by an exempt organization are qualified sponsorship payments as described in section 513(i).*

Description:
The term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments.

However, it does not provide much in the way of clarifying guidance on a few critical issues. The snapshot properly lays out the existing guidance on Qualified Sponsorship Payments, Advertising, and Substantial Return Benefits — the main issues wrestled with in this arena — but it does not provide any new guidance on these issues. Sadly, the snapshot does not provide clarification on "pouring agreements" that ostensibly look like "exclusive provider arrangements," but the IRS has not historically enforced them as unrelated business income.

This very helpful section is included at the end of the snapshot:

> **Issue Indicators or Audit Tips:**
> Review contracts for sponsorship payments to determine if:
>
> 1. The "sponsor" received any substantial return benefit. Payments are contingent upon the level of attendance.
> 2. The payment entitles the payor to the use or acknowledgement of the name or logo (or product lines) of the payor's trade or business in periodicals.
> 3. The payment is made in connection with any qualified convention or trade show activity.
> 4. An exclusive provider arrangement exists.
>
> Determine if the use or acknowledgement contains:
>
> - qualitative or comparative language
> - price information
> - indications of savings or value an endorsement or an inducement to purchase, sell, or use such products or services.

However, read on with respect to the Issue Snapshot entitled "Exclusive Provider Arrangement within Qualified Sponsorship Agreements" released on June 16, 2017…

Pouring Agreements Update

The 2016 snapshot entitled "Advertising or Qualified Sponsorship Payments?" (noted above) still left hanging the situation of a "pouring agreement" whereby a donor/sponsor/partner makes a contribution to a college under an agreement that stipulates the college will only serve ("pour") that donor/sponsor/partner's soft drinks.

It can be argued that this type of payment would not be deemed as "sponsoring" an event. However, the snapshot states, "The Regulations apply to all forms of corporate sponsorship activities and not just single events. Sponsored activities may include a single event, a series of related events, an activity of extended or indefinite duration, and/or continuing support of an exempt organization's operation. A payment may be a qualified sponsorship payment regardless of whether the sponsored activity is related or unrelated to the organization's exempt purpose(s)."

When we saw the 2017 issue snapshot entitled "Exclusive Provider Arrangement within Qualified Sponsorship Agreements" (released on June 16, 2017), we initially thought "Cool, this will put the 'pouring agreement' to rest!" Well, not really.

The 2017 snapshot begins with this clarification:

> An exclusive provider arrangement limits the sale, distribution, availability, or use of competing products, services, or facilities in connection with an exempt organization's activity. An exclusive provider arrangement generally results in a substantial return benefit to the payor. Thus, only the portion of the payment that exceeds the fair market value of the exclusive provider arrangement and any other benefit(s) received is a qualified sponsorship payment that does not constitute receipt of income from an unrelated trade or business.

That makes it sound like the standard soft drink deal would be an exclusive provider agreement and thus the fair market value of the arrangement (um, let's talk valuation) would result in unrelated business income.

The snapshot provides this example:

> An example of an exclusive provider arrangement would be when Brand A pays $10,000 to sponsor an organization's event and the organization agrees to restrict all of its soft drink sales to only Brand A. The fair market value of the exclusive provider arrangement is determined to be $1,000. The fair market value of the exclusive provider arrangement exceeds 2% of the payment (2% of $10,000 is $200), and is not a disregarded benefit under Treas. Reg. Section 1.513-4(c)(2)(ii). Therefore, only the portion of the sponsor's payment that exceeds the fair market value of the exclusive provider arrangement ($9,000) is a qualified sponsorship payment, assuming that no other substantial benefit is provided to Brand A (the $9,000 would be reduced by the fair market value of any other substantial benefit provided). If the exempt organization does not establish that the payment exceeds the fair market value of the exclusive provider arrangement and any other substantial return benefit, then no portion of the payment constitutes a qualified sponsorship payment.

Did you catch the key phrase "…pays $XXX to sponsor an organization's event and the organization agrees to restrict…"? What if the "pouring agreement" (like most) is not related to an "event"?

However, under "Issue Indicators/Audit Tips," the snapshot states that:

> …(a)n exclusive provider arrangement exists if: The arrangement with the sponsor limits the exempt organization's rights for the sale, distribution, availability, or use of any competing products, services, or facilities in connection with conducting the activity.

Also, it should be noted that in the Colleges and Universities Compliance Project it appears the IRS generally only considered payments from these types of agreements UBIT to the extent of services provided by the institution — for example, appearances for the provider by coaches or athletes.

The snapshot concludes with the following:

> A payment that does not meet the criteria as a qualified sponsorship payment is not automatically subject to UBIT. Rather, the unrelated business income tax treatment of such unqualified payment is determined under the existing principles and rules found in IRC Sections 512, 513, and 514. Treas. Reg. Section 1.513-4(d)(1)(i).

Pouring Agreements Update (continued)

I would suggest that most pouring agreements are not qualified sponsorship payments because, as referred to above, they are not related to, attached to, or for a specific event. So according the conclusion above, we must look at each specific pouring agreement and determine whether it is an “exclusive provider agreement” under that full scope of the UBIT rules.

So is your institution’s agreement with a soft drink manufacturer under which you receive “continuing support of an exempt organization’s operation” an unrelated business activity? In the words of Dr. Seuss, “Why are they sad and glad and bad? I do not know. Go ask your dad.”

What’s Going on with the Minister’s Housing Allowance?

In November 2013, a federal judge held that the minister’s housing allowance (under IRC section 107(2)) was unconstitutional because it “violates the establishment clause of the First Amendment.” This was in response to a case filed by a foundation that sued because it did not believe its officers could utilize this tax benefit. The judge delayed the implementation of the ruling until appeals had run their course.

In 2014, the Seventh Circuit Court overturned the lower court judge’s ruling. However, the reversal was not based upon the merits of the case, but on the “standing” of the plaintiffs. Ultimately, the officers of the foundation had not had the IRS deny the minister’s housing allowances claimed on their individual tax returns.

In 2016, the foundation filed a new court case because their officers paid taxes on the housing allowances apparently claimed on their individual return. In August 2016, the federal government made its first filing in this new case. In this filing, the government conceded that, based upon their understanding of the facts, the foundation’s officers have the legal standing to challenge the housing allowance exclusion. The government maintained that the plaintiffs did not have standing to challenge the parsonage exclusion (IRC section 107(1)).

In 2017, based upon the standing of the plaintiffs, the original federal district judge ruled that the clergy housing allowance is an unconstitutional preference for religion. The decision will now likely go to the Seventh Circuit Court of Appeals (Illinois, Indiana, and Wisconsin). Depending on the outcome in that court, the case could go to the U.S. Supreme Court.

With the possibility that the minister’s housing allowance (IRC section 107(2)) might be struck down, religious organizations and clergy should be looking ahead to a several potential issues. First, an increase in clergy taxes would result in increased quarterly estimated tax payments. Second, organizations should be considering the budget implications of increasing compensation for their ministers to offset the negative impact of significant additional taxable income. Finally, ministers who are considering purchasing a new home or refinancing should factor in the potential that the ministers housing allowance may not be available in the future.

Expense Allocations of “Dual Use Facilities”

In the IRS’s 2017-18 Priority Guidance Plan, under “Exempt Organizations” there are 10 items listed as being worked on. EO item number three states, “Guidance under section 512 regarding methods of allocating expenses relating to dual use facilities.”

What are “dual use facilities”? Treasury Regulation 1.512(a)-1(c) states:

> Where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead), shall be allocated between the two uses on a reasonable basis.

The term “reasonable basis” has been an area of much contention over the years. Private letter rulings and court decisions on what is and is not a “reasonable basis” for expense allocations abound.

Expense Allocations of “Dual Use Facilities” (continued)

One example might be a university that owns, runs, and maintains a football stadium. The university hosts seven home football games in the stadium each year. It also hosts a big rock concert every May. Would a reasonable allocation of expenses to the rock concert be one-eighth of all allocable expenses? This includes expenses, depreciation, and similar items attributable to such facilities, such as items of overhead. (Eight events are conducted per year. The concert is one of eight.) Or, as the IRS has asserted in some court cases and rulings and the American Institute of Certified Public Accountants (AICPA) has suggested as a safe harbor, should the expenses allocable to the rock concert be 1/365 of all allocable expenses, based on the fact that the concert takes approximately one day out of 365 in the year? As you can see, the difference would be 12.5% versus .274% — or $125.00 per $1,000 versus $2.74 per $1,000 of allocable expenditures. Think about that difference in terms of millions of dollars of expenses and our current 35% incremental tax rate on unrelated business income.

One of the main court cases in this area is *Rensselaer Polytechnic Institute v. Commissioner* from 1984. In this case, the taxpayer, Rensselaer, used its fieldhouse for functions related to its exempt purpose for many hours per week. The university also received dual-use rental income from a hockey team. The taxpayer calculated allocations for fixed expenses of the fieldhouse based upon the relative times of actual use between exempt and taxable activities. The IRS argued that the appropriate method of allocating fixed costs between exempt and non-exempt activities should be based on the total time available for use. The Second Circuit affirmed the Tax Court’s decision that Rensselaer’s allocation method was “reasonable.”

In June 1997, the National Association of College and University Business Officers (NACUBO) provided the IRS with a draft revenue procedure titled “Safe Harbors for Allocation of Expenses by Colleges and Universities for Purposes of Determining Taxable Unrelated Business Income.” The purpose was stated as follows:

> *This revenue procedure explains optional methodologies that colleges and universities may employ for the allocation of direct and indirect expenses for the purpose of determining taxable unrelated business income (UBI). The methodologies described herein will not be mandatory for any college or university liable for unrelated business income tax, but instead serve as optional safe harbors that set forth a reasonable basis for allocation of costs to unrelated activities.*

The NACUBO draft revenue procedure uses OMB Circular A-21 as a foundation for many of its proposals in this area. The IRS would do well to closely consider this 1997 draft as it endeavors to provide the guidance specified in the priority guidance plan.

We hope that the IRS provides robust guidance — and soon — for this much-traversed issue.

“Farm-to-Table Restaurant” Ruling

As we talk with colleges, seminaries, and universities about revenue enhancement opportunities (REO; see item 24 below for more), a theme of sustainable farming has emerged, with institutions considering and planning farm-to-table restaurants. An interesting 2017 ruling contains some facts that by any institution contemplating this type of venture should review.

In Letter Ruling 201702041, the IRS published its denial of recognition of section 501(c)(3) status for a newly formed organization established to educate individuals about domestic violence and assist victims of domestic violence. To raise funds, the organization proposed to operate two farm-to-table restaurants. The organization planned to purchase goods from local vendors, serve locally grown ingredients, and compensate “volunteers” for work performed at the restaurants. Customers dining at the restaurants would receive tax-deductible receipts for spending money on freshly prepared meals.

The IRS found that the organization did not qualify as a charitable organization because more than an insubstantial part of its activities — specifically, the operation of the two restaurants — was devoted to non-exempt purposes, and that the operation of the restaurants was an unrelated activity that was not in furtherance of the organization’s charitable and educational activities. The IRS noted, as it has on many occasions, that engaging in a trade or business to raise funds for charitable programs is not an exempt activity “merely because the profits will be used” for the program.

"Farm-to-Table Restaurant" Ruling (continued)

The ruling stated that the organization had planned to compensate the workers at the restaurant. If the organization used volunteer labor instead, the activity may have avoided classification as an unrelated business activity. If, however, the organization did not have enough other charitable activities, the operation of the restaurants may have defeated exemption. Alternatively, if these farm-to-table dinners were conducted as occasional fundraising activities rather than the primary ongoing activity of the organization, this should have avoided treatment as an unrelated business activity, because they would not have been regularly carried on.

Also, it would appear that an institution could establish a program or curriculum that aligns with its exempt purpose. If correctly developed and documented, this program could be excluded from unrelated business income.

Form 1098-T Box 1 Only!

The 2015 PATH Act contained a provision that eliminated the option for educational institutions to report on Form 1098-T either payments received (Box 1) or amounts billed (Box 2). For forms required to be filed for 2016 and 2017, the IRS announced that it would not impose penalties if an institution reported the aggregate amount billed for the calendar year for expenses paid (Box 2). Ultimately, the relief extended the rules in effect prior to the PATH Act.

However, in 2017, the IRS announced that no further "Box 1" relief would be granted after 2017. And a look at the 2018 Form 1098-T reveals that Box 2 is shaded out, leaving only one option, Box 1 — "Payments received for qualified tuition and related expenses."

The 2018 instructions state:

> **Box 1.** Shows the total payments received by an eligible educational institution in 2018 from any source for qualified tuition and related expenses less any reimbursements or refunds made during 2018 that relate to those payments received during 2018.
>
> **Box 2.** Reserved.

Summary of 2018 Key Tax Facts

2018 Inflation-Adjusted Amounts

The IRS announced annual inflation adjustments for more than two dozen tax provisions for tax year 2018, including the following:

- The annual exclusion for gifts increased to $15,000 for 2018, a $1,000 increase over 2017.
- The "gross income" threshold for filing Form 990-T remains at $1,000 for 2018 returns — the same as it has been since 1951!
- The OASDI (i.e., Social Security) maximum compensation base ("FICA limit") is $128,400 for 2018, up from $127,200 in 2017.
- The threshold for filing Form 990 electronically remains at $10,000,000 and 250 information returns.
- The foreign earned income exclusion rises to $104,000 for 2018, up from $102,100 in 2017.

2018 Standard Mileage Rates

The standard mileage rates were adjusted downward for 2018. The optional mileage allowance for owned or leased autos (including vans, pickups, or panel trucks) has increased by 1 cent to 54.5 cents per mile for business travel after 2017. The rate for using a car to get medical care or in connection with a move that qualifies for the moving expense also has increased by 1 cent to 18 cents per mile for 2018.

The charitable mileage rate remains steady at 14 cents per mile — this amount is statutory. The House version of the tax reform bill attempted to make the charitable mileage rate adjusted for inflation annually, but this provision did not make it into law.

Form 990 Extension Changes

This is a "last year's news" item, but important for all to note.

Exempt organizations that are required to file Form 990-series returns must file by the fifteenth day of the fifth month after their year-end. Under previous law, these organizations were able to apply for two three-month extensions of time to file (the first extension was automatic). Form 8868 was used to request both of these extensions. In July 2015, Congress passed the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015. This law includes changes to the filing deadlines for several returns.

The new extension process will be effective for taxable years beginning after December 31, 2015. Under the post-2015 rules, exempt organizations will still be required to file Form 990 by the fifteenth day of the fifth month; however, the new law prescribes that the two three-month extensions will be replaced with one automatic six-month extension. The IRS has made changes to Form 8868 to accommodate these changes.

Forms 1095-B and 1095-C 2018 Filing Deadlines Extended

As outlined in IRS Notice 2018-6, these forms are now required to be furnished to individuals by March 2, 2018, instead of the original deadline of January 31, 2018. No additional extension will be permitted beyond March 2, 2018. However, the due date for filing these forms with the IRS remains February 28, 2018, or April 2, 2018, if filing electronically. The availability of an extension of time to file these forms with the IRS using Form 8809 is unaltered.

The IRS has also extended relief for reporting entities that can show that they have made good-faith efforts to comply with the information-reporting requirements of Forms 1095-B and 1095-C for 2017 (both for furnishing to individuals and for filing with the IRS) for incorrect or incomplete information reported on the return or statement.

This relief applies to missing and inaccurate taxpayer identification numbers and dates of birth, as well as other information required on the return or statement. It does not apply to reporting entities that do not make a good-faith effort to comply with the regulations or that fail to file an information return or furnish a statement by the due dates (as extended under the rules described above).

IRS EO Issue Snapshots

One great development instituted by the IRS Exempt Organizations division in the past few years has been the creation of Knowledge Networks (K-Nets) under the overall Knowledge Management (KM) program.

The IRS said that in a continued effort to increase the technical knowledge base of EO employees, KM has several initiatives planned for FY 2018. In particular, KM will continue preparing and presenting approximately three to four live technical events or CPE sessions each quarter. Event topics will be based on requests from Rulings and Agreements and Exam personnel as well data gathered by the Knowledge Networks (K-Nets). These K-Nets will continue to prepare and post technical Issue Snapshots for EO employees and the general public.

IRS EO Issue Snapshots (continued)

In 2017, the IRS EO division issued 12 “Issues Snapshots.” Interestingly, nine of these concerned unrelated business activities issues and the other three had to do with private foundations. The following titles were of special interest to many colleges, seminaries, and universities:

- Volunteer Labor Exclusion from Unrelated Trade or Business (5/12/17)
- Identification and Treatment of Income from Mailing Lists (5/24/17)
- Exclusive Provider Arrangement within Qualified Sponsorship Agreements (06/16/17)
- Rents from Personal Property, “Mixed Leases,” and the Rental Exclusion from UBTI (10/18/17)
- Unrelated Business Income from Debt-Financed Property under IRC Section 514 (11/15/17)

EO has shared that it plans to supplement issue snapshots with new “Issue Casts,” quick and flexible 15 to 20 minute virtual recordings focusing on identified training topics for employees to access at their convenience. These recordings may also be shared as educational outreach for the general public.

The TE/GE “Issue Snapshots” are available at irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots

2018 “Token” Amounts

The deductible amount for “insubstantial benefits to donors” for 2018 was increased by an amount that kept pace with past years’ increases.

IRS Publication 1771 sets forth the following:

> Token Exception — Insubstantial goods or services a charitable organization provides in exchange for contributions do not have to be described in the acknowledgment.
>
> Goods and services are considered to be insubstantial if the payment occurs in the context of a fund-raising campaign in which a charitable organization informs the donor of the amount of the contribution that is a deductible contribution, and:
>
> 1. The fair market value of the benefits received does not exceed the lesser of 2 percent of the payment or $X,* or
> 2. The payment is at least $Y,* the only items provided bear the organization’s name or logo (e.g., calendars, mugs, or posters), and the cost of these items is within the limit for “low-cost articles,” which is $Z.*
>
> Free, unordered low-cost articles are also considered to be insubstantial.

The “asterisked amounts” are $109 (X) for 2018 ($107 for 2017) or the amount contributed to the charity was at least $54.50 (Y) for 2018 ($53.50 for 2017) and the donor receives only “token benefits” (e.g., bookmarks, calendars, mugs, posters, t-shirts, etc.) generally costing no more than $10.90 (Z) for 2018 ($10.70 for 2017). Two things:

1. Note that the token amounts represent the *cost* to the charity, not fair market value.
2. Token items can generally include books and similar items that are marked or stamped with the charity’s logo or name.

IRS Data-Driven Decision Making

The IRS EO division continues to sharpen its data-driven decision making process. Currently, EO reports that there are over 200 “queries” run on Form 990-series returns. The goal is to identify returns filed by exempt organizations with the highest risk of non-compliance.

The division has stated that it will continue to improve Form 990, 990-EZ, and 990-PF compliance models and test the newly developed model for Form 5227, *Split Interest Trust Information Return.*

Raffle Fundraisers

A raffle may look like a unique and exciting way to raise funds. But before engaging in a raffle, an organization should consider the following:

1. The purchase of raffle tickets does not result in a tax-deductible contribution. This is discussed on page 7 of IRS Publication 526, *Charitable Contributions*.
2. When a raffle prize is greater than $600 and more than 300 times the amount of the wager, the organization must report the identity of the winner to the IRS and issue the winner a Form W-2G, *Certain Gambling Winnings*. See page 22 of IRS Publication 3079, *Tax-Exempt Organizations and Gaming*.
3. If the value of the prize is greater than $5,000, the raffle sponsor must withhold 28% of the value of the prize less the cost of the raffle ticket(s) purchased. If the prize is non-cash, the organization must either collect the withholding amount from the winner, or pay an amount equal to 33.33% of the value of the non-cash prize itself. When the sponsor pays the tax withholding amount, the amount of the tax withholding paid is added to the value of the prize on Form W-2G. When withholding is required, the winner must sign Form W-2G attesting to the fact that no other person is entitled to any portion of the payment and that the winnings are subject to regular gambling withholding.
4. Raffles will generally require institutions that are required to file Form 990 to complete Schedule G (Form 990), Part III, “Gaming.” Before holding a raffle it would be advisable to review the Instructions to Schedule G and the Form 990 glossary with respect to the terms “gaming” and “volunteers.”
5. Income from raffle tickets is unrelated business taxable income if raffles are an activity the organization regularly carries on (perhaps more than twice per year or for more than two weeks in duration) or the raffle is not substantially staffed by volunteers.
6. Also, there can be state and local implications to raffles that vary widely depending upon the jurisdiction in which your institution is located and where the raffle might be held. Make sure you research any potential regulatory or registration requirements.
7. Finally, there is the potential public relations angle, which each organization should assess for itself.

EXAMPLE:
Bill buys a $10 raffle ticket for the chance to win a $6,000 cash prize. Bill’s ticket is drawn. Because Bill’s winnings net of the cost of the raffle ticket ($5,990) are greater than $600 and more than 300 times the amount of the wager (the cost of the raffle ticket), the organization sponsoring the raffle must report Bill’s winnings to the IRS, issue Bill a Form W-2G, and withhold $1,677 (28% of $5,990). Additionally, Bill must sign the Form W-2G.

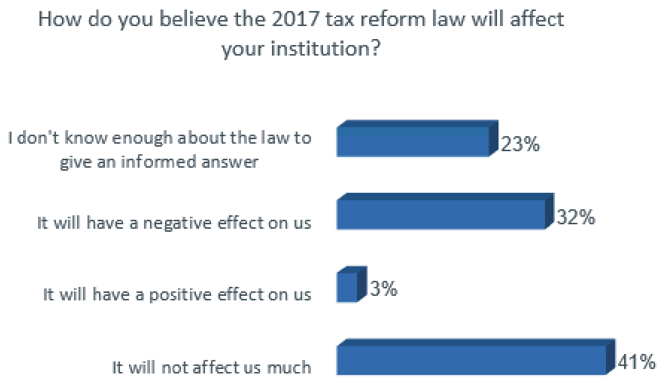
As noted in #4 above, and as several states are looking at Schedule G (Form 990) reporting, your institution needs to consider whether or not your raffle needs to be reported on Schedule G (Form 990), Part III as “gaming.”

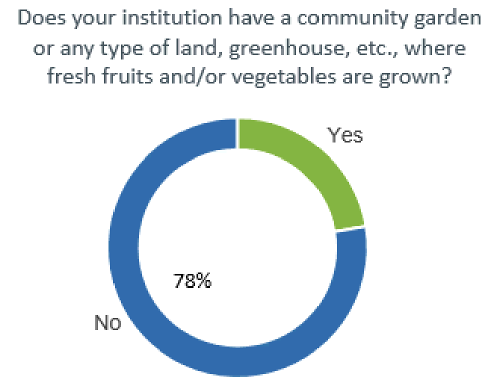
The 2017 Form 990 instructions (draft as of August 1, 2017) provide the following definition of “Gaming”:

> Includes (but isn’t limited to): bingo, pull tabs/instant bingo (including satellite and progressive or event bingo), Texas Hold-Em Poker, 21, and other card games involving betting, 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 (other than events not regularly carried on 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, which events are fundraising events), 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. See Pub. 3079, Tax-Exempt Organizations and Gaming.

Colleges, Seminaries, and Universities (2018 eQueries)

In January 2018 we conducted our annual "eQuery" surveys on each Tuesday of the month, and asked various tax-related questions that institutions informed us they were interested in. The number of responses averaged about 150 per week.





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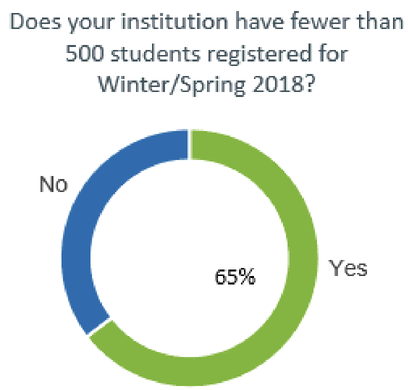

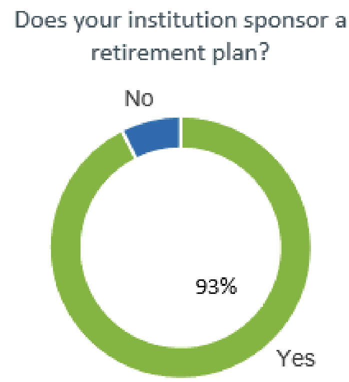

Revenue Enhancement Opportunities (REO)

We continue to get questions about our REO projects. Although the CapinCrouse team would love to work with your institution on a project of this nature, we can also help you to facilitate the process in-house.

In terms of the fun and power we've been seeing with the REO projects we've been privileged to facilitate over the past few years, the results have been creative.

Here's what our process entails, with a break every 60 to 80 minutes to recharge. We start by getting as many leaders of the institution in the room as possible (CEO, COO, CFO, accounting team, board members, deans, key employees, development officers, athletic directors…). Many times, they do not believe we are going to have anywhere near as much fun as we do!

We usually begin the day by spending 30 to 40 minutes looking at a school's Form 990 and the footnotes to its audited financial statements to brainstorm about the "uniquenesses" that we see there. We chart each "uniqueness" on a big yellow sticky note. .

Next, we ask participants to anonymously answer a few fun polling questions such as "What is your favorite scripture?" and "What did you want to be when you grew up?" These answers are also charted to help everyone understand the unique attributes and perspectives within the group.

Revenue Enhancement Opportunities (continued)

Then we brainstorm 30 or so ideas for “wild and crazy” revenue-generating projects. This is a flexible, informal, open time. With our college clients we see ideas tend toward development, facilities, certificate programs, and services, but we try to break those molds. We chart these ideas in four colors, with black for information, blue for strengths or “uniquenessess,” green for positives, and red for negatives.

Typically, by mid-afternoon we’re ready to begin narrowing those ideas down to two workable ideas that we can move forward on with action plans. We typically look for one big, audacious idea and one that is “just add water” and easy to implement. The ideas that are taken down off the wall should not be forgotten — they are often long-term or “partnerable” ideas that may be returned to in the future.

From there, we expand on the two chosen plans to build outline descriptions, determine point people and team members, and establish and calendar action items. Going forward, we work the calendar — driven by action point dates — to implement the revenue-generating projects. It is truly a blast!

Coaches’ Apparel

Issue

In a recent case, the IRS found coaches’ golf shirts and similar apparel provided by the college to be taxable to the coaches.

Situation

Denali Christian College (DCC) is a public charity and a school under IRC sections 501(c)(3) and 170(b)(1)(A)(ii). The Denali Kodiak athletic teams represent DCC in several sports, including basketball, volleyball, baseball, softball, tennis, and cross country.

Every head coach and assistant coach has an employment agreement with DCC. The coaches all receive athletic clothing from DCC in school colors and with the DCC or Kodiak logo, or both. These apparel items are generally worn at games, practices, and other venues representing the college.

DCC’s CFO calls us to ask whether the value of this clothing is taxable to the coaches. We answer that according to the IRS, in most cases it is.

Rules

From the IRS Fringe Benefits Guide:

> **Work Clothes and Uniform Allowances and Reimbursements**
>
> Clothing or uniforms are excluded from wages of an employee if they are:
>
> - Specifically required as a condition of employment, and
> - Are not worn or adaptable to general usage as ordinary clothing.

From a recent IRS ruling with a major university:

> **Conclusion**
>
> The value of the fringe benefit is taxable, unless there is a statute or regulation that excludes them. Internal Revenue Code section (IRC) 61 provides that gross income means all income from whatever source derived, including compensation in the form of fringe benefits. There is no exclusion for athletic clothing provided to coaches or assistant coaches (this clothing would be adaptable to personal use).
>
> The clothing provided to the athletic coaches is a direct result of the employment with the University. The clothing allotted to the athletic coaches is suitable for general wear and would not qualify as a section 162 expense. The items are taxable to the employee. An adjustment is warranted per IRC 3101, 3111 and 3402… The clothing is taxable as wages and subject to Social Security, Medicare and Federal Income Tax.

Fuel Credits?

Issue

There is a potential credit for fuel (e.g., gasoline and diesel) "exclusively for use by a nonprofit educational organization."

Situation

Marathon Bible College (MBC) is a public charity and a school under IRC sections 501(c)(3) and 170(b)(1)(A)(ii). MBC has several vehicles that are only used on campus, for various school activities, and for transporting students between venues. They wonder if they might be able to get a credit back for any of the excise taxes paid on fuels used in these vehicles. We tell them that this is a great question!

To qualify, an institution must be able to identify the type of use (hint: it is likely type 13; see below), report gallons used (or equivalents), complete Form 4136, file a Form 990-T (with the credit claimed on Part IV, Line 45g), and maintain records that include the person who sold the fuel to you and the dates of the purchases.

According to IRS Publication 510, *Fuel Taxes (Including Fuel Tax Credits and Refunds)*, the various uses that meet the "type of use" criteria include exclusive use by a nonprofit educational organization, use in a school bus, and off-highway business use.

Some institutions choose not to take advantage of these credits as the ultimate benefit may only be a few hundred dollars. Also, some institutions would rather not file Form 990-T simply to "transmit" Form 4136.

Rules

From Form 4136, Credit for Federal Tax Paid on Fuels instructions:

> How To Make a Claim
> Complete all information requested for each claim you make. You must enter the number (when requested) from the Type of Use Table, the number of gallons, or gasoline or diesel gallon equivalents (GGE or DGE)… and the amount of the credit.
>
> **Recordkeeping**
> You must keep records to support any credits claimed on the return for at least 3 years from the date the return is due or filed, whichever is later.

From IRS Publication 510:

> **Exclusive use by a nonprofit educational organization (No. 13).** Exclusive use by a nonprofit educational organization means fuel used by an organization exempt from income tax under section 501(a) that meets both of the following requirements.
>
> - It has a regular faculty and curriculum.
> - It has a regularly enrolled body of students who attend the place where the instruction normally occurs.
>
> A nonprofit educational organization also includes a school operated by a church or other organization described in section 501(c)(3) if the school meets the above requirements.

Could Your (Small) Institution Utilize a QSEHRA?

Issue

Most small Christian colleges have heard about the Affordable Care Act (ACA) rule that reimbursing health insurance premiums could result in penalties of $100 per day, per employee. Now there may be a program to help qualified small employers go back to health insurance reimbursement — and without the onerous penalties. A new law provides an opportunity for small employers to reimburse health insurance premiums on a pre-tax basis.

Could Your (Small) Institution Utilize a QSEHRA? (continued)

Situation

Troas Bible College (TBC) is a private college exempt under Internal Revenue Code section 501(c)(3) and 170(b)(1)(A)(ii). They are required to file Form 990 annually. In 2014, TBC ceased reimbursing health insurance premiums for their employees due to edicts in IRS Notice 2013-54. As we discussed tax issues with TBC's controller, we told her about the new 21st Century Cures Act and she indicated that they might like to take advantage of these changes.

This Act allows qualified small employers to offer a new kind of health reimbursement arrangement (HRA) to assist employees in paying for their medical expenses. It was effective January 1, 2017. The new arrangement is called a Qualified Small Employer Health Reimbursement Arrangement (QSEHRA). QSEHRAs are not considered "group health plans" under the ACA. Thus, the market reform requirements — with penalties of $100 per day, per employee — do not apply.

Employers are eligible to offer a QSEHRA if they:

1. Are not applicable large employers as defined under the ACA
2. Do not offer a group health plan to any of their employees

Eligible qualified small employers will be allowed to pay or reimburse employees' eligible medical care expenses through a QSEHRA on a pre-tax basis.

The 21st Century Cures Act also provided additional transitional relief for some small employers who had the arrangement to reimburse health insurance premiums for plan years beginning on or before December 31, 2016.

Rules

The Qualified Small Employer Health Reimbursement Arrangement is codified in Internal Revenue Code section 9831(d)(2). A summary of the qualifications — and a "notice requirement" — are as follows:

A QSEHRA (like a "traditional" HRA) must be funded solely by the employer. The arrangement must reimburse medical expenses as defined by Internal Revenue Code Section 213(d) and must be provided on the same terms to all eligible employees, except that the benefit amount may vary to reflect differences in individual health insurance premiums that are based on age and family size.

Employees may be excluded from coverage if they:

- Are part-time or seasonal;
- Are under 25 years of age;
- Have worked less than 90 days for the employer;
- Are nonresident aliens with no domestic earned income; or
- Are union members covered by a collective bargaining agreement

QSEHRA annual contributions have a limit of up to $4,950 for single or $10,000 for family coverage. These limits will be adjusted for inflation and prorated for partial years.

A QSEHRA sponsor (qualified small employer) must provide all eligible employees with a notice at least 90 days before the start of the plan year (or 90 days before they become eligible, if in mid-year). The notice must include things like the employee's permitted benefit for the year; a statement that the employee is to provide the benefit amount on any application for an ACA exchange premium subsidy; and a warning that the employee may be taxed under the ACA's individual mandate, and owe income tax on QSEHRA reimbursements, unless they maintain "minimum essential coverage."

UBIT: The Required Minimum Level of Knowledge

Situation

Troas Bible College (TBC) is a private college exempt under Internal Revenue Code section 501(c)(3) and section 170(b)(1)(A)(ii). They are required to file Form 990 annually. Their new CFO calls us and says, “I’m new to higher education, with a background in banking, and this UBI stuff seems daunting. How can I find out more about it — and fast?”

We respond by quoting the 2014 report of the Advisory Committee on Tax Exempt and Government Entities (ACT):

> The UBIT rules are not complex. They are, however, very detailed. Tax administrative officials, as well as outside tax advisors, for colleges and universities, must know and understand these rules in order to report the institution’s revenues properly to avoid an underpayment of tax, with interest and penalties.

We refer the CFO to the following resources:

- IRS Publication 598, Tax on Unrelated Business Income of Exempt Organizations
- Thirteenth Report of the Advisory Committee on Tax Exempt and Government Entities (ACT), Analysis and Recommendations Regarding Unrelated Business Income Tax Compliance of Colleges and Universities (page 75)
- Form 990-T, Exempt Organization Business Income Tax Return (Instructions)
- The archives of the Tax Tips for Christian Higher Education blog:
  - Form 990-T: Charitable Contributions deduction – 6/22/17
  - Conferences: Conventions and Trade Shows? – 5/31/17
  - Dual-Use Facility Expenses – 5/17/17
  - Corporate Sponsorships with Benefits – 11/9/16
  - Corporate Sponsorships in the “Hands” of the Sponsor – 11/2/16
  - Do You Need to do a “UBIT Assessment?” – 10/26/16
  - Domestic Production Activities Deduction – 8/17/16
  - Income from Personal Property Rentals – 8/10/16
  - Fundraising “Co-ventures” with Restaurants – 7/6/16
  - Rental of Arena to Concert Promoter = UBIT – 6/8/16
  - Lessons from a College Golf Course – 5/18/16
  - Might Hosting an NFL Training Camp Mean UBIT? – 5/4/16
  - When Advertising in a Sports Program is not UBIT – 3/23/16
  - Related or Unrelated – That is the Question! – 2/24/16
  - Providing “Services” May Result in UBIT – 2/17/16
  - Do You Participate in “Travel Tours?” – 1/6/16
  - Christmas Basketball Tourney – Sponsorships – 12/23/15
  - But What About a “Guest House?” – 11/4/15
  - A “Hotel” on Campus? – 10/28/15
  - UBIT and the Christmas Cantata – 9/30/15
  - Online Periodicals Can Present Interesting Issues – 8/12/15
  - Could Some Of Your Bookstore Sales be Taxable? – 7/22/15
  - Might Laundry Operations Result in Taxes Owed to the IRS? – 6/24/15
  - Will I Be Taxed for Summer Camp Activities on My Campus? – 6/3/15

UBIT: The Required Minimum Level of Knowledge (continued)

Rules

From IRS Publication 598:

> Unrelated business income. Unrelated business income is the income from a trade or business regularly conducted by an exempt organization and not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity.
>
> Certain trade or business activities aren't treated as an unrelated trade or business. See *Excluded Trade or Business Activities*, later.

From the Form 990-T Instructions:

> **Who Must File**
>
> The following entities must file Form 990-T. Any domestic or foreign organization exempt under section 501(a) or section 529(a) if it has a gross income of $1,000 or more from a regularly conducted unrelated trade or business (see Regulations section 1.6012-2(e)). Gross income is gross receipts minus the cost of goods sold (see Regulations section 1.61-3).

About the Author

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Dave is dedicated to meeting client needs in the exempt organization tax arena through review of client returns, consulting engagements, training, and the compilation of the annual CapinCrouse *Higher Education Tax Reporting Trends Project*. He has 29 years of accounting experience and serves several industry committees, including the AICPA Not For Profit Advisory Council. Dave has also served on the IRS Advisory Committee on Tax Exempt and Government Entities (ACT).

About CapinCrouse

As a national full-service CPA and consulting firm devoted to serving nonprofit organizations, CapinCrouse provides professional solutions to organizations whose outcomes are measured in lives changed. Since 1972, the firm has served domestic and international outreach organizations, universities and seminaries, foundations, media ministries, rescue missions, relief and development organizations, churches and denominations, and many others by providing support in the key areas of financial integrity and security. With a network of offices across the nation, CapinCrouse has the resources of a large firm and the personal touch of a local firm. Learn more at capincrouse.com.

CapinCrouse is an independent member of the BDO Alliance USA.