# Higher Education Tax Update

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## Contents

## 2018 Tax Year in Review

Wow! There was a lot going on in 2018 — and it has followed us into 2019! From the earthshaking effects of some of the Tax Cuts and Jobs Act (TCJA) to the changes in reporting wrought by FASB ASU 2016-14 requirements, the Supreme Court's shakeup of sales tax rules in *South Dakota v. Wayfair*, and at least one government shutdown, we have a lot to keep our eyes on. Hopefully, the items summarized here will help you stay ahead of the curve in terms of tax compliance and reporting. Enjoy.

## The "Parking Tax" is Real — and Likely Requires Your Institution's Attention

The TCJA added Internal Revenue Code (IRC) section 512(a)(7) to tax costs — not revenues — associated with "disallowed fringe benefits." These disallowed benefits include any qualified transportation fringe, any parking facility used in connection with qualified parking, or any on-premises athletic facility. Because of an anomaly in the final version of the TCJA, as of now the on-premises athletic facility provision generally is not applicable. Throughout 2018, we all speculated (and re-speculated) on what the guidance regarding the "taxability" of "qualified parking" might mean.

In December 2018, Treasury released Notice 2018-99. The new parking tax (section 512(a)(7)) guidance in Notice 2018-99 features:

- A list of the types of expenses included in "total parking expenses."
- An opportunity to make a retroactive change to "parking arrangements" — to change parking space designations from "employee only" — up until March 31, 2019.
- A somewhat algebraic, four-step "safe harbor" reasonable method of calculating the addition to an institution's unrelated business taxable income in accordance with section 512(a)(7).
- A "50% rule" in Step 2 of the prescribed methodology whereby expenses for parking spaces not reserved for employees may be disregarded if more than 50% of parking is provided to the general public.
- Limited penalty relief for some institutions who have not paid estimated taxes for the parking tax they may owe for years ending in 2018 or 2019, or both (Notice 2018-100).

The Notice defines "total parking expenses" as follows:

> For purposes of this notice, "total parking expenses" include, but are not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments or a portion of a rent or lease payment (if not broken out separately). <u>A deduction for an allowance for depreciation on a parking structure owned by a taxpayer and used for parking by the taxpayer's employees is an allowance for the exhaustion, wear and tear, and obsolescence of property, and not a parking expense for purposes of this notice.</u> [Emphasis added.]

In tandem with Notice 2018-99, the IRS released Notice 2018-100, which may provide limited relief to some institutions who did not file Form 990-T in a timely manner for years ended in 2018. Also, we are still hoping for repeal. As with many issues regarding the Congress/IRS/Treasury: Film at 11.

## Form 990-T and "Siloing" in IRC Section 512(a)(6)

The TCJA also added IRC section 512(a)(6) which, frankly, goes against any pretense of "parity" between for-profit entities and not-for-profit entities. The new section deems that 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. A transition rule says that net operating losses (NOLs) arising in a taxable year before January 1, 2018 that are carried forward to a future taxable year are not subject to this rule.

## Form 990-T and “Siloing” in IRC Section 512(a)(6) (continued)

Guidance on 512(a)(6) was floated in 2018 in the form of Notice 2018-67. Although the Notice provided some nice safe harbor provisions regarding the treatment of investment Schedule K-1s for these purposes, it mostly muddied the waters by suggesting that the silos (or baskets or buckets) for various activities be delineated using the NAICS six-digit code. There are 1,057 NAICS six-digit codes – yikes! Ultimately, there were a plethora of comments on this Notice from a wide range of interested parties. It will be interesting to see if the IRS considers those comments as it constructs temporary – and ultimately final – regulations in this area.

## There’s More to IRC Section 4960 Than We Thought

The TCJA also brought us the new section 4960, a tax on “excess executive compensation.” Throughout 2018, there was confusion about whether public colleges were subject to this excise tax. Section 4960(a) imposes an excise tax of 21% on the amount of remuneration paid by an applicable tax exempt organization (ATEO) with respect to the employment of any covered employee in excess of $1 million and on any excess parachute payment paid by such organization to any covered employee. Although most of the institutions reading this will not pay any covered employee more than $1 million, you should be attentive to the codicil about excess parachute payments. A covered employee is one of the five highest-compensated employees in any year after 2016.

Guidance on this section was provided with Notice 2019-9 (December 31, 2018). That Notice included 39 question and answer scenarios. Here are two:

> Q-17: What is a parachute payment under section 4960(c)(5)(B)?
>
> A-17: (a) In general. The term “parachute payment” means any payment in the nature of compensation made by an ATEO (or a predecessor organization of the ATEO) or a related organization to (or for the benefit of) a covered employee if-
>
> 1. the payment is contingent on the employee’s separation from employment with the employer; and
> 2. the aggregate present value of the payments in the nature of compensation to (or for the benefit of) the individual that are contingent on the separation equals or exceeds an amount equal to three times the base amount. [See exclusions]
>
> Q-9: Who is a covered employee within the meaning of section 4960(c)(2)?
>
> A-9: The term “covered employee” means any employee (including any former employee) of an ATEO, if the employee-
>
> 1. is one of the five highest-compensated employees of the organization for the taxable year of the ATEO, or
> 2. was a covered employee of the ATEO (or any predecessor) for any of the ATEO’s preceding taxable years beginning after December 31, 2016.

Institutions liable for this excise tax would check the “Yes” box on Form 990, Part V, Line 15 and report and pay the tax on Form 4720, Schedule N.

## Moving Expense Reimbursements/Deductions Suspended

The TCJA contains provisions in sections 11048 and 11049 that 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 to the end of the new “(k) SUSPENSION OF DEDUCTION FOR TAXABLE YEARS 2018 THROUGH 2025” subsection.

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

## Private College/University Endowment Excise Tax

The TCJA also added an interesting section at IRC section 4968, an excise tax on "endowment" earnings of certain private colleges and universities (reportedly fewer than 40 schools). The provision imposes a 1.4% excise tax on the net investment income of private colleges and universities that are "applicable educational institutions" (AEIs). AEI generally means:

1. The school has at least 500 tuition-paying students, and
2. 50% of its tuition-paying students are located in the U.S.

The threshold computation applies to AEIs with endowment assets having an aggregate fair market value at the end of the preceding taxable year of at least $500,000 per student (minimum of $250,000,000 – 500 qualifying students x $500,000 per student). Assets used directly in carrying out the institution's exempt purpose are excluded.

The IRS provided interim guidance with Notice 2018-55. While this Notice is technical, it did provide us with valuable insight into two IRS positions:

- Capital gain basis = fair market value (FMV) at December 31, 2017 for property that was continuously held until its disposition by the educational institution.
- Losses will generally be allowed only to the extent of gains from such dispositions, with no capital loss carryovers or carrybacks.

Institutions liable for this excise tax would check the "Yes" box on Form 990, Part V, Line 15 and report and pay the tax on Form 4720, Schedule N. Because there is no requirement to make estimated tax payments for the section 4968 tax, Form 990-W does not apply to the section 4968 tax.

## GAAP vs. Form 990 Accounting

There are several places where GAAP and Form 990 accounting have historically deviated, such as unrealized gains/losses and donations of facilities or services. This has become more pronounced with the advent of the ASU 2016-14 financial statement reporting requirements. Currently, the main area of interest is that the FASB has changed the number of net asset classifications from three to two (net assets without donor restrictions and net assets with donor restrictions), but the IRS continues to show three (Unrestricted, Temporarily restricted, Permanently restricted) on Form 990, Part X. There is a great deal of back and forth on how to "convert" and report these amounts. The IRS has some suggestions in the new 2018 Form 990 instructions for Form 990, Part X, Lines 27 – 29:

> CAUTION!
>
> Effective for reporting years ending after December 15, 2017, ASC 958-205, Not-for-Profit Entities–Presentation of Financial Statements (ASC 958), addresses reporting of donor-restricted endowments and board-designated (quasi) endowments. Further, a number of states have enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). If the organization is subject to UPMIFA or ASC 958, it may affect the amounts reported on lines 27 through 29.
>
> **Line 27.** Unrestricted net assets. Enter the balance per books of unrestricted net assets. For years ending after December 15, 2017, ASC 958 refers to "unrestricted net assets" as "net assets without donor restrictions." Unrestricted net assets are neither permanently restricted nor temporarily restricted by donor-imposed stipulations. <u>All funds without donor-imposed restrictions must be classified as unrestricted, regardless of the existence of any board designations or appropriations.</u>
>
> **Line 28.** Temporarily restricted net assets. For years ending after December 15, 2017, ASC 958 does not use the term "temporarily restricted net assets." However, this line can be used to show the balance per books of net assets with donor-imposed restrictions that may require resources to be used after a specified date (time restrictions), or used for a specified purpose (purpose restrictions), or both. <u>Organizations may also opt to leave Line 28 blank and report all net assets subject to donor-imposed restrictions on Line 29.</u>

## GAAP vs. Form 990 Accounting (continued)

> **Line 29.** Permanently restricted net assets. Enter the balance per books of net assets with donor restrictions. If net assets with donor-imposed restrictions for time or purpose of expenditure are shown on Line 28, do not include those items in the balance shown on Line 29. [Emphasis added.]

## The New World of Functional Expenses

Another interesting place where GAAP and Form 990 reporting might — but don't have to —deviate is in the new area of functional expense reporting and disclosure. For many years, institutions have been allocating "functional expenses" on Form 990, Part IX among Program service, Management and general, and Fundraising. Part IX has a stringent set of instructions regarding which line and column various expenses should be reported on. Now the FASB has published their own guidelines and examples under ASU 2016-14.

The two sets of rules are not necessarily mutually exclusive. Institutions should be careful in planning for the manner in which they will report functional expenses as a separate statement in their audited financials or in the notes to those financial statements. It is wise to consider Form 990, Part IX as you complete your financial statements for years ending in 2019.

## Minister's Housing Allowance Update

In November 2013, a federal judge held that the minister's housing allowance under IRC section 107(2) is unconstitutional because it "violates the establishment clause of the First Amendment." This was in response to a case a foundation filed because it did not believe its officers could use 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 its 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).
Several groups filed amicus briefs with the Seventh Circuit in 2018. On October 24, 2018, oral arguments were heard before the Court of Appeals. We expect a decision in the first half of 2019.

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 might be struck down, religious organizations and clergy should be looking ahead to 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 minister's housing allowance may not be available in the future.

## The “Bicycle to Work” Fringe is Suspended

Historically, some institutions have paid a monthly reimbursement to staff and faculty who ride their bikes to campus. Prior to the enactment of the TCJA (effective January 1, 2018 in this case), “qualified bicycle commuting reimbursements” of up to $20 per qualifying bicycle commuting month were excludible from an employee’s gross income. A qualifying bicycle commuting month was any month during which the employee regularly used the bicycle for a substantial portion of travel to a place of employment and during which the employee did not receive transportation in a commuter highway vehicle, a transit pass, or qualified parking from an employer.

Reasonable expenses were those incurred in a calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if the bicycle was regularly used for travel between the employee’s residence and place of employment.

The provision suspends the exclusion from gross income and wages for qualified bicycle commuting reimbursements. The exclusion does not apply to taxable years beginning after December 31, 2017 and before January 1, 2026.

Precise narrative from the 2017 Tax Cuts and Jobs Act:

> SEC. 11047. SUSPENSION OF EXCLUSION FOR QUALIFIED BICYCLE COMMUTING REIMBURSEMENT.
>
> (a) IN GENERAL. – Section 132(f) is amended by adding at the end the following new paragraph:
>
> ‘‘(8) SUSPENSION OF QUALIFIED BICYCLE COMMUTING REIMBURSEMENT EXCLUSION. – Paragraph (1)(D) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.’’.
>
> (b) EFFECTIVE DATE. – The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

## Do You Have UBIT from “Alternative Investments?”

When we speak of “alternative investments,” we are generally referring to investments in partnerships or Subchapter S corporations that produce Schedule K-1s annually. If your school receives Form 1065 or Form 1120-S Schedule K-1s, you should be aware that they are apt to produce reportable unrelated business income (UBI). For 1065 K-1s we start with Line 20, Code V to investigate potential UBI. We then look to the statements accompanying the schedule. With 1120 K-1s, virtually every item of income on the schedule is taxable. Remember, there are state tax issues that must be considered, too.

With the introduction of IRC section 512(a)(6) and UBI “siloing,” questions arise about how to “silo” revenues from the various activities reported on Schedule K-1. Notice 2018-67 provides initial guidance on this matter: investment partnerships in which the entity has a 2% or less profits interest and capital interest throughout the year are aggregated as one activity per the Schedule K-1. We await proposed regulations on this matter.

## 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.

The 2018 Form 1098-T has Box 2 shaded out, leaving the only option as Box 1 — “Payments received for qualified tuition and related expenses.” It also appears that those institutions that used Box 2 in 2017 and are “forced” to use Box 1 in 2018 should check Box 3, *Checkbox for Change of Reporting Method*, on the 2018 Form 1098-T.

## Form 1098-T Box 1 Only! (continued)

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.
>
> **Box 3. Checkbox for Change of Reporting Method**
> Check this box if you have changed your method of reporting. You have changed your method if the method you are using for 2018 is different than the method you used for 2017.

The 2019 Form 1098-T also “reserves” Box 3.

## Form 1098-T Penalties Still Possible

Unfortunately, we are still seeing some IRS penalty notices for Form 1098-T filings where some students’ Taxpayer Identification Numbers (TIN) were omitted. The IRS has included a nearly hidden checkbox, embedded in Box 3 of the “red” form, to indicate that a school properly followed the prescribed manner of soliciting TINs.

From the 2018 Form 1098-T Instructions:

> Student’s TIN and checkbox. Enter the student’s TIN, as provided to you on Form W-9S, Request for Student’s or Borrower’s Taxpayer Identification Number and Certification, or other form. If you solicited the student’s TIN in writing (Form W-9S or other form) for the current year, check the box. Also check the box if you obtained the student’s TIN in a prior year by making a solicitation in writing (Form W-9S or other form) or you obtained the student’s TIN in a prior year from his or her financial aid application or other form and in either case have no reason to believe the TIN previously obtained is incorrect. Check the box if the institution is filing the Form 1098-T with nothing in the field for the student’s TIN because the institution has no record of a TIN, but only if you made a written solicitation for the TIN on or before December 31 of the year for which you are filing the Form 1098-T. By checking the box and filing Form 1098-T with the IRS (for electronic filers), you certify under penalties of perjury that you have in good faith complied with the standards in Treasury Regulations section 1.6050S-1 governing the time and manner of soliciting the TIN of the student. Filers who transmit paper forms to the IRS will make such certification by signing Form 1096 in conjunction with filing the returns with the boxes checked in the fields designated for the student’s identification number.

From Treasury Regulation 1.6050S-1(e)(3)(iii):

> (iii) Manner of soliciting TIN. An institution or insurer must request the individual’s TIN in writing and must clearly notify the individual that the law requires the individual to furnish a TIN so that it may be included on an information return filed by the institution or insurer. A request for a TIN made on Form W-9S, “Request for Student’s or Borrower’s Taxpayer Identification Number and Certification,” satisfies the requirements of this paragraph (e)(3)(iii). An institution or insurer may establish a system for individuals to submit Forms W-9S electronically as described in applicable forms and instructions. An institution or insurer may also develop a separate form to request the individual’s TIN or incorporate the request into other forms customarily used by the institution or insurer, such as admission or enrollment forms or financial aid applications.

## Summary of 2019 Key Tax Facts

**2019 Inflation-Adjusted Amounts**

The IRS announced annual inflation adjustments for more than two dozen tax provisions for tax year 2019, including the following:

- The annual exclusion for gifts remains at $15,000 for 2019, the same amount as 2018.
- The “gross income” threshold for filing Form 990-T remains at $1,000 for 2018 returns — the same as it has been since 1951! (But there *are* some Form 990-T changes!)
- The OASDI (i.e., Social Security) maximum compensation base (“FICA limit”) is $132,900 for 2019, up from $128,400 in 2018.
- The threshold for filing Form 990 electronically remains at $10 million and 250 information returns.
- The foreign earned income exclusion rises to $105,900 for 2019, up from $103,900 in 2018.
- The highly compensated employee limit for 2019 is $125,000, up $5,000 from the 2018 limit of $120,000.

## 2019 Standard Mileage Rates

The standard mileage rates were adjusted upward for 2019. The optional mileage allowance for owned or leased autos (including vans, pickups, or panel trucks) has increased by 3.5 cents to 58 cents per mile for business travel in 2018. The rate for using a car to get medical care has increased by 2 cents to 20 cents per mile for 2018. The moving expense mileage rate is generally suspended until after December 31, 2025. The charitable mileage rate remains steady at 14 cents per mile – this amount is statutory. In the House version of 2017 tax reform, there was an attempt to make the charitable mileage rate adjusted for inflation annually. This provision did not make it into law.

## Form 990 Changes

Although the Form 990, Part X lines for net assets (Lines 27, 28, and 29) have not been updated yet, the IRS did update the form for aspects of the TCJA. Form 990, Part V has two added items. These are right under Line 14, Did the organization receive any payments for indoor tanning services during the tax year?.

Line 15 concerns the new IRC section 4960 and asks, “Is the organization subject to the section 4960 tax on payment(s) of more than $1,000,000 in remuneration or excess parachute payment(s) during the year?”

The new Line 16 of Part V is related to the “excise tax on certain private college endowments” and asks, “Is the organization an educational institution subject to the section 4968 excise tax on net investment income?”

And as mentioned earlier, the Form 990 instructions (and the instructions to Schedule D) have been updated to consider the effects of ASU 2016-14.

## Form 990-T Gets Its First Major Facelift in 67 Years!

We like to joke sometimes about Form 990-T looking virtually the same as it did in 1951. Same basic layout. Same $1,000 specific deduction. Same paper filing only. Back then it was on legal-length paper.

But the form has gotten a facelift for 2018. Not only does Part IV, Line 39 reflect the flat 21% tax rate, but a new Part III has been dropped in that includes Line 33, “Total of unrelated business taxable income computed from all unrelated trades or businesses.” In addition, with a tip of the cap to IRC section 512(a)(7), we get a new Line 34, “Amounts paid for disallowed fringes.” This is where amounts imputed into UBI for the “parking tax” will be reported. There’s also a new Line 35, “Deduction for net operating loss arising in tax years beginning before January 1, 2018,” where pre-TCJA net operating losses (NOLs) may be deducted against UBI. This includes the institution’s required reporting of the employee share of “total parking expenses.”

## Form 990-T Gets Its First Major Facelift in 67 Years! (continued)

Also, a Schedule M (Form 990-T) has been introduced for organizations with more than one unrelated trade or business. These organizations should complete Part I and Part II on page 1 of Form 990-T for their first unrelated trade or business, then complete and attach a separate Schedule M for each additional unrelated trade or business. Report the sum of the unrelated business taxable income from Line 32 of Form 990-T and each Schedule M on Part III, Line 33. If Line 32 of any Schedule M is less than zero, do not include it in the sum reported on Part III, Line 33. Refer to the instructions for Parts I and II for the corresponding lines on Schedule M. Schedule M looks suspiciously similar to Form 990-T, Page 1!

The Form 990-T (and Schedule M) instructions have been updated to support these changes.

## How Net Operating Losses Have Been Turned Upside Down

There is a new methodology for dealing with NOLs due to changes brought to us courtesy of the TCJA. Most institutions no longer have the option to carryback an NOL. Generally, NOLs arising in tax years ending after 2017 can only be carried forward. The two-year carryback rule in effect before 2018 generally does not apply to NOLs arising in tax years ending after December 31, 2017. In addition, for losses arising in taxable years beginning after December 31, 2017, the NOL deduction is limited to 80% of taxable income. This is determined without regard to the deduction.

So that means we need to track NOLs that arose from all unrelated business activities (and were reported on prior Form 990-Ts) separately from NOLs that occur in tax years beginning after December 31, 2017. And the post-2017 NOLs must be tracked by separate business activity or "silo." Sounds like a lot of work. Not to mention, for losses arising in taxable years beginning after December 31, 2017, the net operating loss deduction is limited to 80% of taxable income (determined without regard to the deduction).

## IRS EO Issue Snapshots

One great development instituted by the IRS Exempt Organizations (EO) 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 2019. 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 as data gathered by the K-Nets. The K-Nets will continue to prepare and post technical Issue Snapshots for EO employees and the general public.

In 2018, EO issued 12 Issues Snapshots. Interestingly, nine of these concerned unrelated business activities issues and the other three were related to private foundations. The following titles will be of special interest to many colleges, seminaries, and universities:

- Exempt Organization Gaming and Unrelated Business Taxable Income (4/5/2018)
- Understanding How Income Affects Qualification for Exemption as a IRC Section 501(a)(2) Corporation (6/2/2018)

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.

## 2019 “Token” Amounts

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

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 $111 (X) for 2019 ($109 for 2018) or the amount contributed to the charity was at least $55.50 (Y) for 2019 ($54.50 for 2018) and the donor receives only “token benefits” (e.g., bookmarks, calendars, mugs, posters, T-shirts, etc.) generally costing no more than $11.10 (Z) for 2019 ($10.90 for 2018). 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.

## Sales Tax Issues Post-*Wayfair*

Many schools are interested in the recent *South Dakota v. Wayfair* decision by the Supreme Court and ask us whether they may have to register and pay sales taxes in various states in the future. Every jurisdiction is different, but you certainly need to be tracking sales for potential exposure to new state laws. (This is not unlike the procedures that should be in place in the state charitable solicitations registration realm.)

Ultimately, the 1992 *Quill* decision made state nexus dependent upon “physical presence” in a given state. This might have been evidenced by property in the state, employees in the state, etc. The *Wayfair* decision discards the physical presence requirement and opens the gates for states to base sales tax nexus upon the volume of sales in their state.

In the wake of *Wayfair,* several states had new nexus rules coming online in 2018, with more in 2019. It would behoove all higher education institutions to talk with their tax advisors about these changes. Many contain thresholds for sales dollars or transactions, or both. Review the various state laws carefully for definitions and amounts.

Several states have no economic nexus policies. Conversely, 16 states have $100,000 and 200 transaction thresholds, as exemplified by Indiana’s rules: “Retail sales of tangible personal property, products delivered electronically or services that exceed $100,000, or are made in 200 or more separate transactions.” At the lower end of the threshold spectrum are Oklahoma, Pennsylvania, and Washington, which have a threshold of $10,000 or more of taxable sales in the state.

## A Tuition Waiver for a Former Employee is Taxable

Based on a recent Tax Court ruling, the value of a tuition waiver used by a dependent of a former employee is taxable income to the former employee in the year(s) that the tuition waiver is used.

Let's illustrate this with the example of a tuition waiver benefit provided to a laid-off employee for his dependents. The employee separated from service at the school seven years before under a reduction in force. He received a severance package which included:

1. Payment of accrued vacation time,
2. Severance pay dependent on length of service,
3. Six months of health plan coverage,
4. Assistance in seeking employment, and
5. An extended tuition waiver (extended waiver) policy

One of the former employee's dependents is currently enrolled at the school and using the tuition waiver benefit. From IRC section 117(d):

> Qualified tuition reduction. (1) In general. Gross income shall not include any qualified tuition reduction. (2) Qualified tuition reduction. For purposes of this subsection , the term "qualified tuition reduction" means the amount of any reduction in tuition provided to an employee of an organization described in section 170(b)(1)(A)(ii) for the education (below the graduate level) at such organization (or another organization described in section 170(b)(1)(A)(ii) ) of:
>
> (A) such employee, or
>
> (B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(h).

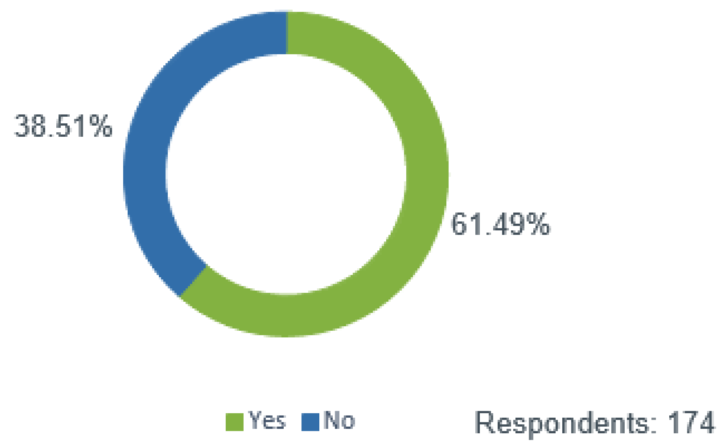
From Tax Court Summary Opinion 2018-25:

> The determination of whether a taxpayer has constructively received income ordinarily requires factual analysis. Constructive receipt of income occurs when the income is set apart and available for withdrawal by the taxpayer, but not when receipt is subject to substantial limitations or restrictions.
>
> Section 117(d)(1) provides that "[g]ross income shall not include any qualified tuition reduction." To be a "qualified tuition reduction" the reduction in tuition must be provided to an employee of a qualified education institution for the education, below a graduate level, at a qualified education institution of either the employee or someone treated as an employee under section 132(h). Those treated as employees include former employees who separated from service "by reason of retirement or disability" and the dependents of employees.
>
> Conclusion. For the reasons stated above, we conclude that petitioner was not an employee of Tulane in 2013 as contemplated by section 117(d)(2)(A) or section 132(h). Thus, the tuition waiver benefit received in 2013 is not excludable from petitioners' gross income under section 117(d).

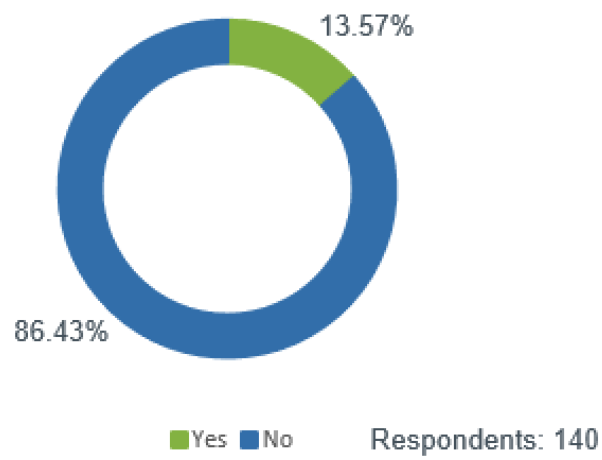
## Colleges, Seminaries, and Universities (2019 eQueries)

In January 2019 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 questions, number of respondents, and percentages of "Yes" answers are as follows:

**Does your institution currently have any designated "employee-only" parking spaces? (For instance, "Staff only," "Faculty only," "President," "Dean of Music," "Employee of the Month," etc.)**

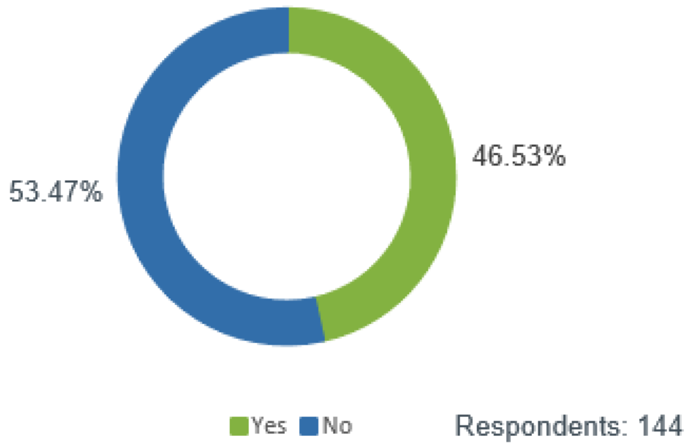



**Have you checked out the census mapping to see if your campus is in or near a "Qualified Opportunity Zone"?**

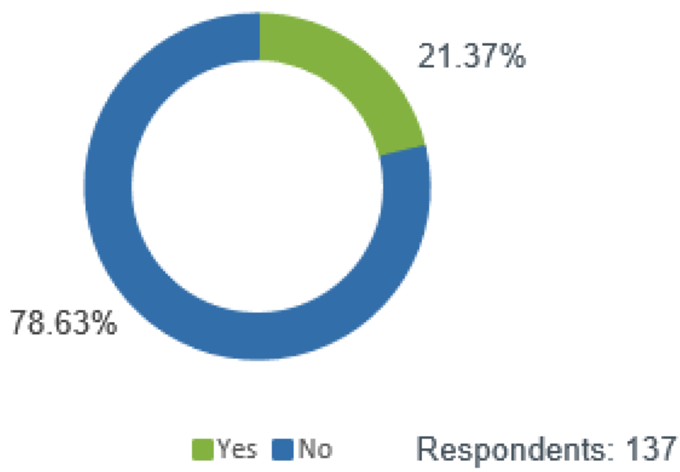


## Colleges, Seminaries, and Universities (2019 eQueries, continued)

**Does your institution receive any Schedule K-1s annually from investments in partnerships, S Corporations, hedge funds, etc.?**




**Has your team already written the functional expense narrative that is required to be a part of your financial statements this year?**



## “Qualified Opportunity Zones”?

There is an interesting provision in the 2017 TCJA that could provide a funding source for institutions looking at revenue enhancement opportunities (alternative business income activities). New IRC sections 1400Z-1 and 1400Z-2 provide this opportunity (pun intended). Here’s an example:

Troas Bible College (TBC) is a private college exempt under IRC section 501(c)(3) and 170(b)(1)(A)(ii). They are required to file Form 990 annually.

TBC has been approached by a local businesswoman about an alternative business income activity proposal. The idea would be to set up a qualified opportunity fund (QOF) that TBC would participate in by establishing a new course of study for students who would work in the endeavor. The QOF would then seek investors who are interested in investing capital gain amounts in a tax-advantaged investment.

Basically, “Qualified Opportunity Zones” (QOZ) have been mapped out throughout the U.S. based on census data. When investments are made in these designated zones, investors may defer recognition on invested capital gains. Investments would be made into a qualified opportunity fund that your school could set up or participate in. The three types of tax incentives are deferral of tax on capital gains, partial decreases of tax (5-year rule, 7-year rule), and “no additional tax” on capital gains (10-year rule).

Ultimately, the incentive for investors is that they may defer tax on capital gains by investing in funds that operate QOFs in QOZs. The amount of the tax deferral will depend on the holding period of the investment in the QOF. Currently, to maximize the tax benefit investors must invest in a QOF in 2019 because the program sunsets on December 31, 2026.

In another example, if an investor owned publicly traded stock in MNO, Inc. with a basis of $100,000 and sold it for $1,100,000, she would normally pay taxes on a $1,000,000 capital gain. If she invested in a QOF in 2019 and held that investment until December 31, 2026, the investor would defer the taxes on the 2019 sale of MNO, Inc. stock until 2026 and – because it was held in a QOF for seven years – she would receive an “imputed” basis in the stock of 15% of the original QOF investment ($150,000 basis). (Note that because she is deferring the tax on the $1 million MNO capital gain, her basis in the QOF investment begins at zero.) With the 10-year rule, there are some post-acquisition gain calculations involved as the program technically expires on December 31, 2026.

This is a simplified summary. The information and guidance on QOZs is fairly technical, and there are many hoops to jump through and rules to navigate. Internal Revenue Bulletin (IRB) Notice 2018-48 provides a grid listing of the designated qualified opportunity zones by state, county, census tract number, tract type, and ACS data source. The notice is 518 pages long with 516.5 pages consisting of this line-by-line, detailed list. It’s much easier to use the interactive map at cims.cdfifund.gov/preparation/?config=config_nmtc.xml. (You’ll need Adobe Flash Player.)

From Proposed Regulation 1.1400Z2(a)-1:

> **(a) In general.** Under section 1400Z-2(a) of the Internal Revenue Code (Code) and this section, an eligible taxpayer may elect to defer recognition of some or all of its eligible gains to the extent that the taxpayer timely invests (as provided for by section 1400Z-2(a)(1)(A)) in eligible interests of a qualified opportunity fund (QOF), as defined in section 1400Z-2(d)(1). Paragraph (b) of this section defines eligible taxpayers, eligible gains, and eligible interests and contains related operational rules. Paragraph (c) of this section provides rules for applying section 1400Z-2 to a partnership, S corporation, trust, or estate that recognizes an eligible gain or would recognize such a gain if it did not elect to defer the gain under section 1400Z-2(a).

You should consider…

- The TCJA introduced IRC sections 1400Z-1 and 1400Z-2 – “Qualified Opportunity Zones.”
- For QOF investments held for five years, the taxpayer’s basis is increased by 10% of the amount of deferred gain.
- For QOF investments held for seven years, the taxpayer’s basis is increased an additional 5% (to 15%) of the amount of deferred gain.
- For QOF investments held beyond the maximum deferral date (i.e., December 31, 2026) and for a minimum of 10 years, the taxpayer’s basis in the investment shall be equal to the fair market value of the investment on the date it is sold or exchanged, resulting in no additional recognized gain.

## 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 30 years of accounting experience and serves on 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).

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