2017 Higher Education

Tax Reporting Trends Project

CAPINCROUSE LLP

Introduction

Welcome to the eighth edition of CapinCrouse's annual *Higher Education Tax Reporting Trends Project*. This unique statistical review includes financial, tax, and demographic data compiled from the January 2017 eQueries, our weekly email mini-surveys. We averaged 153 responses a week, and each week one respondent received a $25 gift card.

Our goal is for this report to be a useful reference guide and information tool. While we recognize that no two higher education institutions are exactly alike, the editorial and statistical information contained here should assist your accounting team in gaining a better understanding of potential tax reporting issues that you and your peer institutions face.

As you may note, we have changed the format of this year's report. In response to a changing environment, we've streamlined the narrative and data-gathering process, and are providing an electronic report rather than a printed booklet. Additionally, to provide a quick-read format we've foregone the geographical data and sorting by institution size (Categories A, B, and C).

We would love your feedback on the new format as compared to prior editions. Please email us at collegetax@capincrouse.com to let us know what you think.

Enjoy!

On the cover:

De Witt Field at Cornerstone University in Grand Rapids, MI was built in 2013 and is an innovative approach to combining a residence hall with the excitement of athletics. The complex is home to the Golden Eagle baseball team as well as 92 residents in Central Hall. The team's athletic center and the student housing complex are in the same building. The center and residence hall is situated just beyond the stadium's backstop wall.

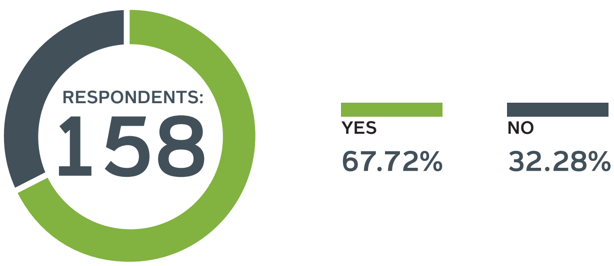
Cover image courtesy of Cornerstone University.

Colleges, Seminaries, and Universities – eQueries 2017

In January 2017, 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 answers are as follows:

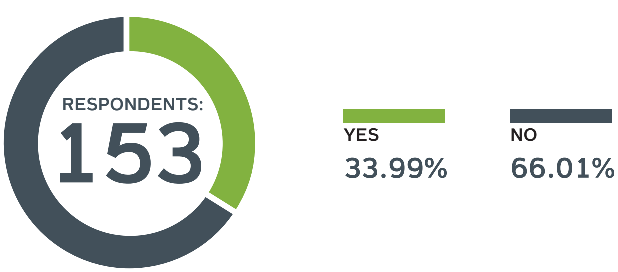
Does your institution have more than 500 students registered for Winter/Spring 2017?



Historically, in our annual *Higher Education Tax Reporting Trends Project* report we've tracked the number of students enrolled at each institution and categorized schools as Category A (over 1,700 students), Category B (between 500 and 1,700 students), and Category C (under 500 students). For perspective, in the 2016 *Tax Reporting Trends Project* report Category C included 82 of the 190 participating schools (43.16%). In 2017, Category C schools make up 32.28% of the respondents.

Certainly, institutions that enroll fewer than 500 students face different challenges, fewer regulatory restrictions, and generally more economic obstacles than institutions enrolling a larger number of students.

Does your institution receive rental income from space on any communications towers or equipment?



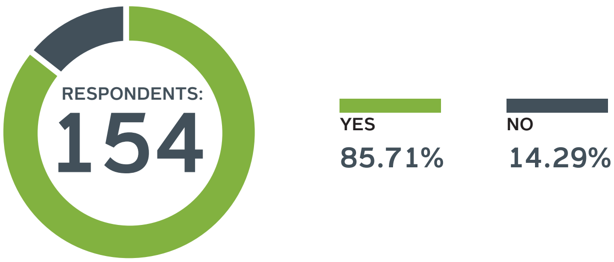
At the 2017 NACUBO Unrelated Business Income Tax Conference in Seattle, there were at least three separate discussions regarding rental income from communications towers. Interestingly, there were inconsistencies in opinions on, the handling of, and correspondence with the IRS and state officials on this matter.

One confusing issue has to do with towers that are "attached" to buildings and other structures. One exemplary ruling in this arena is murky on the facts. The ruling states, "…the tower is permanently affixed to the real property…" Does "real property" here refer to a building or raw land?

The 2014 Report of the Advisory Committee on Tax Exempt and Government Entities (ACT) notes the following in Appendix A:

> **Cell Tower Rentals**
>
> **Situation 5**
>
> R is a private college that owns and operates a radio station whose activities are related to its exempt purpose. The transmission equipment is on a stand-alone tower on R's campus and there is no debt on the tower property. The tower is not considered real property under the laws of the state in which R is located. R rents space on the tower to a cellular phone company. The rental income from the cellular phone company is unrelated business income.
>
> **Situation 6**
>
> The facts set forth in Situation 5 are the same, except that R's radio tower is located on top of a dormitory. There is no acquisition indebtedness on the dormitory building. The tower is part of a building and is considered real property under the laws of the state in which R is located. The rental income from the cellular company is excluded from unrelated business income.
>
> **Situation 7**
>
> L is a public university that enters into an agreement with a telecommunications company, M, to lease real property to M on which M will build a cell phone tower. L will not provide any services and will not put any of its equipment on the tower. M will erect the tower and place a fence around the tower. M will also pay all expenses associated with the cell phone tower. The rental income to L is not unrelated business income.

Does your institution have any employees who receive a minister's housing allowance?



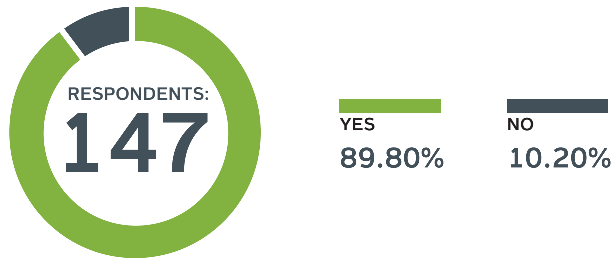
It's no secret that the minister's housing allowance is under fire. Note that there is a distinction in the Internal Revenue Code with regard to "minister's housing allowance" (IRC section 107(2)), a "parsonage allowance" (IRC section 107(1)), and a provision of housing "for the convenience of the employer" (IRC section 119). The section 107(2) "housing allowance" is the provision currently in peril in the courts.

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 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 after its officers paid taxes on the housing allowances apparently claimed on their individual returns. In August 2016, the federal government made its first filing in this new case. In its filing, the government conceded that, based upon its understanding of the facts, the foundation's officers have the legal standing to challenge the housing allowance exclusion (IRC section 107(2)). The government maintained that the plaintiffs did not have standing to challenge the parsonage exclusion (IRC section 107(1)).

Does your institution sell apparel or other products with your school logo on them to the public via a bookstore, website, or catalog?



Virtually 90% of responding institutions sell "logo apparel" or products. This can be a great revenue generator for colleges, seminaries, and universities, especially larger institutions that are able to "license" their logo and receive "royalties" for sales of clothing and products from a third party. There are a few speedbumps for the unwary, however.

First, we have generally seen the IRS deem the following "logo sales" to be unrelated business activities, in varying degrees:

1. Sales to the general public
2. Sales of clothing and products that do not have a "connection" to the institution
3. Internet sales

Next, it can be cumbersome to discern or calculate the amount of sales to the general public. Even though any reasonable method (given all facts and circumstances) is the standard, how does your institution's accounting system navigate this issue?

Finally, as we look to the future there are some proposed tax reform provisions that could greatly affect "logo sales."

From the U.S. House Committee on Ways and Means' "2014 Tax Reform, Discussion Draft" (The "Camp Draft"):

> **Sec. 5002. Name and logo royalties treated as unrelated business taxable income.**
>
> **Current law:** Current law designates certain activities as per se unrelated trades or businesses for UBIT purposes, including advertising activities and debt management plan services.
>
> **Provision:** Under the provision, any sale or licensing by a tax-exempt organization of its name or logo (including any related trademark or copyright) would be treated as a per se unrelated trade or business, and royalties paid with respect to such licenses would be subject

to UBIT. The provision would be effective for tax years beginning after 2014.

JCT estimate: According to JCT [Joint Committee on Taxation], the provision would increase revenues by $1.8 billion over 2014-2023.

Tax Reform 2017?!

Speaking of potential "tax reform," the best answer in late summer of 2017 is "Who knows?" The two documents getting the most press seem to be the President's "one-page framework" and the Camp Draft from 2014. As the "Big Six" continue to meet, let's keep this conversation going. At some point, you may want to contact your Congresspeople.

Issue

In May 2017, the President's team issued a one-page framework for tax reform. How might that affect your institution?

Example Situation

Saltwater Christian College (SCC) is a private college exempt under Internal Revenue Code section 501(c)(3) and section 170(b)(1)(A)(ii). It is required to file Form 990 annually. SCC's CFO calls and asks, "I keep hearing about major tax reform. How might this affect SCC?"

We told them this:

The Trump Administration released a one-page summary of the "core principles" of its proposal for sweeping tax reform. A fellow at the Urban Institute pessimistically observed, "First draft of Reagan tax reform: three-volume 500+ page treatise. First draft of Trump: bullet points."

To be fair, the proposal, for which some Congressional leaders were consulted, appears to be using the detailed, 1,000-page 2014 Camp Draft as a foundational document. Republican leaders said that the summary points would be viewed by Congress as "critical guideposts." Further, these leaders iterated that they expect 2017 tax reform to be a "months-long overhaul process."

For business taxpayers:

- The business tax rate would decrease from 35% to 15% for corporations, and the top tax rate for pass-through businesses (including LLCs, partnerships, and sole proprietorships) would be reduced from 39.6% to 15%.
- There would be a one-time repatriation tax on offshore earnings. The exact percentage of the tax rate is still being negotiated, although a 10% rate has been rumored.
- There would be a shift from a worldwide system of taxation (under which a U.S. taxpayer is generally taxed on his or her worldwide income regardless of where earned) to a territorial system (under which income would generally be taxed in the country where it is earned).

For individual taxpayers:

- The current seven individual income tax rates would be reduced to three: 10%, 25%, and 35%. The tax brackets (i.e., income levels at which these rates would apply) have not yet been determined.
- The standard deduction would be doubled (it was $12,600 for 2016), with the intended result that fewer taxpayers would itemize. The plan as announced does not address the personal exemption, although the President's plan presented during the presidential campaign called for it to be eliminated. (For 2016, the married taxpayer standard deduction plus exemptions for a family of four was $28,800.)
- The alternative minimum tax (AMT) would be repealed.
- There would be some sort of tax relief for child and dependent care expenses, although no specifics were provided.
- The 3.8% net investment income tax (which was enacted as part of the Affordable Care Act, or Obamacare) would be repealed.
- The estate tax would be repealed.
- Most "tax breaks" (including "above-the-line" reductions and itemized deductions) would be repealed. Exceptions would be made for certain provisions involving home ownership, charitable giving, and retirement savings.

In response to a question at a press conference on April 26, 2017, U.S. Treasury Secretary Steven Mnuchin specifically said that the mortgage interest deduction and charitable contribution deduction would be retained.

There is some concern for charities in two areas.

First, the effect on charitable giving could be negative. The combination of doubling the standard deduction (projected to change the percentage of Form 1040 "itemizers" from 33% to 5%), getting rid of all itemized deductions except mortgage interest and charitable contributions, and repealing the estate tax would potentially diminish tax-based charitable giving. A study by the Indiana University Lilly Family School of Philanthropy estimates that charitable giving may decrease by $13 billion annually.

Second, the Camp Draft contains several revenue-generating provisions focused on UBIT. These include:

- Name and logo royalties treated as unrelated business taxable income.
- Unrelated business taxable income separately computed for each trade or business activity (i.e., no

taking losses or net operating losses of one type of activity against profits from another type of activity).

- Increased specific deduction from $1,000 to $10,000.
- Modification of qualified sponsorship payments.
- Clarification of unrelated business income tax treatment of entities treated as exempt from taxation under section 501(c)(3).
- Increase (doubling) of information return penalties for late, inaccurate, or incomplete returns.

We should continue to diligently pray for the process and to plan based upon details as they become available. More to come.

Rules

From President Trump's one-page plan, "2017 Tax Reform for Economic Growth and American Jobs":

Goals For Tax Reform

- Grow the economy and create millions of jobs
- Simplify our burdensome tax code
- Provide tax relief to American families – especially middle-income families
- Lower the business tax rate from one of the highest in the world to one of the lowest

Individual Reform

- Tax relief for American families, especially middle-income families:
    - Reducing the 7 tax brackets to 3 tax brackets of 10%, 25%, and 35%
    - Doubling the standard deduction
    - Providing tax relief for families with child and dependent care expenses
- Simplification:
    - Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers
    - Protect the home ownership and charitable gift tax deductions
    - Repeal the Alternative Minimum Tax
- Repeal the death tax
- Repeal the 3.8% Obamacare tax that hits small businesses and investment income

Business Reform

- 15% business tax rate
- Territorial tax system to level the playing field for American companies
- One-time tax on trillions of dollars held overseas
- Eliminate tax breaks for special interests

Process

- Throughout the month of May, the Trump Administration will hold a listening session with stakeholders to receive their input and will continue working with the House and Senate to develop the details of a plan that provides massive tax relief, creates jobs, and makes America more competitive – and can pass both chambers.

Bottom Line

- The business tax rate would decrease from 35% to 15% for corporations and other entities
- There would be 3 individual tax brackets (10%, 25%, and 35%) rather than 7
- Itemized deductions would be "dissolved" — except charitable contributions and home mortgage interest
- The estate tax would be repealed
- Beware of increased "UBIT taxes"…

We welcome the opportunity to talk with you about this or any other higher education tax issue. Please contact us at collegetax@capincrouse.com.

Photo courtesy of Charleston Southern University.

Sharonda Coleman-Singleton, mother of current Charleston Southern University baseball team member Chris Singleton, was killed June 17, 2015, in the tragic Emanuel AME shooting. The Sharonda Coleman-Singleton Enrichment Center will celebrate her life and legacy and will serve as a gathering space for athletes to learn and grow spiritually and academically. The Enrichment Center will be the home for Fellowship of Christian Athletes gatherings, Bible studies, and team-building events, instilling a sense of pride, commitment, and community support in former and current members of the baseball program.

The Singleton Baseball Complex plaza space and courtyard will create an exciting fan experience. The memorial plaza will recognize outstanding CSU baseball alumni, including Hall of Fame members and Buccaneers who continued their careers in the major leagues. The central part of this plaza will be a “Love is Stronger” memorial. The Stadium Courtyard will be located inside the stadium gates in front of the new complex.

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. CapinCrouse is an independent member of the BDO Alliance USA.

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CapinCrouse maintains a specialized team of people who focus on the higher education services provided by the firm.

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