Higher Education Tax Update

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IRS – New Information Document Request (IDR) Process

Let's face it, IRS audits of exempt organizations have been painful and convoluted for years. The process has generally been initiated by the IRS sending organizations a packet in the mail. In this packet, organizations found a Form 4564, Information Document Request — or, in some cases, multiple Form 4564s! This IDR generally asked for a very comprehensive amount of information — books and records (generally including three years of bank statements and cancelled checks), annual tax returns, related returns (e.g., employment tax returns), Form 1099 series information returns, prior and subsequent year returns, etc.

The IRS even summarizes the EO exam process on their website as follows:

> An audit starts with the initial contact and continues until a closing letter is issued. A compliance check or compliance check questionnaire starts with the initial contact. The IRS may contact the organization again if the IRS needs further information, or if the organization does not respond to the compliance check or questionnaire. The IRS typically issues a closing letter at the end of a compliance check, but not at the end of a compliance check questionnaire.

In late 2016, the Tax Exempt and Government Entities Division of the IRS issued new internal guidance for its agents on issuing IDRs. The IRS is training all of its agents on the new process, which will go into effect on April 1, 2017.

Under the new process:

1. Taxpayers will be involved in the IDR process.
2. Examiners will discuss the issue being examined and the information needed with the taxpayer prior to issuing an IDR.
3. Examiners will ensure that the IDR clearly states the issue and the relevant information they are requesting.
4. If the taxpayer does not provide the information requested in the IDR by the agreed-upon date, including extensions, the examiner will issue a delinquency notice.
5. If the taxpayer fails to respond to the delinquency notice or provides an incomplete response, the examiner will issue a pre-summons notice to advise the taxpayer that the IRS will issue a summons unless the missing items are fully provided.
6. A summons will be issued if the taxpayer fails to provide a complete response to the pre-summons letter by the response due date.

Under the new process, the field auditors' managers will be required to be actively involved early in the process and ensure that IRS Counsel is prepared to enforce IDRs through the issuance of a summons when necessary. The new process is designed to follow the "Taxpayers Bill of Rights" in all matters.

The IRS touts that the updated process will:

- Provide for open and meaningful communication between the IRS and taxpayers.
- Reduce taxpayer burden and provide consistent treatment of taxpayers.
- Allow the IRS to secure more complete and timely responses to IDRs.
- Provide consistent timelines for IRS agents to review IDR responses.
- Promote timely issue resolution.

Sunita Lough, Tax Exempt/Governmental Entities Commissioner, speaking at a Fall 2016 tax conference, stated:

> The point is accountability. Accountability first falls on us, the IRS, on our agents to make sure that the cases are moving. They first make sure that they are asking the right questions in an information document request. We are trying to do issue-focused audits and the agent should tell the taxpayer or the power of attorney what issue the agent is trying to resolve so we can help each other out to resolve the issue. So the conversations are the most important part of the IDR process. The agent calls the taxpayer and says, "This is the issue I am working on; these are the documents I need to resolve this issue or to come to a conclusion." Instead of asking for the kitchen sink and having a fishing expedition, the agent specifically says, "What is it that you can give me that will help me resolve this issue?" So you draft the IDR after you've had those conversations and then you ask the taxpayer or the power of attorney, "When can you give me those documents?"

IRS – Issue Snapshots

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

The IRS tells us that in a continued effort to increase the technical knowledge base of EO employees, KM has several initiatives planned for FY 2017. 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 Knowledge Networks (K-Nets). These K-Nets will continue to prepare and post technical Issue Snapshots for EO employees and the general public.

EO completed five snapshots (including "Advertising or Qualified Sponsorship Payments?" and "IRC Section 4946 Definition of Disqualified Person") in 2016 and currently has over 20 snapshots in development based on issues raised to KM by agents and the general public. This includes private foundation qualifying distributions, conservation easements, limited liability companies, trusts and IRC 508(a), requirements for community health needs assessment (CHNA), 501(c)(4) and determining primary activity, and a VEBA non-discrimination overview.

EO has shared that it plans to supplement Issue Snapshots with new "Issue Casts," quick and flexible 15 – 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 www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots

Repeal and Replacement of the Affordable Care Act

President Trump and Republican lawmakers continue to pursue and act upon a widespread 2016 campaign pledge to repeal and replace Obamacare. Paul Ryan, Speaker of the House, recently stated that the plan will be worked on in the spring and summer of 2017, after the budget process.

There are several proposals 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 children can stay on parents' plan up to age 26) and allows "options" for states. One option is to continue with the ACA.

Repeal of the "Johnson Amendment"?

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 Internal Revenue Code 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 on February 4, the President said that he wants to "get rid of and totally destroy the Johnson Amendment" so that "representatives of faith [could] speak freely and without fear of retribution."

As an aside, the "Johnson" involved is none other than former president Lyndon B. Johnson. He spearheaded the passage of this provision as a reaction to one of his Texas Congressional campaigns in the mid-1950s, when nonprofits aligned themselves against him. Many viewed this as a payback by Johnson at the time.

If this repeal comes to pass, it would certainly increase the political free speech options for colleges and churches. Might it also provide funding opportunities for institutions that want to dive into political advocacy?

Advertising vs. Qualified Sponsorship Payments

An IRS EO Issue Snapshot released on September 29, 2016 deals with "QSPs" — qualified sponsorship payments under I.R.C. section 513(i). On the whole, this snapshot contains a great summary of the relevant code sections and somewhat lives up to the information provided in the preface:

> 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 these as unrelated business income.

There is a very helpful section at the end of the snapshot entitled "Issue Indicators or Audit Tips."

> **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.

Pouring Agreements

Exclusive provider. An arrangement that limits the sale, distribution, availability, or use of competing products, services, or facilities in connection with an exempt organization's activity generally results in a substantial return benefit. For example, if in exchange for a payment the exempt organization agrees to allow only the payor's products to be sold in connection with an activity, the payor has received a substantial return benefit.

To quote the aforementioned Issue Snapshot on Advertising:

> Treas. Reg. 1.513-4(c)(2) provides that if there is an arrangement or expectation that the payor will receive a substantial return benefit with respect to any payment, then only the portion of the payment that exceeds the fair market value of the substantial return benefit is a qualified sponsorship payment. However, if the exempt organization does not establish that the payment exceeds the fair market value of any substantial return benefits, then no portion of the payment constitutes a qualified sponsorship payment.

That Regulation section deems insubstantial to be less than 2% of the payment. The wording is, "A benefit is disregarded if the aggregate fair market value of all the benefits provided to the payor during the organization's taxable year is not more than 2% of the amount of the payment."

Pouring Agreements, continued

The snapshot still leaves 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)."

Is your institution's agreement with a soft drink manufacturer in which you receive "continuing support of an exempt organization's operation" an unrelated business activity?

Tax Reform and Qualified Sponsorship

Finally, the September 29, 2016 Issue Snapshot on QSPs may end up having a very short shelf life. Although we are still waiting to see what 2017 might bring with respect to tax reform — major or otherwise — there may be some insight to be gained by looking at the U.S. House Committee on Ways and Means' "2014 Tax Reform, Discussion Draft" (The "Camp Draft"). That proposal includes the following:

> **Sec. 5008. Qualified sponsorship payments.**
>
> **Current law:** Under current law, for purposes of the UBIT rules, an unrelated trade or business does not include the activity of soliciting and receiving qualified sponsorship payments. A qualified sponsorship payment generally is any payment made by a business sponsor with respect to which the business receives no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the business in connection with the tax-exempt organization's activities. Such a use or acknowledgment does not include advertising of such sponsor's products or services (i.e., qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services).
>
> **Provision:** Under the provision, the UBIT exception for qualified sponsorship payments would be modified in two respects. First, if the use or acknowledgement refers to any of the business sponsor's product lines, the payment would not be a qualified sponsorship payment, and, therefore, would be treated by the tax-exempt organization as income from an advertising trade or business — which is a *per se* unrelated trade or business. Second, if a tax-exempt organization receives more than $25,000 of qualified sponsorship payments for any one event, any use or acknowledgement of a sponsor's name or logo may only appear with, and, in substantially the same manner as, the names of a significant portion of the other donors to the event. Whether the number of donors is a significant portion is determined based on the total number of donors and the total contributions to the event, but in no event shall fewer than 2 other donors be treated as a significant portion of other donors. Thus, a single business could not be listed as an exclusive sponsor of an event that generates more the $25,000 in qualified sponsorship payments. Such a contribution would be treated as advertising income by the tax-exempt organization and subject to UBIT. The provision would be effective for tax years beginning after 2014.
>
> **JCT estimate:** According to JCT, the provision would increase revenues by less than $50 million over 2014-2023.

Minister's Housing Allowance

In November 2013, a federal judge held that the minister's housing allowance (under I.R.C. 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 that 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 the government's filing, it 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 – I.R.C. section 107(1).

California Scheming (SB 1146)

In June 2015, the Supreme Court found that same-sex marriage was legal throughout the United States. The issue was raised across the press, social media, and in private conversations as to whether this decision (*Obergefell v. Hodges*) would result in limits, censorships, and/or legal actions against religious organizations whose beliefs stood in contrast to the Supreme Court's decision and the resulting government mandates.

At the core of these speculations was the issue of whether religious organizations might lose their tax-exempt status. Might the IRS begin to revoke the exempt status of religious organizations? There appeared to be precedent for this action by the IRS, and advocates of this position have been citing the *Bob Jones University v. the U.S.* racial discrimination case from the 1970s. In fact, in his dissent in *Obergefell* Justice Roberts stated, "Indeed, the Solicitor General candidly acknowledged that the tax exemptions of some religious institutions would be in question if they opposed same-sex marriage."

In 2016, several states endeavored to take action to advance or limit the reach of the Obergefell decision. Notably, the California state Senate passed a bill (SB 1146) that purported to amend the California Equity in Higher Education Act to forbid religious institutions of higher education from considering religion in admissions, forbid them from requiring students to participate in religious activities, and otherwise end "discriminating" on the basis of religion. In addition, the bill would have made it easier for gay and transgender students to sue private universities for discrimination and would have denied state student aid to institutions that did not follow the newly mandated rules.

Faced with organized opposition from California religious colleges, the California Senate dropped those provisions in SB 1146 that purported to restrict religious freedoms. However, the state senator who introduced the provisions noted that he would likely reintroduce similar legislation in 2017.

Expense Allocation of "Dual-Use Facilities"

One of the 15 exempt organization projects listed in the IRS's 2016-17 Priority Guidance Plan is "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 Allocation 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 1/8 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.

2016 ACT Report

The Advisory Committee on Tax Exempt and Government Entities (ACT) presented its 2016 Report of Recommendations at a public meeting in Washington, D.C. on June 8, 2016. The Exempt Organizations (EO) Subcommittee report is titled, "Stewards of the Public Trust: Long-Range Planning for the Future of the IRS and the Exempt Community."

The EO Subcommittee's report focuses on planning for the future — big picture areas the EO function should consider in planning for the next two to three decades in overseeing exempt organizations.

2016 Act Report, continued

The specific recommendations are as follows:

1. Ensure that EO staff are equipped to carry out the responsibilities of the EO.
2. Provide leadership and guidance on major issues impacting the exempt organizations sector, both current and those anticipated in the near future.
3. Give exempt organizations the tools they need to be tax compliant:
    a. Detailed audit data.
    b. Relevant, user-focused guidance, akin to former CPE text.
    c. An easily navigated website.
4. Assure cyber integrity through technology tools, data collection, and secured cyber storage.
5. Release and share data where appropriate for public use.
    a. IRS information sharing with state charities officials.
    b. Electronic filing and dissemination of IRS information.
6. Foster two-way communication between the IRS Exempt Organizations division and the nonprofit sector.
    a. Find ways to solicit input from a greater number of voices (including small nonprofits) and provide open channels for stakeholders to take issues to the IRS.
    b. Revise the Determination Letter to educate exempt organizations on their tax obligations and responsibilities.
    c. Use current technology to communicate with exempt organizations.
    d. Increase the availability of strong expert resources through IRS TE/GE phone customer service.

Catalog Sales Deemed UBIT (TAM 201633032)

In Technical Advice Memorandum (TAM) 201633032, the IRS ruled that an organization's sales of product (possibly heirloom seeds) were not related to its exempt purpose and were, in fact, unrelated business activities. Even though the organization's research and educational activities were substantially related to its exempt purposes, the fact that the sales were conducted in conjunction with, or (in the case of its online catalog) through the same vehicles as, the organization's exempt activities, did not convince the IRS to reach a conclusion that the sales were also substantially related. The products were sold via an online catalog and also in retail stores throughout the U.S. The information and examples in the TAM were so heavily redacted that the ruling was difficult to follow, but this could have implications for colleges and universities that sell merchandise such as logo apparel online.

Form 1098-T Student Taxpayer ID Number – and Checkbox

2016 Form 1098-T Instructions:

> Enter the student's taxpayer identification number, 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), check the box. By checking the box and filing Form 1098-T with the IRS (for electronic filers), you certify under penalty of perjury that you have in good faith complied with the standards in regulation section 1.6050S-1 governing the time and manner of soliciting the taxpayer identification number 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 field designated for the student's identification number.

2017 Form 1098-T Instructions:

> Student's taxpayer identification number 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), check the box. By checking the box and filing Form 1098-T with the IRS (for electronic filers), you certify under penalty 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.

Form 1098-T Student Taxpayer ID Number – and Checkbox, continued

This seems to align with the provision in the 2015 Trade Practices Extension Act (TPEA) that "allows educational institutions to certify, under penalties of perjury, that the institution has followed proper TIN solicitation procedures."

The process for properly requesting TINs is enumerated in Treasury Regulation 1.6050S(1)(e)(iii) as follows:

> 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.

NACUBO: To avoid being subject to fines for failure to report correct TINs on Form 1098-T, institutions must solicit any missing TINs:

- at least once a year
- in writing
- with a clear notice that the individual is required by law to provide the TIN so that it may be included on an information return.

Form 1098-T "Amounts Billed" Penalties Not Imposed

The 2015 PATH Act contains a provision that eliminated the option for educational institutions to either report on Form 1098-T payments received (Box 1) or amounts billed (Box 2). The IRS announced in 2016 that it would not impose penalties for 2016 Forms 1098-T if the institution reported the aggregate amount billed for the calendar year for expenses paid after December 31, 2015. This relief was largely brought about by the efforts of NACUBO. Ultimately, the relief extended the rules in effect prior to the PATH Act. Then, with Announcement 2016-42 (2016-49 IRB), the IRS further extended relief through 2017, for 1098-T forms to be filed in 2018. We should learn more about this reporting in 2017, either through more clarification or tax reform. Stay tuned

Summary of 2017 Key Tax Facts

2017 Inflation-Adjusted Amounts

The IRS announced annual inflation adjustments for more than two dozen tax provisions for tax year 2017, including the following:

- The annual exclusion for gifts remains at $14,000 for 2017, like it was for 2016.
- The "gross income" threshold for filing Form 990-T remains at $1,000 for 2017 — the same as it has been since 1951!
- The OASDI (i.e., Social Security) maximum compensation base ("FICA limit") is $127,200 for 2017, up from $118,500 in 2016.
- The threshold for filing Form 990 electronically remains at $10,000,000 and 250 information returns.
- The foreign earned income exclusion rises to $102,100 for 2017, up from $101,300 in 2016.

2017 Standard Mileage Rates

For 2017, the standard mileage rates were adjusted downward. The optional mileage allowance for owned or leased autos (including vans, pickups, or panel trucks) has decreased by 0.5¢ to 53.5¢ per mile for business travel after 2016. The rate for using a car to get medical care or in connection with a move that qualifies for the moving expense also has decreased by 2¢ to 17¢ per mile for 2017. The charitable mileage rate remains steady at 14¢ per mile. This amount is statutory.

Form 990 Extension Changes

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 of several returns.

The new extension process is 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 is working to make changes to Form 8868 to accommodate these changes.

A review of the DRAFT Form 8868 for 2017 (draft dated September 27, 2016) reveals no Part II. Further, the draft instructions (under "What's New") state:

> *There is now an automatic 6-month extension of time to file instead of the previous 3-month automatic extension and subsequent request for an additional 3-month extension. The form and instructions have been revised accordingly.*

Filing Deadlines for Forms W-2 and 1099-MISC

The PATH (Protecting Americans from Tax Hikes) Act of 2015 has accelerated the filing deadlines for Forms W-2 and 1099-MISC. Section 201 of the PATH Act inserts a new I.R.C. section 6071(c) stating:

> (c) RETURNS AND STATEMENTS RELATING TO EMPLOYEE WAGE INFORMATION AND NONEMPLOYEE COMPENSATION—Forms W-2 and W-3 and any returns or statements required by the Secretary to report nonemployee compensation shall be filed on or before January 31 of the year following the calendar year to which such returns relate.

This new provision will require Forms W-2, W-3, and returns or statements to report non-employee compensation (such as Form 1099-MISC) to be filed on or before January 31 of the year following the calendar year to which such returns relate. The provision is effective for returns and statements relating to calendar years after the date of enactment (e.g., filed in 2017). In addition, electronically filed returns will no longer be eligible for an extended filing date.

2017 Token Amounts

The deductible amount for "insubstantial benefits to donors" for 2017 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.

2017 Token Amounts, continued

The asterisked amounts are $107 (X) for 2017 ($106 for 2016) or the amount contributed to the charity was at least $53.50 (Y) for 2017 ($53 for 2016) and the donor receives only "token benefits" (e.g., bookmarks, calendars, mugs, posters, tee shirts, etc.) generally costing no more than $10.70 (Z) for 2016 ($10.50 for 2015). 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, etc. that are marked or stamped with the charity's logo or name.

FLSA Overtime Rule Delayed by Judge in Texas

On November 22, 2016, Texas Federal District Court Judge Amos L. Mazzant III issued a preliminary injunction temporarily delaying the implementation date of the Department of Labor's (DOL) new overtime rule for executive, administrative, and professional employees scheduled to go into effect on December 1, 2016. You can see the full text of the court's ruling at www.wagehourblog.com/files/2016/11/Nevada-v-DOL-Order-Granting-Emergency-Injunction.pdf

What does the ruling mean? The jury is still out on the long-term effect of the court's ruling. The DOL can appeal the judge's ruling and it is uncertain whether such an appeal would be successful. The new Trump administration could elect to forgo an appeal and let the court's injunction stand. So this eleventh hour injunction has left things in a state of flux.

What should you do? This too is unclear. If you have already announced raises to bring affected employees above the new rule's salary limit, you should consult an employment law attorney in your state for any potential legal issues that may arise from withdrawing a promised raise. Similarly, you should thoughtfully approach adjusting changes you have already made related to time tracking since the ultimate fate of the rule is unknown. If you have not rolled out any changes, you may have at least a reprieve before you need to make any adjustments.

At the end of the day, there is still much we don't know and we encourage you to stay tuned!

IRS Data-Driven Decision Making

In 2015, the IRS Exempt Organizations (EO) Division Examinations Section migrated from a "project-oriented" exam selection process to a more "data-driven" process. Over the prior several years, the EO Division had selected organizations for examinations largely through "compliance projects" (e.g., the Colleges & Universities Compliance Project and Employment Tax Compliance Project). Starting in 2014, the EO Division began utilizing "data-driven decision making." With this process, the EO Division is using queries run based upon answers included on Form 990-series returns to identify issues that may require examination.

An example (not given by the EO Division, which closely guards its queries!) might be an instance where an organization answers "Yes" to Form 990, Part VI, Line 5, "Did the organization become aware during the year of a significant diversion of the organization's assets?" and then fails to "explain the nature of the diversion, dollar amounts and/or other property involved, corrective actions taken to address the matter, and pertinent circumstances on Schedule O (Form 990 or 990-EZ)."

An IRS official gave the following example at a conference in November 2015:

> It's that we try as we're making decisions to use data and that's rather than having a hunch about something, so let's go off and do that. Instead, let's step back and make sure that the data supports the direction in which we're going. To give you a recent example of data-driven decision-making in the exempt organizations world, Exempt Organizations finalized a case selection model that uses the core Form 990 and supplementary forms and schedules to identify possible issues of non-compliance. The case selection model combines over 150 data queries into one master query that is run against all filed Forms 990 to identify organizations with the most potential non-compliance. The individual queries are categorized by the significance or risk of the potential issue by using return information and internal data sources to identify organizations for potential non-

compliance. Obviously, the whole idea is that any time we're doing examinations, and again in a time of very limited resources, let's use our resources the best we can. Hopefully, something will be done with respect to high-risk organizations so where there's that potential for non-compliance, that's when the IRS examiner should be out there.

This should serve as a heads-up to all exempt organizations to ensure that they carefully review Form 990 before filing.

Sunita Lough: So the other topic, it's a good segue into issue-focused exams. We've been working with what I call the Headquarters RAAS, Research Analytics and Applied Statistics function, which was recently reorganized and we have a really good new director who came from academia, from the outside, Ben Herndon. It's been a pleasure working with them on selecting exams based on data.

We have had a number of meetings with their behavioral scientists, statisticians, I don't even know some of the terms, data analysts and who have been meeting with us to re-educate them on what are the issues in exempt organizations, employee plans, tax-exempt bonds. They educate us on how to do research on data. I always say there was a time when EO did all that themselves or TEB did all that. Well, when I build a house or when I want to open this room a little bit more, I get an engineer because if I knock the wall down and it's a load-bearing wall, it's going to come crashing down.

It's really important to understand the roles. Our EO folks are EO folks. They're not data analysts so we are working with data analysts. They are data analysts, they don't understand EO law so we've spent a lot of time having conversations, what keeps you up at night, what worries you about EO issues? What is on the 990 return that would help us get to those issues?

So those kind of conversations have educated each other and, as a result, what we are doing is we have put 400 returns, some of them are probably out in the field. A lot of them have just been selected on what I call the virtual shelf because they are virtual on the computer server on private benefit and inurement. A hundred returns on private foundations that have been selected based solely on data and we're going to see how it works and those returns should be coming out.

The IDR process, being the issue-focused exam that we are doing, will hopefully lead us. It's not just one thing, you have to put together a lot of different things to make it work well. The issue-focused exam should be coming out fairly soon.

The other focus we have in Exempt Organizations is the 501(r) reviews. We are required to do 501(r) reviews. We do one-third every year. We have classifiers who do them and, as a result, if they find non-compliance based on the reviews they've done, they will refer the case for exam. This year we have 311 exams on the 501(r) and so they are in the field, they're field audits, and some of the issues, the deficiencies that were noted, were lack of community health needs assessments under 501(r), no financial assistance or emergency medical care policies, and also the filing and collection requirement under (r)(6). So those 311 audits are going on so you will see a lot of that. We continue to do the model queries and we get a lot of referrals and we classify those.

Our hope is this is going to make the exempt process more efficient; the point is burden reduction. The statistical sample is still important for us to know the compliance level but what we really want to focus on in audits is what we think of as non-compliant taxpayers. The statistical sample does result in us auditing a lot of no-change cases and we are burdening taxpayers who are compliant so it behooves us with the lack of resources and taxpayer burden to really look to see what are we putting in the audit stream to the best of our abilities and the information that we have available before we start an audit.

"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 also 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 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/or 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 themselves.

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.

Cybersecurity Definitely Needs Your Attention

Is your data secure? Cyberattacks are a significant risk for all nonprofits, and higher education institutions face unique risks. It's vital to protect your institution's information systems, data, and public trust.

CapinCrouse has expanded its nonprofit cybersecurity expertise and services through a merger with Traina & Associations, a national information security audit and consulting firm.

"The need for expert information security services is rapidly increasing as nonprofits face numerous and diverse cybersecurity threats," said James Oberle, Partner and CEO at CapinCrouse. "Traina & Associates brings leading expertise and experience to our firm, allowing us to empower our nonprofit clients in the critical area of information systems risk management."

Cybersecurity Definitely Needs Your Attention, continued

Traina & Associates, a CapinCrouse company*, offers a comprehensive Cybersecurity Assessment to help you evaluate and reduce your organization's cybersecurity risk. This includes:

- A thorough assessment of over 100 different information security controls to determine whether they exist and are operating as intended.
- A vulnerability assessment to identify any potential vulnerabilities that may be exploited. This consists of scanning both your internal network and external Internet-facing systems against a database of more than 50,000 known vulnerabilities.

Learn more at capincrouse.com/cybersecurity

*Traina & Associates is an authorized trade name of Capin Technology LLC, a subsidiary of Capin Crouse LLP.

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 percentages of "Yes" answers are as follows:

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

- Respondents 158
- Percentage of "Yes" answers 67.72%

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

- Respondents 153
- Percentage of "Yes" answers 33.99%

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

- Respondents 154
- Percentage of "Yes" answers 85.71%

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

- Respondents 147
- Percentage of "Yes" answers 89.80%

Revenue Enhancement Opportunities (REO)

There is a new day dawning for Christian higher education. It will be the innovative, nimble, and flexible institutions who flourish as the future unfolds. And not only flourish financially, but they will be able to abundantly shepherd those under their charge and transform our world.

Every institution should be planning and executing what we call "REO" — revenue enhancement opportunities. It is a process that you can do with your leadership team internally or you can involve others. We would love to be involved in this process with you.

Revenue Enhancement Opportunities (REO), continued

Phase I of REO involves an all-day meeting with the institution's leadership. We invite the president; trustees; accounting, development, athletics, and facilities departments — whoever needs to be there. We spend the time working together to identify unique aspects of the institution and of the team. Then we brainstorm ideas for activities that can provide alternative revenue sources. The plan is to put as many ideas up on the wall as possible and then pare them down to one short-term project ("Just Add Water" – JAW) and a long-term project that will be planned, designed, and launched in Phase II.

Phase II of the REO process involves training and execution. We will appoint a champion (not be the president) and a team of four to eight leaders who will be trained in Lean Six Sigma Green Belt techniques. The team will carry forth the idea → plan → reality.

Executive Compensation Studies

At Issue

Executive compensation at higher education institutions is under increased scrutiny by the public and the IRS. Further, if your executive compensation is deemed by the IRS to be unreasonably high, it can result in substantial penalties levied against the executive and, potentially, the board of trustees.

Situation

Denali Christian College (DCC) is a private college that is exempt under I.R.C. section 501(c)(3) and section 170(b)(1)(A)(ii). At their recent board meeting, the topic of executive compensation arose. Specifically, the compensation committee wondered what they should be doing to satisfy one of the three required areas of Treasury Regulation 53.4958-6 (known as the "rebuttable presumption" clause), namely "comparable data."

The CFO isn't sure how to answer the question, so the college calls us. First, we tell them they should ensure that all three of the "rebuttable presumption" facets are met — including independent board approval, use of comparable data, and documentation of the process.

Schedule J (Form 990) contains check boxes in a section (Part I, Line 3) that ask which, if any, of the following methods were used to arrive at executive compensation: compensation committee, independent compensation consultant, Form 990 of other organizations, written employment contract, compensation survey or study, or approval by the board or compensation committee. The instructions to Schedule J describe "compensation survey or study" as follows: "refers to a study of top management official compensation or functionally comparable positions in similarly situated organizations."

As an aside, all institutions should ensure that their description of the process for determining executive compensation (on Form 990, Schedule O) conforms to the IRS's expectations in this area.

We encourage the team at DCC to contract to have a compensation study done by an outside consultant for any executives listed at Form 990, Part VII, Section A. Further, the shelf life of these studies is about 24 months. They should be done more frequently if significant compensation changes occur.

Rules

Treasury Regulation 53.4958-6(c)(2)(i):

> In general. An authorized body has appropriate data as to comparability if, given the knowledge and expertise of its members, it has information sufficient to determine whether, under the standards set forth in §53.4958-4(b), the compensation arrangement in its entirety is reasonable or the property transfer is at fair market value. In the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the availability of similar services in the geographic area of the applicable tax-exempt organization; current compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the disqualified person. In the case of property, relevant

Executive Compensation Studies, continued

> information includes, but is not limited to, current independent appraisals of the value of all property to be transferred; and offers received as part of an open and competitive bidding process.

IRS Form 990 Instructions (2016):

> Part VI, Line 15. Answer "Yes" on line 15a if, during the tax year, the organization (not a related organization or other third party) used a process for determining compensation (reported in Part VII or Schedule J (Form 990)) of the CEO, executive director, or other person who is the top management official, that included all of the following elements…
>
> …[2] Use of data as to comparable compensation for similarly qualified persons in functionally comparable positions at similarly situated organizations.

Schedule J (Form 990), Part I, Line 3 instructions:

> Compensation survey or study refers to a study of top management official compensation or functionally comparable positions in similarly situated organizations.

Bottom Line

More and more, executive compensation is becoming a hot issue in higher education. And what your team thinks is "reasonable" may be disputed by the IRS if you have not taken the proper steps to meet the "rebuttable presumption of reasonableness" set forth in the regulations. You should seek expert advice in this area and have compensation studies done by outside experts.

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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, 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.