CACUBO 2019 TAX UPDATE:
Resilience in Navigating Federal Tax Reform

February 21, 2019
Your instructors

Carley Umstead
Tax Senior Manager
Cedar Rapids, IA
319-298-5272
Carley.Umstead@rsmus.com

Debbie Singer
Senior Manager
Chicago, Illinois
312-634-3180
Debbie.Singer@rsmus.com
## Agenda

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Objectives

By the end of this course, you will:

• Understand the provisions of the Tax Cuts and Jobs Act (TCJA) with the most widespread impact on colleges and universities

• Be aware of the availability of certain credits & incentives for not-for-profit entities and higher education institutions
FEDERAL TAX REFORM UPDATE
For Nonprofits
President Trump signed into law H.R. 1, the Tax Cuts and Jobs Act (TCJA) on Dec. 22, 2017.

Today, we will review the most widely applicable provisions for colleges and universities that are related to:

- unrelated business income tax
- excise taxes on high compensatory arrangements
- fringe benefits (namely, employer provided parking)
- donors and planned giving
## TCJA Changes – UBIT – Separate Activities

<table>
<thead>
<tr>
<th>Prior Law</th>
<th>New Law under TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>All unrelated business activities were considered in the <strong>aggregate</strong> to compute unrelated business taxable income (UBTI).</td>
<td>Compute UBTI for each trade or business activity <strong>separately</strong>.</td>
</tr>
<tr>
<td>Net income and net loss arising from different activities could offset income/loss from other activities.</td>
<td>Net loss from one activity cannot be used to offset income from a different activity.</td>
</tr>
</tbody>
</table>

“Basketing” or “Bucketing”
TCJA Changes – UBIT – Separate Activities
What is a separate trade or business?

What if we invest in partnerships or LLCs that pass-through UBI? Do we have to determine each underlying trade or business generating the UBI and segregate the income and loss?
TCJA Guidance – UBIT – Separate Activities

Notice 2018-67 (issued August 2018)

• For activities directly carried on by the nonprofit, use North American Industry Classification System (NAICS) 6-digit codes

• For activities indirectly carried on through partnership investments, aggregate UBI from all investment partnerships if the organization has a minority interest and no control
## TCJA Changes – UBIT – Tax Rate

<table>
<thead>
<tr>
<th>Prior Law</th>
<th>New Law under TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tiered tax rate structure with a bottom rate of 15% and a top rate of 35%</td>
<td>Flat tax rate of 21%</td>
</tr>
</tbody>
</table>

**This represents a tax increase on nonprofits who averaged $90,000 or less in taxable income**
## TCJA Changes – UBIT – Net Operating Losses

<table>
<thead>
<tr>
<th>Prior Law</th>
<th>New Law under TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizations could carry back net operating losses (NOLs) for two years; and carry them forward for 20 years.</td>
<td>Eliminates carryback of NOLs.</td>
</tr>
<tr>
<td>There was no limit on the amount of taxable UBI that a nonprofit could offset with NOLs, i.e., an organization could offset 100% of taxable income.</td>
<td>Allows carryforward of NOLs indefinitely.</td>
</tr>
<tr>
<td></td>
<td>NOLs are limited to offsetting 80% of taxable income.</td>
</tr>
</tbody>
</table>

**Guidance - Notice 2018-67 (issued August 2018)**

- New (post-2017) NOLs should first be used against the associated income from which they are derived.
- Then, use the old (pre-2018) NOLs against the total UBI until the old NOLs are completely exhausted.
## TCJA Changes – Executive Compensation

<table>
<thead>
<tr>
<th>Prior Law</th>
<th>New Law under TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>No stated limits for compensation.</td>
<td>21% excise tax on:</td>
</tr>
<tr>
<td>However, organizations were, and still are, responsible for setting reasonable compensation that is not in violation of the private inurement and private benefit rules. Accordingly, excess benefit transaction excise taxes still apply.</td>
<td>Remuneration in excess of $1 million paid to top five covered employees and Any excess parachute payments (Severance 3x base annual salary)</td>
</tr>
</tbody>
</table>

**Guidance - Notice 2019-09 (issued December 31, 2018)**

- Measured on employer's calendar year ending within its fiscal year to align with Form 990 & Form W-2.
- Effective date is the first tax year of the employer beginning after December 31, 2017, excluding any prior year’s remuneration paid or vested.
- Confirms for public universities that those that do not have a section 501(c)(3) exemption letter from the IRS and do not exclude income under section 115(1) are not subject to the section 4960 excise tax.
<table>
<thead>
<tr>
<th>Prior Law</th>
<th>New Law under TCJA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Businesses could deduct the cost of providing parking to employees.</td>
<td>Free parking is only in Monopoly.</td>
</tr>
<tr>
<td>Nonprofits could provide parking to employees with no tax consequence.</td>
<td></td>
</tr>
</tbody>
</table>
• Unrelated business taxable income ("UBTI") of an organization will be increased by any amount for which a deduction is not allowable for income tax purposes by reason of section 274 and which is paid or incurred by such organization for any:
  – qualified transportation fringe (as defined in section 132(f)),
  – parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or
  – on-premises athletic facility (as defined in section 132(j)(4)(B))
• Qualified transportation fringe benefits means any of the following fringe benefits provided by an employer to an employee:
  - Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee’s residence and place of employment
  - Any transit pass
  - Qualified parking
  - Any qualified bicycle commuting reimbursement (suspended for amounts paid after Dec. 31, 2017 and until the 2026 tax year)
Qualified parking means parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work by transportation, in a commuter highway vehicle, or by carpool.
TCJA Guidance – UBIT – Qualified Parking

Notice 2018-99 (issued Dec 10, 2018)

• The employer can use any reasonable method of determining the loss of deduction (cost of providing parking)

• Using the fair market value (FMV) of the parking provided to the employee is not a reasonable method

Notice 2018-100

• If certain requirements are met, organizations will not be subject to an underpayment of estimated taxes penalty for any payments required to be made on or before December 17, 2018.
Notice 2018-99 breaks the treatment of parking expenses into two separate categories:

- Employer pays a third party for employee parking spots.
- Employer owns or leases all or a portion of a parking facility.
Employer pays a third party for employee parking spots.

- E.g., parking ramp, parking garage, flat lot
- The amount the employer pays to allow its employees to park at the third party lot or garage is generally the total annual cost of the employee parking paid to the third party.
- What if the employee elects pre-tax payroll deferral to “pay for their own” parking?
Employer owns or leases all or a portion of a parking facility.

• For owned (or leased) lots parking expenses are defined as regular costs of taking care of the parking lot or other parking facility, such as:
  - repairs, maintenance, utilities
  - insurance, property taxes, interest expense
  - removal of snow, leaves, trash, cleaning
  - parking attendant and security costs, and
  - the actual lease or rental payments for the lot (or portion of the lot)

• Notably, depreciation is not considered a cost of parking.

• What if the value of the parking provided is zero, i.e., no one from the public would pay to park there?
4 Step “Reasonable Method”:

1. Calculate the disallowance for spaces reserved for employees

2. Determine the primary use of remaining spaces that can be used by either employees or the general public (>50%)

3. If Step 2 yields >50% employee use, calculate the allowance for spaces reserved for the general public (nonemployees, clients, students, patients, congregants, visitors)

4. If any spaces remaining after Steps 1-3, reasonably determine, based on actual or estimated usage, the employee use of such remaining spaces
IRS Priority Guidance Plan – FY June 30, 2019

• List of guidance projects that IRS and Treasury will focus on during the July 1, 2018, through June 30, 2019, year.

• Items of interest to colleges and universities include:
  – the new section 512(a)(6) siloing rules
  – the section 512(a)(7) parking tax
  – the “excess remuneration” excise tax under section 4960
  – allocation of expenses for dual use activities

• The plan does not include guidance on the new section 170(l) disallowance for payments made in return for athletic event seating rights, including how to implement this new provision with regard to priority points.
Changes to Form 990-T

• In November, the IRS released draft instructions for Form 990-T (see https://www.irs.gov/pub/irs-dft/i990t–dft.pdf), which provide that organizations with multiple trade or business activities should report the first activity in Block H and the remainder of the activities on Schedule M.

• Subsequently, a draft schedule M was released and can be found at https://www.irs.gov/pub/irs-dft/f990tsm--dft.pdf.

• For 2018, the addback for disallowed fringe benefits appears beneath expenses. (For 2017, it was in “other income.”)
Impact of tax reform on donors and planned giving strategies

• Doubling of the standard deduction paired with $10,000 cap on state tax deduction will reduce the number of households who benefit from a charitable deduction on their 2018 tax bill
  - The Tax Policy Center estimates that the law cut the number of itemizers in 2018 from 46 million to 19 million.
  - “Lumpy” giving or “bunching” contributions

• Despite TCJA changes, a new study predicts that total charitable giving will increase each of the next two years, with higher education seeing growth of 3.5% in 2019 and 5.7% in 2020.

Source: Indiana University Lilly Family School of Philanthropy
CREDITS & INCENTIVES
For Nonprofits
Many states have incentive programs that can benefit not-for-profit entities:

- Refundable Tax Credits
- Training grants and programs
- Deal closing funds
Refundable Tax Credits

• Refundable tax credits are tax credits that provide benefits regardless of liability.

• Certain states allow not-for-profit entities to claim refundable tax credits.

• Not-for-profit entities receive cash refunds if they qualify for these credit programs.
Example of Refundable Credit: Iowa Redevelopment Credit

• Available to taxpayers that invest in brownfields or greyfields in Iowa.

• Tax credit is calculated based on a percentage of the investment at the project. The amount of the percentage is negotiated with the Iowa Economic Development Agency.

• Tax credit is not generally refundable but not-for-profit entities can claim refundable tax credits for their investments.
Training Grants and Programs

• Most states offer training grants to assist employers with training needs for new and retained employees

• Grants may be paid directly to the employer with the training needs or be used to pay educational institutions for training assistance.
Example of Training Grants: Minnesota Jobs Training Incentive Program

- Minnesota offers training assistance through its Jobs Training Incentive Program.
- Training grants of up to $200,000 are available to eligible businesses creating new jobs.
- Grants are competitive and must be secured before the training occurs.
Deal Closing Funds

• Most states have deal closing funds available which help bridge the financing cap for capital projects.

• Certain states include not-for-profit entities as eligible businesses for purposes of this program.
Example of Deal Closing Fund: Indiana RIF

• Indiana Regional Impact Fund (RIF) is a deal closing fund that makes investments into organizations that advance regional development strategies.

• Grant amounts vary but the size of the benefit is based partially on the amount of capital investment and the number of new jobs created as a result of the investment.

• Not-for-profit entities can qualify for these grants.
NEW MARKET TAX CREDITS
For Nonprofits
NMTC – Opportunity

Opportunity

• The NMTC program is a competitive federal incentive program designed to encourage investment in distressed areas through third party private capital investment in exchange for Federal income tax credits.

• NMTC is available in all 50 states to projects in certain census tracts that provide community benefits. However, because of the competitive nature of the program, not all projects will receive funding allocation.

Estimated Benefit

$1.5 Million - $2.5 Million on an allocation award of $10 Million. The benefit varies depending on the size of the allocation.
NMTC – Authority

• The NMTC program was created by the Community Renewal and Tax Relief Act of 2000.
• Regulations are codified in Section 45d of the IRC.
• NMTC was most recently reauthorized through the 2019 allocation round by the Protecting Americans from Tax Hikes (PATH) Act of 2015.
• It is expected that the program will be extended because of bi-partisan support for it. Congress is currently considering a permanent extension of the program.
NMTC – Allocations

2017 Allocation Round
• $3.5 Billion in 2017 allocation authority was announced on February 13, 2018.
• Seventy-three (73) CDEs out of 230 CDE applicants received allocations.

2018 Allocation Round
• Applications for a share of the $3.5 Billion in 2018 allocation were due June 28, 2018.
• Awardees to be announced in Winter 2019 although this could be delayed because of the government shutdown.
NMTC – Overview

- Congress enacted the NMTC program to encourage investment in Low Income Communities (LICs) by providing funding to projects in distressed areas using money from third party investors.
- NMTC is administered by the Community Development Financial Institutions Fund (CDFI) – a branch of the U.S. Treasury Department.
- A Community Development Entity (CDE) is a domestic corporation or partnership that acts as an intermediary to deliver investment to qualified LICs in exchange for tax credits that it has been allocated.
- CDEs receive tax credit allocations on an annual basis through a competitive process established by CDFI.
Third party investors receive federal income tax credits for making Qualified Equity Investments (QEIs) into the CDEs. The CDEs then direct funding for these projects by using the proceeds of the QEIs to make investments in Qualified Active Low Income Community Businesses (QALICBs).

Investments can be in real estate or in business operations. The QALICB receives cash up-front in the form of an interest-only forgivable loan. At the end of seven (7) years, the loan to the QALICB entity is forgiven.

Competition for funding is significant and not all projects that meet NMTC qualifications will receive allocations.
Colleges and Universities Use NMTC

- Boston Conservatory
- Missouri University of Science and Technology
- University of the Cumberlands
- Rutgers
NMTC – Overview

- NMTC Allocation
- Investment in distressed areas
- Tax credits (39% over 7 years)
- Qualified Equity Investment
- Qualified Low Income Community Investment
- Fees (using below-market interest rate payments)
- Balance of allocation amount less the QEI
- QALICB or related entity

CDE

Investor
## NMTC – Stakeholder Benefits

<table>
<thead>
<tr>
<th>Party</th>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>QALICB</td>
<td>Forgivable loan to reduce project investment needs. During the period that the loan is outstanding, QALICB pays interest only on the loan, typically at a rate of 0.5% - 2%.</td>
</tr>
<tr>
<td>Investor</td>
<td>39% federal income tax credit over 7 years based on the total allocation amount (5% in Years 1-3 and 6% in Years 4-7)</td>
</tr>
<tr>
<td>Community Development Entity</td>
<td>Fee for making the award and managing the process over the 7 year period (typically 5% of allocation plus annual fees)</td>
</tr>
<tr>
<td>CDFI / Low Income Communities</td>
<td>Economic investment in distressed areas.</td>
</tr>
</tbody>
</table>
## NMTC – Calculation of Benefit to QALICB (estimate only)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Allocation (Investment)</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>NMTC Generated (39% of total allocation)</td>
<td>$3,900,000</td>
</tr>
<tr>
<td>Equity Investment (0.77 discount rate)</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>QALICB or related entity</td>
<td>$7,000,000</td>
</tr>
<tr>
<td><strong>Less Estimated Fees</strong></td>
<td></td>
</tr>
<tr>
<td>CDE Project Fee</td>
<td>$500,000</td>
</tr>
<tr>
<td>Closing Costs</td>
<td>$250,000</td>
</tr>
<tr>
<td>Annual Fees (Total)</td>
<td>$250,000</td>
</tr>
<tr>
<td><strong>TOTAL ESTIMATED NET BENEFIT to QALICB</strong></td>
<td>$2,000,000</td>
</tr>
</tbody>
</table>