TEGE Exempt Organizations Council
Comments to Assist with Regulatory Implementation of the Tax Cuts and Jobs Act

August 17, 2018

This document collects the feedback from the individuals participating in the TEGE Exempt Organizations Council's subcommittees on tax reform since the enactment of Public Law No. 115-97 (the "Tax Cuts and Jobs Act" or "TCJA"). It is a follow-up to conversations held earlier in the year among members of the TEGE Exempt Organizations Council and representatives of the Internal Revenue Service ("IRS") Office of Associate Chief Counsel and Treasury Department ("Treasury") about implementation of the TCJA and the need for regulatory guidance. These prior conversations have been referred to and reiterated in this document. As requested, many examples have been incorporated to illustrate points discussed herein.

The TEGE Exempt Organizations Council was formed to (i) open and maintain lines of communication between the Tax Exempt & Government Entities Division (the "Division") of the IRS and the practitioner community, (ii) provide the Division with the thinking of the practitioner community on procedural and systemic matters, (iii) provide practitioners a forum to share their concerns with the IRS regarding both policies and specific tax issues and procedures, (iv) educate the practitioner community and the exempt organizations community. The Council's members and participants include attorneys, certified public accountants, and other practitioners and professionals in the exempt organizations community (including in-house practitioners and professionals).

The comments below do not necessarily represent the views of the TEGE Exempt Organizations Council or any particular Council member. The preparers of these comments were not engaged by any client for the purpose of submitting these comments or otherwise to influence the development or outcome of regulatory guidance.

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I. Limitation on Charitable Contributions for Stadium Seating Under Internal Revenue Code (the "Code") Section 170(l)

Although the statutory language looks like it should be straightforward to apply, in practice, it is difficult to determine whether common practices in the higher education athletic industry fall within the scope of Section 170(l) as revised by the TCJA.

The examples below illustrate the difficulties of determining what constitutes "the right to purchase tickets." In each example, the relevant question is, "Is this payment deductible?"

Example 1: Donor gives $X to University Athletic Foundation ("UAF"). UAF donors are given the right to purchase season tickets to University stadium before tickets are made available to the general public. University stadium is not sold out.

Example 2: Same facts as Example 1, except that University stadium is sold out. Therefore, season tickets are only available to UAF donors.

Example 3: Donor gives $X + $Y to UAF. UAF donors receive priority points for all contributions to UAF. A contribution of $X gives donors the right to purchase two season tickets before such tickets go on sale to the general public. Cumulative priority points awarded to UAF donors determine the ordering of seat selection associated with season tickets, and therefore, the right to purchase better seats when the University stadium is reseated (either when former seat holders give up their season tickets or when the University periodically reseats all ticket holders).

Example 4: Donor gives $Z to University Scholarship Foundation ("USF") in year 1. UAF awards priority points with rights enumerated in Example 3 to donors who make contributions to USF. For a donor to USF to utilize those priority points, the donor must make a separate contribution of $X to UAF. Donor makes no contribution of $X to UAF in year 1 but makes a contribution of $X in year 2, utilizing cumulative priority points obtained in year 1 to select season tickets before such tickets go on sale to the general public.

Example 5: Same facts as Example 4, except a separate contribution of $X is made to UAF in year 1.

Example 6: Donor gives $X to UAF in exchange for a ticket in an area of the stadium reserved for people who pay $X for tickets. The fair value of the ticket can be established as $X - $Y.

Example 7: Same as Example 6, except the ticket is not for a designated seat but for a designated area of the stadium (like a sky box or lounge with seats to observe the event). The fair value of the ticket can be established as $X - $Y.

Transition relief for pledge agreements predating TCJA
Donors entered into these pledge agreements based on an expectation of an 80% deduction, and if that deduction is now going to be denied entirely, universities are worried that the donors are just going to default on their pledge agreements (and, of course, universities don't really want to be in the position of having to enforce pledge agreements against defaulting donors). Some universities have indicated they have already budgeted projects, etc. with an expectation that these pledge agreements are going to be fulfilled.

Other questions

a. What is "an athletic stadium of such institution"?
b. Must the institution own the stadium?
c. Does this rule only apply to home games?
d. Does "stadium" encompass all athletic facilities or is there a minimum number of spectators?
e. Do seating rights relate only to the seat at the arena, or do they relate to other privileges at the event as well, such as access to a lounge or VIP booth?

II. Section 512(a)(6) Separate Computation of Unrelated Business Taxable Income

A. Identification of a Separate Trade or Business

Section 512(a)(6) provides a "Special rule for organization with more than 1 unrelated trade or business." If, and only if, an organization has two or more unrelated trades or businesses, then the new rule requires the separate computation of unrelated business taxable income ("UBTI") on a trade-or-business-by-trade-or-business-basis. The critical question, therefore, is what constitutes a trade or business?

Active conduct rule. Section 513(c) defines a "trade or business" as "any activity which is carried on for the production of income from the sale of goods or the performance of services." In other words, a trade or business requires the active conduct of a business—selling goods, performing services—not the passive receipt of investment earnings.

Fragmentation rule. In addition, Section 513(c) proscribes the following "fragmentation rule" for identifying an organization's unrelated trades or businesses:

> an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

It is not necessary to have a separate entity in order to have a separate trade or business, and a single entity can have multiple trades or businesses.

The fragmentation rule of Section 513(c) presents a challenge in combination with the silo rule of Section 512(a)(6) because each trade or business, when viewed as a collection of activities is infinitely fragmentable. The regulations will need to explain not only how to group activities associated with the sale of goods or performance of services into a single trade or business but also what is the smallest unit or quantum of activity for purposes of determining the existence of a trade or business.

The factors listed below are helpful for purposes of grouping multiple activities into a single trade or business silo for purposes of Section 512(a)(6):

(i) Causal connection to UBTI—i.e., the degree to which the activity is substantially related or contributes importantly to the generation of the revenue or loss. Would the revenue or loss have occurred but for the activity?

(ii) Common control over the activity by the same persons pursuant to the same policies and procedures;

(iii) Geographic location where activities are carried out; and

(iv) Interdependencies between or among the activities, for example, the extent to which the activities:

    (a) involve the same products or services,
    (b) involve products or services that are customarily provided together,
    (c) are provided to the same customers,
    (d) are conducted by the same individuals,
    (e) involve common planning and coordination, or
    (f) are treated as a single unit or category for accounting and reporting purposes.

Regulations should provide flexibility in combining similar activities into a single trade or business. For example, an entity may have multiple locations with a single type of UBI activity (such as a hospital with laboratory or pharmacy services for non-patients) that ultimately have similar management at some level of the organization but may have separate reporting due to external factors (such as different payor agreements).

To the extent a tax-exempt organization derives UBTI from activities that do not meet the Section 513(c) definition of "trade or business," but rather are statutorily deemed to be UBTI (e.g., receiving interest, rents, royalties, and annuities from controlled entities under Section 512(b)(13); providing qualified transportation fringe benefits to employees under Section 512(a)(7); receiving rental income treated as UBTI under Section 512(b)(3)(B); receiving debt-financed income treated as UBTI under Section 512(b)(4); receiving Subpart F insurance income under Section 512(b)(17); or receiving partnership income treated as UBTI under Section 512(c)), the organization may aggregate gross UBTI and losses from these sources for purposes of calculating net UBTI under Section 512(a)(6).

EXAMPLE 1

Taxpayer A is a tax-exempt organization that does not actively conduct any unrelated trades or businesses, but is subject to UBTI from six sources: (1) income from rental properties that either varies based on income or profits derived from the rental property or is more than 50% attributable to rental of personal property under Section 512(b)(3)(B); (2) income from debt-financed property under Section 512(b)(4); (3) payments of interest and royalties that are subject to UBTI under Section 512(b)(13) because they are received from for-profit subsidiaries (“controlled entities”) whose activities are not substantially related to Taxpayer A’s exempt purposes, and because the interest and royalty payments reduce the controlled organizations’ “net unrelated income”; (4) its costs incurred in providing qualified transportation fringe benefits, including transit passes and qualified parking, to its employees, which results in UBTI pursuant to Section 512(a)(7); (5) Subpart F insurance income under Section 512(b)(17); and (6) investment income from partnerships under Section 512(c). Taxpayer A does not engage in an active trade or business, as defined in Section 513(c), to generate any of these six streams of income.

None of these six sources of UBTI is in fact a trade or business, as described in Section 513(c). Unlike the active business operations described in Example 5 below, they are passive activities of Taxpayer A, income from which is statutorily treated as being, or deemed to be, unrelated trade or business income derived from an unrelated trade or business for purposes of Section 512. These activities, therefore, should not be separately computed for purposes of Section 512(a)(6). Thus, any losses incurred from any of these activities (e.g., Taxpayer A’s debt-financed rental properties) could offset Taxpayer A’s gains from these activities that are deemed UBTI pursuant to Section 512(b)(3), 512(b)(4), 512(b)(13), 512(b)(17), 512(a)(7), and/or 512(c). In addition, because they are not subject to Section 512(a)(6), they may be used to offset income or loss from any other trade or business, regardless of whether such trade or business is separately computed.

EXAMPLE 2

Taxpayer B is a Section 501(c)(3) tax-exempt organization with a diversified investment portfolio that it manages pursuant to an asset allocation policy. A single group of its employees manages all the investments in the portfolio, which management is overseen by Taxpayer B’s investment committee. This portfolio consists of various asset classes, including stocks (domestic and international), fixed income, real assets, commodities, and partnerships. The portfolio is diversified over industry and geography to manage risk. The investments are all passive, and Taxpayer B does not own more than 50% of any investment partnership or investment asset. Some of Taxpayer B’s investments generate UBTI. For instance, some of the partnerships it invests in, or entities those partnerships invest in, invest in debt-financed rental property or active businesses (e.g., oil and gas). Taxpayer B receives hundreds of Forms 1065 and Schedules K-1 from these partnerships each year, many of which report UBTI from the investments. Taxpayer B accounts for these investments as a single category, which appears for accounting and reporting purposes as a single line item (investments). Taxpayer B reports all investment income attributable to unrelated business activity as a single category on Form 990-T (Part I, line 5 – income (loss) from partnerships and S corporations). Similarly, passive investment income is normally aggregated and reported as a single nonoperating item (“investments”) on an exempt organization’s balance sheet. Different employees manage the investments than those employees who manage Taxpayer B’s operations.

As described in Example 1 above, an exempt organization’s investment in a partnership is not a trade or business, as described in Section 513(c), as it does not involve production of income from sale of goods or performance of services. *See Higgins v. Commissioner*, 312 U.S. 212

(1941) (investing for one's own account is not a trade or business). Rather, income from such investment attributable to an unrelated trade or business carried on by the partnership is deemed UBTI under Section 512(c). As such, none of the UBTI should be separately computed under Section 512(a)(6).

To the extent that Treasury and the IRS may consider any UBTI arising from Taxpayer B's investments to be trades or businesses, which we do not recommend for the reasons above, all such UBTI should be classified as a single trade or business rather than multiple trades or businesses for purposes of Section 512(a)(6). The investments are conducted as a single activity in a single, diversified investment portfolio, managed by the same individuals, under the oversight of the same investment committee, pursuant to the same strategy and policy. Thus, Taxpayer B should be entitled to aggregate all investment income (and losses) from its different investments in calculating its UBTI.

EXAMPLE 3

Taxpayer C is a tax-exempt organization that receives advertising income from multiple sources, including a digital newsletter, website, and print magazines. The same individuals oversee media and advertising staff who solicit, sell, and place the advertisements, pursuant to the same media strategy and advertising policy. Many of the advertisers advertise in multiple forms of Taxpayer C media. Although Taxpayer C's media audiences are not identical, there is substantial overlap between the audiences for its print publications, website, and digital newsletter. Taxpayer C reports income from all advertising as a single category, "advertising income," on Form 990-T, Part I, line 11.

Taxpayer C's multiple advertising activities for its multiple forms of media are a single trade or business, for purposes of Section 512(a)(6). The advertising is conducted as a single trade or business, managed by the same individuals, pursuant to the same strategy and policy, and reported as a single income category on Form 990-T. Thus, Taxpayer C may aggregate all advertising income (and losses) from its different media in calculating its unrelated business taxable income.

EXAMPLE 4

Taxpayer D is a tax-exempt organization that owns and manages several different rental properties in the same metropolitan area. The properties generate unrelated business taxable income due to services the organization provides to the tenants. The tenants of these properties are diverse. For instance, one of the properties is a commercial office building, while another consists of residential apartments. Another property includes a large meeting hall that Taxpayer D rents to different, unrelated parties at different times during the year for various events. All of these rental activities are conducted by the same group of Taxpayer D's employees and contractors. For instance, assuming the properties are geographically close to one another, Taxpayer D may use the same maintenance staff, property management personnel, advertising staff, lawyers, and insurance agents in connection with its rental properties. These individuals and their activities are overseen by the same managers of Taxpayer D who determine strategies and goals for using the rental properties and generating income following the same rental policies and procedures. Taxpayer D accounts for all rental income as a single category, which it reports as a single category on Form 990-T: "rent income" on Part I, line 6.

As described in Example 1, above, an exempt organization's rental activities are generally not trades or businesses, as described in Section 513(c), because they generally do not involve production of income from the sale of goods or performance of services. But to the extent that any of Taxpayer D's rental activity constitutes a trade or business (e.g., because Taxpayer D provides substantial services in connection with the rental), operation of such rental properties is a single trade or business, for purposes of Section 512(a)(6). The rental activities are conducted as a single trade or business. Although the customers for the properties are diverse, they rent property that is managed by the same individuals, pursuant to the same strategy and policies. The rental properties are located in the same metropolitan area, which enables the same property management and maintenance personnel to manage and maintain the properties. Rental income is treated as a single category for accounting and reporting purposes. Thus, Taxpayer D may aggregate all unrelated rental income (and losses) from its different properties in calculating its unrelated business taxable income.

EXAMPLE 5

Taxpayer E is a tax-exempt organization that engages in three distinct activities that are not substantially related to its tax-exempt purposes: (1) a coffee shop that sells food and beverages to the general public; (2) a consulting and management service to unrelated third parties; and (3) operation of a parking lot available to the general public. Although these activities are ultimately overseen by the same executives of Taxpayer E, they are operated independently on a day-to-day level by different sets of employees, pursuant to different policies and procedures. They serve different customers, few of whom overlap. Taxpayer E accounts for these activities differently.

These multiple activities are different trades or businesses, for purposes of Section 512(a)(6). The activities involved in generating income or loss from the coffee shop, consulting and management service, and parking lot are severable because they do not bear a causal relationship to one another—i.e., the income earned from consulting would have occurred regardless of whether the organization incurred the expense of buying coffee beans for the coffee shop. Moreover, there is no interdependence of management among the activities. Each is conducted as different businesses by different employees for different purposes in different manners, and have very few overlapping customers. Taxpayer E treats them as different categories for accounting and reporting purposes. Thus, Taxpayer E may not aggregate income or losses from these separate activities in calculating its unrelated business taxable income.

EXAMPLE 6

Taxpayer F is a tax-exempt organization that operates multiple hospitals and other health care facilities and activities. It operates several pharmacies and laboratories, some in city X and some in city Y, which is located 30 miles west of city X. Taxpayer F treats its pharmacy and laboratory sales to patients as related income not subject to UBIT, and its pharmacy and laboratory sales to non-patients as UBTI. Taxpayer F's laboratory facilities are separate from its pharmacy facilities, though some are co-located in the same building. The laboratory and pharmacy in city X serve many (though not all) of the same patients, and the laboratory and pharmacy in city Y also serve many of the same patients. There is some interdependence between the organization's laboratories and pharmacies in serving non-patients; for instance, the lab results of a non-patient may determine what medicine that non-patient will purchase from a pharmacy of the organization. Pharmacy and laboratory activities are both component, related parts of the organization's strategy for serving community health needs and reaching nonpatients; its executives take the same community needs of city X and city Y (some of which overlap) into account in determining where and how to operate its pharmacies and laboratories. Generally, the employees in each pharmacy and laboratory are separate and do not overlap with one another, though some of the same managers oversee the operations of the pharmacy and laboratory.

In this example, after taking into account all the relevant facts and circumstances, different groupings of activities may be permissible, including:

(1) All pharmacy activities as a single trade or business
(2) All laboratory activities as a single trade or business
(3) All laboratory and pharmacy activities in city X as a single trade or business
(4) All laboratory and pharmacy activities in city Y as a single trade or business
(5) All pharmacy and laboratory activities as a single trade or business
(6) All pharmacy and laboratory activities as separate trades or businesses

The more interdependent these activities are, and the more they are operated under common control, by common employees, under common management, pursuant to common employees, serving generally the same customers, and being accounted for and reported as a common unit or category, the more reasonable it would be to treat these activities as a single trade or business, for purposes of Section 512(a)(6).

B. Net Operating Losses ("NOL") / Suspended Losses

The new Section 512(a)(6)(A) states that losses are computed separately: "unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business."

Section 512(a)(6)(C) provides that when an organization computes the sum of UBTI from each unrelated trade or business silo, "unrelated business taxable income with respect to any such trade or business shall not be less than zero." In interpreting this provision, the question arises whether losses in excess of income in a particular unrelated trade or business silo are to be extinguished or carried forward to future tax years, and, if so, what are the mechanics for applying such losses from prior tax years.

The technical explanation for this section states that "[a] net operating loss deduction is allowed only with respect to a trade or business from which the loss arose" and "[t]he provision generally does not, however, prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year, where appropriate." Joint Committee on Taxation, Description of the Chairman's Mark of the "Tax Cuts and Jobs Act" Scheduled for a Markup by the Senate Committee on Finance on November 13, 2017 (JCX-51-17) at 168 (Nov. 9, 2017). This is strong evidence that Congress did not intend to disallow excess siloed losses but rather that excess losses from a prior year should be available to offset income in future tax years arising from the same trade or business that gave rise to the loss.

Further evidence for this intent can be found in the transition rule provided in Section 13702(b)(2) of the Tax Cuts and Jobs Act addressing "[c]arryovers of net operating losses" which states that

> If any net operating loss arising in a taxable year beginning before January 1, 2018, is carried over to a taxable year beginning on or after such date--(A) subparagraph (A) of section 512(a)(6) of the Internal Revenue Code of 1986, as added by this Act, shall not apply to such net operating loss, and (B) the unrelated business taxable income of the organization, after the application of subparagraph (B) of such section, shall be reduced by the amount of such net operating loss.

While the transition rule and technical explanation address the treatment of losses from prior years, Section 512(a)(6) itself does not provide details on the mechanics of how an organization may use losses previously confined to a trade or business silo by operation of Section 512(a)(6) in a prior year.

We recommend that regulations clarify and address the following issues:

1. Treatment of previously siloed losses. Expenses from one trade or business that are not able to be deducted in one taxable year because they exceed the net income from that trade or business can be used to offset income from that trade or business in a future year. Likewise, income from one trade or business may be offset by losses arising from that same trade or business in a prior year.

2. Assuming organizations may accumulate unused losses from prior years in their various unrelated trade or business silos, what happens when the organization sells one or more of the unrelated trade or business silos? In order for organizations to get the benefit of their siloed losses from prior tax years, we recommend that a sale, exchange, liquidation, dissolution or other event terminating an organization's trade or business should cause any accumulated losses from prior tax years first to be applied to any gain realized on the

disposition of said trade or business activity and then to be released from that trade or business silo so that they can be used to offset UBTI from other sources.

3. Interaction of corporate NOL rules with 512(b)(6) and other transition year issues:

- Under other provisions in the TCJA, the NOL deduction for corporate NOLs arising in tax years beginning after December 31, 2017 is limited to 80% of net taxable income. Should this rule apply to UBIT losses as well, or does the transition rule under Section 13702(b) of the TCJA allow for a 100% offset?

- For tax years ending after December 31, 2017, corporate NOL carrybacks were eliminated, and NOLs generated after December 31, 2017 have an unlimited carryforward. Do these rules apply to UBIT loss carryforwards? In other words, please clarify whether suspended separate silo losses are also subject to an 80% limitation annually and unlimited carryforward.

- Alternative Minimum Tax ("AMT") was eliminated for corporations, but was not eliminated for trusts. The AMT NOL deduction is limited to 90% of net alternative minimum taxable income. Which rule applies to UBIT earned by tax-exempt organizations, whose entity classification status includes trusts, corporations, unincorporated associations, etc. It appears that for trusts, an 80% limitation applies to regular tax NOLs for years beginning after 2017 and 90% for AMT NOL's.

EXAMPLES

Example #1: Exempt organization X is a calendar year corporation with multiple lines of business (LOB A and LOB B), with the following assumptions:

- An NOL carryforward was generated prior to January 1, 2018 (i.e., represents pre-reform NOLs)
- In 2018, LOB A activity generates income whereas LOB B activity generates losses
- In 2019, LOB A activity generates income and LOB B activity generates income

The calculation of net unrelated business taxable income in 2018 includes income from LOB A, and no losses related to LOB B. The LOB B losses are suspended.

NOL carryforwards generated before January 1, 2018 offset 100% of 2018 net income, with remaining NOL carryforward available in 2019. The calculation of 2019 UBTI would take into account suspended LOB B losses from 2018, if any, where LOB B activity generates income in 2019.

An NOL deduction is allowed up to 100% of 2019 net income to the extent of pre-2018 generated NOLs.

Example #2A: Exempt organization Y is a calendar year corporation with a single line of business, with the following assumptions:

- An NOL carryforward was generated prior to January 1, 2018 (represents pre-reform NOLs)
- In 2018, a single line of business generates a loss
- Loss generated in 2018 is treated as an NOL carryforward to 2019 (not suspended losses) because Section 512(a)(6) doesn't apply unless there are multiple trades or businesses
- In 2019, a second line of business is added
    - Old line of business A – net income
    - New line of business B – net loss

The application of Section 512(a)(6) limitations will result in net income reported from business A and suspension of the business B loss. Pre-reform NOLs would be utilized first based on age up to 100% of 2019 net income. Post-reform NOLs can be taken up to 80% of 2019 net income (assuming pre-reform NOLs utilized do not offset all 2019 net income).

Note: The 80% limit appears to be an aggregate limit, thus not 80% of the remaining 2019 net income after utilization of pre-reform NOLs, but rather 80% of 2019 net income before any NOL deduction.

For example: Assume the entity has $50,000 in net income from old business A, and ($30,000) in pre-reform NOLs. It appears that the 80% post-reform limit would be applied against taxable income before any NOLs are considered. Thus the post-reform NOL available to apply 2019 current year income is computed as follows:

> NOL Cap computation: $50,000 x 80% = $40,000. The utilization of $30,000 in pre-reform NOLs would provide capacity for an additional $10,000 in post-reform NOLs.

The alternative would be to calculate the 80% limitation after utilization of the pre-reform NOLs as follows:

> $50,000 - $30,000 pre-reform NOLs = $20,000 x 80% = $16,000.

The NOL cap under the alternative approach is $16,000 vs. $40,000. We do not believe, however, that this alternative calculation is consistent with the statute.

Example #2B: Exempt organization that is a calendar year corporation with a single line of business, with the following assumptions:

- An NOL carryforward was generated in 2017 or before (pre-reform NOLs)
- Net loss in 2018
- Additional amount treated as an NOL carryforward to 2019 (not suspended excess deductions) since Section 512(a)(6) doesn't apply unless there are multiple trades or businesses
- Added second line of business in 2019
    - Old line of business A – net loss
    - New line of business B – net income

The application of Section 512(a)(6) limitations results in net income from business B reported and the business A excess deductions are a suspended loss. Pre-reform NOLs would be utilized first based on age up to 100% of net income.

Post-reform NOLs can't be taken because they did not arise from the business creating the net income.

Example #3A: Corporation from Example 2 with pre-2018 and post-reform NOLs carried to 2020 and suspended losses from LOB A

- Net income or loss in 2020
    - Older LOB A – net income
    - Newer LOB B – net loss
- Application of Section 512(a)(6) limitations results in net income from LOB A and suspended loss from LOB B
- Suspended losses from prior years for LOB A would be available to offset current year LOB A income before applying any NOL carryforwards
- If there is still net income from LOB A after applying the LOB A suspended losses, then pre-reform NOLs would be taken first based on age up to 100% of net income
- Post-reform NOL deductions could be taken up to 80% of net income after suspended expenses deducted

Example #3B: Corporation from Example 2 with pre- and post-reform NOLs carried to 2020 and suspended losses from LOB B

- Net income or loss in 2020
    - Older LOB A – net income
    - Newer LOB B – net loss
- Application of Section 512(a)(6) limitations results in net income from LOB A and suspended loss from LOB B
- Prior years' suspended losses would not be available to LOB B in this tax year
- Pre-reform NOLs would be taken first based on age up to 100% of net income
- Post-reform NOL deductions could be taken since they are generated by LOB A up to 80% of net income

C. Expenses Not Attributable to a trade or business

1. Fringe benefit expenses related to Section 512(a)(7), if any allowed
2. Charitable contributions
3. Tax preparation and consulting fees related to UBTI in general but not to a specific line of business
4. State tax expense

To the extent these are not a "trade or business" they should not be limited by Section 512(a)(6).

It seems that they would not be able to be offset by suspended excess deductions from a trade or business.

It would seem that the expenses or deductions could be used to reduce overall taxable income and that this would happen after application of Section 512(a)(6); in other words, expenses or deductions could be used to offset any taxable income from UBTI silos that had net income. Consistent with historical tax reporting whereby current year activity is netted first, before applying NOL carryforwards, we would anticipate that these deductions are applied against UBTI before determining whether there is net income or net loss for the tax year for which NOL carryforwards could apply.

D. Transition & Penalty Relief

Tax-exempt organizations need transition and penalty relief while guidance is pending on interpretation of Section 512(a)(6) in order to give them adequate time to determine how the new aggregation rules will affect the organization's activities, to educate employees, and to establish record-keeping processes and systems to account for income and expenses in accordance with the guidance.

It is not clear at this point how the IRS will interpret and delineate between separate trades and businesses for purposes of Section 512(a)(6) of the Internal Revenue Code. While tax-exempt organizations are making good-faith efforts to identify a reasonable delineation, it is possible that

IRS guidance will require a shift in approach. As organizations compile documents and records of their various activities, transition relief for a period of time is crucial.

The IRS has recognized in many cases the need for providing transition relief, extension of due dates, and penalty relief. For example, Notice 2018-10 provided temporary relief to medical device manufacturers from the failure to deposit penalties imposed by Section 6656 in recognition of the short timeframe between the end of the moratorium period and the due date of the first return. Notice 2016-70 extended the due dates for certain information reporting requirements for 2016 imposed by the Patient Protection and Affordable Care Act under sections 6055 and 6056 in recognition of the fact that a substantial number of employers, insurers, and other providers of minimum essential coverage needed additional time to gather and analyze the relevant information and prepare the relevant tax forms. Notice 2013-45 provided transition relief for 2014 from information reporting requirements applicable to insurers, self-insuring employers, and certain other providers of minimum essential coverage under 6055, the information reporting requirements applicable to large employers under 6056 and employer-shared responsibility provisions under 4980H.

As recognized by the IRS in prior IRS notices (see Notice 2016-70), in implementing new information-reporting requirements, short-term relief from penalties is frequently provided and is appropriate to provide such relief with respect to guidance on Section 512(a)(6). Transition relief recognizes the challenges involved in developing new procedures and systems to accurately collect and report information in compliance with new reporting requirements. Relief is needed to provide additional time for input from stakeholders affected by changes in an effort to simplify information reporting consistent with effective implementation of the law (*see* Notice 2013-45). Transition relief is needed to provide stakeholders time to adapt reporting systems.

Recommendations:

1. Extend implementation and enforcement of Section 512(a)(6) for at least one year, preferably two years, following the issuance of guidance by the IRS and Department of Treasury.

2. To the extent implementation and enforcement of Section 512(a)(6) cannot be delayed, extend transition relief from penalties for underpayment of taxes under Section 6655 to tax-exempt organizations that can show they have made good-faith efforts to comply with the requirements under Section 6655 relating to estimated tax payments for unrelated business taxable income. Underpayment of taxes would not be assessed if the amount of payment (or calculation of no payment) was calculated based on the organization’s prior methodology for making payments.

III. Trust and Partnership Issues

A. Section 67 Miscellaneous Itemized Deductions

Tax Cuts and Jobs Act Section 11045(a) creates IRC Section 67(g) that suspends all miscellaneous itemized deductions in Code Section 67(a). This provision appears to be related to 2% itemized deductions for individual taxpayers. Code Section 67(e) states that trusts are allowed to take any costs paid or incurred in connection with the administration of the trust and would not have been incurred if the property was not held in trust.

Open issues:

Clarification is requested whether tax preparation, legal, and trustee fees are still deductible as expenses incurred despite the entity being a trust.

- For 990T purposes (against separate trade/business or generally)
- For IRC 4960 net investment income purposes of a private foundation

For tax-exempt organizations that are set up as a trust, there is now the limitation of 2% itemized deduction for individuals. But Section 67(e) clearly states that costs incurred that are directly connected to the administration of the trust would be deductible. As a result, it appears that items such as tax preparation and legal and trustee fees would still be deductible for either UBTI purposes or for Section 4940 purposes, as appropriate. But this needs clarification: these are items that we want to flag in order to give organizations and practitioners the tools they need to understand how they will be taxed and how they will be limited for net investment income tax purposes and UBTI purposes.

Further, it appears that the investment management fees are no longer allowed for trusts. Therefore, further clarification (within the form instructions) for Section 4940 purposes would be helpful because Section 4940(c) allows for the deduction of any expenses that are directly related to the earning of that net investment income. As a result, a private foundation that is organized as a trust has a disadvantage over one that is organized as a corporation if these individual limitations were to apply. Hence, if it is not addressed or clarified, this is something that would easily be overlooked by practitioners.

Absent a change in legislation, what we are trying to do is address the issues around items that are evidently part of the investment portfolios and expenses that go along with operating an entity. Thus, due to the individual tax law changes, tax-exempt organizations that are formed as trusts are being severely disadvantaged. While many tax-exempt organizations are organized as corporations, there are still a large portion of them out there that are organized as trusts and don't have any choice in terms of their legal structure. Hence, we suggest that the business trust rules would be helpful to allow these types of deductions for tax-exempt organizations formed as a trust.

B. Section 164 State and Local Tax Deduction

1. $10,000 Limitation

TCJA modifies the state and local etc. tax deduction rules of IRC Section 164 to limit the deduction of taxes under IRC Section 164(a)(1), (2) and (3) or Section 164(b)(5) to $10,000. However, the statute also provides for a deduction for purposes of a trade or business or for IRC 212 purposes. In addition, foreign real estate taxes appear to be carved out of the Section 164(a)(1) deduction for individuals (and, therefore, trusts).

Open issues:

- Clarification as to the applicability, if any, of the $10,000 limit on state etc. tax deductions. Specifically, are the following deductible in full against UBTI and against IRC Section 4960 net investment income, as applicable?
- Section 164(a)(1) provides for deduction for state and local, and foreign real property taxes.
- Section 164(a)(2) provides for deduction for state and local personal property taxes.
- Section 164(a)(3) provides for deduction for state and local and foreign income, war taxes and excess profit taxes.
- Section 164(b)(5) regarding general sales taxes.

Given that there is, in some cases, a $10,000 limit on state and local tax deductions, a tax-exempt trust may be disadvantaged by this limitation. Is this a technical error in the statute that would need a technical correction? With respect to further clarification on the form instructions regarding the UBTI and Section 4940, will the $10,000 amount have to be aggregated for the entire entity with a result of having the state and local taxes passed through on your K-1s also subject to these limitations? This makes the analysis for the K-1s even more robust and makes the siloing process even more complicated.

Additional discussion:

- Will the Section 212 exception to the limitation apply to state and local taxes passed through on partnership K-1s? And included in that UBTI silo (see separate discussion in the UBTI submission).
- Will state and local taxes associated with UBTI per se be unlimited as they are associated with a Section 212 or trade or business activity?
- It will be helpful to clarify these matters in the instructions to the 990-T and 990-PF regarding both unrelated business income taxes and regarding net investment income of private foundations.

2. Qualification as a business trust

Business trusts may not be subject to the potential $10,000 limit on the deduction of state, local and foreign income taxes and state/local real estate taxes, as well as the denial of miscellaneous itemized deductions. Investment manager fees, for example, are one category of common miscellaneous itemized deductions. Non-business trusts may be subject to these limitations.

Open issues:

- Are business trusts exempted from the individual limits on state and local taxes and miscellaneous itemized deductions?
- Under what circumstances could a private foundation be considered a business trust?
- Under what circumstances could a pension plan be considered a business trust?

The Act eliminated the deduction of miscellaneous itemized deductions and limited the deduction of state and local taxes generally to $10,000 for individuals. However, the statute treats trusts similarly to individuals for these provisions. We believe the intent in these limits are to prevent individuals from getting around the individual rules by using trusts. However, there is no specificity in these rules as to the type of trusts these rules apply to. As such, private foundations, pension plans, or voluntary employees' beneficiary associations ("VEBAs") that are trusts caught up in these deduction rules. Each of these organizations would then be precluded from deducting fees such as investment management fees, which seems to be a very harsh and perhaps unintended result.

As such, we considered whether these organizations could qualify as a business trust, presuming a business trust would not be subject to these limitations. Based on the current regulations, it is likely that organizations such as private foundations, pension plans, or VEBAs would not qualify to be deemed a business trust. In terms of fairness brought forth by the unintended consequence that applies to these types of organizations, we ask that IRS consider modification of the definition of a business trust to include the above-mentioned organizations, as well as other tax-exempt trusts — *assuming there are no unintended consequences of such classification*. The practitioners here are not experienced with business trust concepts (this is used in the private wealth realm).

If a business trust is not an appropriate solution to this issue for tax-exempt trusts, we ask that a legislative fix be provided for tax-exempt trusts specifically with respect to the denial of deduction of miscellaneous itemized deductions as well as limits on state and local tax deductions.

C. Section 199A Partnership Deduction

New Code Section 199A provides for a potential 20% pass-through deduction for taxpayers other than corporations. Some nonprofits and all pensions are trusts. These rules are quite complex and include a series of calculations of greater of lesser of calculations and then limits that may or may not apply depending on W-2 wage income. For purposes of allocating W-2 wages to trusts, the domestic production activities rules are referenced. Further, these calculations are performed at the taxpayer level, requiring pass-through entities to provide the necessary information. The pass-through entity may not be aware of whether the tax-exempt organization is a trust as its tax status is that of a tax-exempt organization. Further, the deduction is limited based on taxable income.

Open issues:

- A road map or calculator tool of how the deduction might apply to tax-exempt trusts would be very useful.

- Clarification if amounts within the calculation are solely those attributable to reported unrelated trade or business activities or to all activities of the pass-through entity since the amount of the deduction is in part limited by 20% of the adjusted taxable income.

- Clarification on how these calculations may be interrelated with the separate silo calculations for trade or business activities for UBTI purposes.

- Clarify whether the calculation of qualified business income is after the business interest expense limitations, as applicable.

Individuals and trusts (noncorporate organizations) will be able to take advantage of the new rules regarding qualified business income. Many of the tax-exempt trusts are going to be receiving this information from their pass-through entities. Therefore, there are many questions about how this new deduction is going to play out, especially with the UBTI siloing rules and how the trade or business is going to be interpreted. This new provision has multiple thresholds: a net business income threshold for the activity that would likely come through on the K-1s; an adjusted taxable income at the entity level (taxable income less the capital gains). This is an area that is difficult to visualize largely due to the fact that there are no guidelines for what constitutes a trade or business. Once we understand what constitutes a trade or business for purposes of Section 512(a)(6), we can then visualize what it means for a tax-exempt trust. However, a transition relief time period would be helpful in order to allow some time to go through the process. As a result, the qualified business income deduction will be an area that will need more attention and focus in order to better understand what it means in terms of a trust.

One helpful thing to think about is whether the definition of a trade or business—or any accompanying allocation rule—should either be the same or different for purposes of Sections 199A and 512(a)(6) provisions.

D. Business Interest Expense Flowing Through Partnerships

Business interest expense incurred within a partnership is limited at the partnership level that generates the interest expense in the tax year when the expense is incurred. Any excess business interest expense, though, is a carryforward and tracked at the partner level. With a tax-exempt organization, business interest may be incurred and generate unrelated business income but as the debt gets paid down, the private foundation partner may have less unrelated business taxable income and more of the partnership income that is excluded from UBTI but instead reported as net investment income. At point of sale of the investment, the private foundation partner may or may not have unrelated business income from the sale of the partnership interest.

Open issues:

Will the excess business interest expense ever be deductible against net investment income, or otherwise usable by the private foundation to offset taxable income?

E. § 55(d) Alternative Minimum Exemption Amounts

1. Application of Alternative Minimum Tax Exception for Trusts

The Tax Cuts and Jobs Acts temporarily increases alternative minimum tax exception for individuals. TCJA Section 12003(a) modifies IRC Code Section 55(d)(4) for the increases in the AMT exemption amounts for individuals, however the bill indicates that the exemption for trusts is "without regard to the substitution" for married filing joint of surviving spouse but does not refer to the exemption amount that appears in IRC Section 55(d)(1)(D) which is the current section applicable to trusts and estates.

- Is the AMT exemption amount for trusts $78,750 or $22,500?
- Is such amount then indexed for inflation?

While there are exemption amounts (for exempt organizations) that are stated in the statute (i.e., $78,750 (IRC Section 55(d)(1)(A)) or $22,500 (IRC Section 55(d)(1)(D)), it is unclear what the correct amount is to be applied to a trust, based on the vague language of the statute. The other inquiry with respect to the AMT lies within the realm of whether that amount is indexed for inflation.

2. Alternative Minimum Taxable Income and the UBTI silo and Passive Activity Loss ("PAL") rules

Based on our reading of the statute for the alternative minimum tax NOL deduction, it appears that the AMT NOL limitation is still 90% of AMTI. See Sections 55(b)(2) (Alternative minimum taxable income), 56(a)(4) (Alternative tax NOL deduction), and 56(d) (Alternative tax NOL deduction defined).

Further, the UBTI silo rules appear to refer to any NOL. Thus, it appears that the NOL applied for AMT purposes is limited to 90% of AMTI for that silo, and not 80% as is the case for regular tax purposes. This should be highlighted in the instructions for AMT for exempt organizations.

F. Interrelationship of Various Deduction Limitations

Trust deductions are limited in ways that do not apply to corporations. For example, trusts are subject to the passive activity loss rules, in addition to the UBTI loss limitations by trade or business.

Further, nonbusiness trusts may also be subject to the state, local and foreign income tax and state and local property tax deduction limitation of $10,000 and the denial of the deduction of miscellaneous itemized deductions. The interrelationship of the rules can be confusing.

Open issues:

- In what order are the various limitations applied and how do they interrelate?
- Business interest expense is limited at the entity level — so first to underlying pass-through entity with excess limitation available at partner level
- Passive activity loss limitations
- If applicable, there is a state, local and foreign income tax deduction limit of $10,000 (as some such costs may be included in K-1 income that is subject to the passive activity loss rules)
- Miscellaneous itemized deductions such as investment management fees
- Charitable contribution deduction (including pass-through vs. direct charitable contribution)

The PAL rules do apply for trusts, and so those limitations are already in place. But we will now have new layers of limitations, such as on state and local deductions and miscellaneous itemized deductions. The issue lies within the ordering of all of these various provisions and how they interrelate. For example, the PAL deduction would probably have to be one of the first steps in this analysis that needs to happen before going to the next level.

Another question: where does the charitable contribution deduction fall within the analysis? Tax-exempts have charitable contribution deductions that come through from their K-1s, but also that come directly from the charitable organization's handing out of grants to qualified organizations. How do these apply to the various business lines under the UBTI silo rules? This factor also fuels the argument that investments should be considered as one business activity, thus simplifying a lot of these provisions. If they aren't considered as one activity, and alternatively as separate activities, then organizations might even have to prepare a 990T for every K-1, generating an immense administrative burden with respect to the already complex trust process.

G. Partnership return instructions

K-1 Information for exempt organization partners:

Even before the TCJA, K-1s received by exempt organization partners frequently do not contain sufficient information for exempt partners to complete their returns. This is particularly true for partnerships that invest in lower-tier partnerships. In part, this is because the lower-tier partnership does not know that there is a tax-exempt organization up the chain.

Open issues:

- Partnership K-1s should be required to provide all information necessary for a tax-exempt partner to prepare his or her return both when the partner is an exempt organization as well as when the partner is a partnership (unless the partner definitively knows that there is no upper-tier exempt organization partner)
- This is particularly true for information for purposes of computing foreign tax credits.
- Consider whether to have two boxes for exempt organizations on K-1s – one for an exempt organization corporation and one for an exempt organization trust. There are more differences in the information needed as a result of the TCJA than in the past.

As practitioners serving tax-exempt organizations, the information that is needed to effectively and accurately file the tax return is not adequately given. Part and parcel of this issue is largely that there are a lot of fund-to-fund partnerships in the investment world. Therefore, when you look at underlying investments, it may be unknown that there is a tax-exempt partner that is up the chain, so the information may not be provided in order to perform the calculations and properly file the tax return.

For example for state UBTI purposes, we don’t often get UBTI information separate from the allocation of the whole partnership to identify our state UBTI. From a foreign tax credit perspective, we do not get the information we need to know to determine how much of the foreign source income or taxes are attributable to untreated business income.

With tax reform, there is now more information that we will need from the underlying partnerships in order to fully complete our returns. There are also some differences with respect to the information that is needed if you are a corporation or a trust. By way of example, based on the boxes that are checked on the K-1, there is a box for an exempt organization, but no other box that distinguishes between a corporation or a trust EO. Therefore, we suggest that the tax-exempt organization box on the K-1 be split into two boxes, accounting for the differences between a corporation and a trust.

Additional comments:

Central repository for K-1s:
Taxpayers that have a lot of partnership investments struggle with getting their K-1 information efficiently and completely. Each partnership has its own website to pull down a taxpayer's K-1, as well as different formats on each site. We realize this is not a short term effort, but it would be really helpful if there were a central repository for all K-1s to which partnerships post that then could be accessed by the partner using his or her EIN and unique password. In this way, considerable hours can be saved by taxpayers that have numerous K-1s to obtain.

Change in K-1 to have fields for all possible information:
Optical readers can mechanically read standard information and upload it into software. However, many K-1s do not have all the required information in the K-1 form itself, but instead bury much of the information in the footnotes to the K-1. While this can't be completely avoided, it could be significantly reduced by changing the form to have fields for all needed information (or a second page/table for UBTI related items). In this way, taxpayers and their return preparers could use today's technology to avoid all the manual input that is required. This would also improve accuracy.

K-1 instructional requirements:
Unless the form itself changes to be more inclusive of required information, we request that the K-1 instructions provide a list of the information required to be provided, particularly for special organizations such as tax-exempt organizations. Even though the instructions indicate that the partnership is required to provide all the information necessary for a partner to file his or her tax returns, that does not currently happen. In part, this is due to funds of funds where lower-tier funds do not know that there is an upper-tier partner that is tax-exempt, or chooses to assume that there is not. Making the instructions clear by listing what is required would help ease this problem.

Thus, we suggest that the K-1 instructions require partnerships to provide (include a list) all of the information an exempt organization would need to file its tax return, even if the partnership itself does not include any tax-exempt organization partners. An exception to this is if all the partners are individuals or the partnership KNOWS there are no tax-exempt partners up the chain. This might occur in closely held business structures, for example.

A suggested list to start for exempt organizations would include:

- Foreign source items specific to UBTI — not just in total for the return. These are necessary to determine foreign tax credits.
- Unrelated business income and related factors/adjustment items by state and local jurisdiction, as well as income in total by state
- Miscellaneous itemized deductions (for UBTI, vs. in total) and, separately, items that are ultimately determined to be deductible by a tax-exempt trust, or potential adjustments coded for a trust for limitations of

deductions such as state tax deductions that may be included in a different line item

- Identification of Credits in Line 15 that are related to unrelated business activities

- Amount of trade or business interest expense treated as Unrelated Business Income ("UBI") and any new breakout for UBTI for Section 163j applicability

- Required bifurcation of income by income categories rather than listing as only 20V, especially applicable for trusts that have different rates and rules for passive activities. Therefore, these taxpayers need to understand character of income/loss items as well

- UBI amounts for the new 199A deduction

- Use of numerical values instead of percentages when calculating UBTI for specific line items

- Listing of UBI amounts for depletion information for 17d, e, f and 20T.

IV. International Tax

A. Section 951A (GILTI)

- Section 951A (GILTI): The inclusion required by section 951A is not treated as subpart F income except (see section 951A(f)) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959 , 961, 962, 993(a)(1)(E), 996(f)(1) , 1248(b)(1) , 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D) , and 6655(e)(4).

- **Questions:**
- The list above does not include Section 512(b)(17). How will GILTI be characterized for a tax-exempt entity?
- Is it possible to apply past IRS precedents (are Sub F PLRs and rulings relevant?)
- Accordingly, the UBTI status of GILTI must be tested, but how?
- Corporate shareholders are allowed a 50% deduction; how would this be handled at the tax-exempt level and for reporting?

Issues for IRS Guidance:
Section 512(b) has an exclusion from UBTI for dividends and similar payments. It would be helpful to have Subpart F income GILTI classified as a dividend-like payment for purposes of

UBTI. The historic treatment of subpart F income as a dividend is in the legislative history, so having that clear in the guidance is helpful as then can relate to the 512(b) exclusion from income of dividends.

Updated Issues requiring clarifications

Is GILTI income subject to UBTI?

- Section 512 defines UBTI but doesn't take into account the new rules.
- While GILTI income is not Subpart F income, it is similar to Subpart F income (i.e., taxation of certain types of CFC income), so we are hoping that future Notices or Treasury Regulations will consider whether GILTI income will be excluded from the definition of UBTI.
- Suggestion: GILTI for tax-exempts can be addressed under 951A(f)(1)(B)
    - Exception: The secretary shall provide rules for the application of subparagraph (A) to other provision of this title in any case in which the determination of subpart F income is required to be made at the level of the controlled foreign corporation.
- Characterization of income can be addressed under this exception as to whether it should be treated as Subpart F and/or UBI. In addition, if this income is to be treated like UBI, then are only tax-exempt corporations allowed the deductions below? Trust versus corporation must be clarified when citing a tax-exempt entity. If GILTI has its own character and possible UBTI, then the deduction (cited below) should be allowed for tax exempts.
    - For taxable years of domestic corporations beginning after December 31, 2017, but on or before December 31, 2025, a domestic corporation is allowed a deduction equal to the sum (capped at taxable income) of 37.5% of its FDII, 50% of GILTI, and corresponding Section 78 gross-up. For taxable years of domestic corporations. beginning after December 31, 2025, the percentages are changed to 21.875% and 37.5%, respectively:

B. Section 59A: base erosion and antiabuse tax (BEAT)

- If a tax-exempt organization makes a deductible payment to a foreign affiliate (defined as 25% common ownership), such payment may be subject to the incremental minimum tax.
- No exception to this tax exists for tax-exempt organizations.

However, from a pure policy perspective, if the deduction is not giving rise to a tax benefit, the suggestion would be that the tax does not apply unless it was to a business line that generates UBTI.

C. Transition 965 tax reporting

Transition Inclusion

- Since the transition tax is considered and reported like Subpart F income, reporting may be an issue. Subpart F income has been reported by private foundations under the net investment tax calculation (NII). The Section 965 inclusion would be subject to the NII tax. The question arises as to how you do the computation and tax since it is separate. Like Subpart F being a component of the NII tax, it would be seem practical that the Section 965 inclusion would be treated similar to Subpart F income with respect to calculating the NII tax liability. Given this is part of the NII tax calculation, will the private foundation need to file the Section 965 statement? Clarification would be suggested with respect to the NII tax calculation, since the inclusion is a component of another tax calculation, and the statement should not be required.

- There appears to be a broader question in the PF's calculation of tax.

- Is the NII tax based on the gross or net Section 965 inclusion? It would appear that the PF would not be eligible for the participation exemption and would therefore be subject to Section 4940 excise tax on the gross E&P inclusion under Section 965(a)

- Disclosure related to gross and net Section 965 inclusion would be required from underlying partnerships that are passing on the transition tax liability to partners.

- Is it also a fair presumption that the PF cannot avail itself of Section 965(c) installment election for the payment of NII that results from subpart F inclusion? Section 965(h)(6) defines net tax liability under Section 965 as taxpayer's net income tax attributable to subpart F inclusion determined under Section 965

- If an exempt organization doesn't have to pay the transition tax (i.e., it is excluded as dividend), do they still have to prepare the Section 965 statement (and related calculations) or just add a statement to say that Section 965 has no effect on them? Given that the transition tax is similar to the Subpart F inclusions and Section 512(b)(17), and if there is no inclusion required; no additional data or statements are required besides the reporting of the Section 5471, if required under Section 6038. Clarification should be made that if there is no Section 965 income inclusion, no statement is required. At this point, the EO will base the reporting on how Subpart F is reported.

D. Administrative Burden of International Tax Forms

- For EOs in general. Due to diversified portfolio, many EOs have Section 926 and Section 8865 filing requirements. There is no UBTI-generated filing required, but there are many forms to complete and attach to a 990T.

Is it possible to carve out these filing requirements for these types of organizations?

- Now, a Section 5471 requirement with respect to the transition tax may also be due. It appears (based on the FAQ) that a Section 5471 might be required for each investment that has a Section 965 income inclusion that would be an administrative burden. If the partnership prepares the Section 5471 requirement can we have a carve out that removes the requirement for investors in the partnership particularly for those that do not have a 10% or greater interest?

- A tax-exempt entity organized under U.S. law is indeed a U.S. person, since it would be a U.S. corporation or trust. Thus, if a U.S. tax-exempt directly or indirectly owned more than 50% of a foreign corporation, then the foreign corporation would be a CFC.

- As for the tax-exempt investor, under the HIRE Act, every U.S. shareholder of a PFIC must now file a report with respect to the PFIC every year, unless the Service provides otherwise — IRC §1298(f) effective as of March 18, 2010

- Notice 2010-34

  "The Internal Revenue Service is developing further guidance regarding the reporting obligations under §1298(f). In the meantime, persons that were required to file Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund, prior to the enactment of §1298(f) must continue to file Form 8621 as provided in the Instructions to such form (e.g., upon disposition of stock of a PFIC, or with respect to a qualified electing fund under §1293). Shareholders of a PFIC that were not otherwise required to file Form 8621 annually prior to 18 March 2010, will not be required to file an annual report as a result of the addition of §1298(f) for taxable years beginning before 18 March 2010."

Treasury Regulation § 1.1298-1T(c)(1) provides that the exemption from Form 8621 reporting for tax-exempt entities does not apply if income from the PFIC would be UBTI. Assuming that everything in the portfolio is partially debt-financed, a portion of the income that it would produce is UBTI. Thus, this exemption from UBTI reporting is of no use to a tax-exempt investor. Therefore, even though there is not a current income pickup for the tax-exempt investor, he or she must file an 8621 if there is debt-financing. To reduce the burden of filing requirement if clarification could be made regarding tax-exempt investors, filing is only required when there is an inclusion, it would minimize the burden of filing blank 8621s.

V. Section 4968 College Endowment Excise Tax

- Does “tuition-paying students” mean “students who are charged tuition” or “students who in fact pay tuition?”

- Do “tuition-paying students” include those who receive financial aid?

- Does “tuition” include fees, room and board, and other payments that students make to colleges and universities?

- When is tuition considered paid with respect to calling a student a tuition-paying student (date paid, date billed, course start date, course end date)?

- Do “students” include those who attend an institution’s educational programs through distance learning and online courses?

- Does “student” only include students of programs described in Section 25A(f)(2), which is referenced for the definition of “eligible educational institution” for 4968?

- How should institutions determine whether more than 50 percent of the tuition-paying students of which are located in the United States? Is it by reference to the physical location of the school’s classrooms, or by reference to the residency of the students?

- What are assets used directly in carrying out the institution’s exempt purpose?

- The statute says that supporting and supported organizations of the college or university are “related.” How do we determine what portion of a supporting organization’s assets are used to support a college or university?

- How will the organization determine the amount of assets used in carrying out the organization’s exempt purpose? Will this be determined under principles similar to Regulation 53.4942(a)-2(c)(3)?

- Can assets and investment income be excluded from the calculation if the assets and income are not intended or available for the use in the organization’s educational activities? For example, assume that an organization operates a museum open to the public and, in the same legal entity, also operates a school that is an eligible educational institution. Can assets and investment income that are only intended and available for the museum’s activities and operations be excluded from the Section 4968 calculations?

- How are assets and investment income attributed to educational organizations from supporting organizations that support multiple educational institutions?

- Are assets and investment income from related organizations (including supporting organizations) included in the calculations if the assets and income are not intended or available for the use or benefit of the educational organization?

- Is income excluded from the excise tax to the extent that the income is subject to tax under Section 11 or Section 511?

- Timing and form of reporting and remitting of the tax. Presumably this will be a Part I tax on Form 4720 (used to pay Chapter 42 and 43 taxes, and this is in Chapter 42) due by the due date of the 990 (without extensions) if it follows the instructions for other Part I taxes and can be extended by Form 8868. There does not appear to be any requirement for estimates, which is good, particularly given the cliff nature of the tax (i.e., student No. 500 causes the tax to be due in full).

Definitional guidance:

- For purposes of Section 4968(b)(2), "students" include:
  - Only those students of an eligible educational institution who are enrolled for credit in programs described in Section 25A(f)(2).
  - Maybe this is best defined by reference to Section 25A(b)(3). If so, reference only Section 25A(b)(3)(A) and not the at least ½ time portion of Section 25A(b)(3)(B)? Or go for the whole definition
- For purposes of Section 4968(b)(1)(A) "tuition-paying students," regarding "tuition":
  - One potential definition is to use Section 472 of the Higher Education Act "cost of attendance." This would be easy, but would be broader than needed. It includes tuition, fees, books, etc.
  - Another potential is the concept of "family contribution" in Section 473 of the Higher Education Act
  - A better approach is to use the definition of "qualified tuition and related expenses" under Section 25A(f)(1)(A),(B),(C) as adjusted "for certain scholarships" by Section 24A(g)(2); will institutions have this information?
- For purposes of Section 4968(b)(1)(A) "tuition-paying students," tuition is considered "paid" by a student if:
  - Payment is received by the institution from the student or other individual (as opposed to another organization? What if it is a loan?)
  - Tuition is not considered paid solely because the student is billed for the tuition if the student is not ultimately responsible for remitting such payment.
- For purposes of Section 4968(b)(1)(A) "tuition-paying students," tuition is considered "paid" by a student if paid by the end of the taxable year for a course beginning in the taxable year. Other options would include:
  - Courses ending instead of beginning in the taxable year
  - Payments made during the taxable year
  - Considerations:

- What information will the institution have access to as to scholarships, etc.
- You wouldn't want to inflate numbers by potentially having payment in more than one taxable year for a course only occurring in one year
- You would want information that would be available by the time that reporting and remitting is required
- Would we want to except payments remitted to the institution that the institution reasonably believes to be scholarships or other assistance from other organizations (if so, only governmental and charitable ones or any other organizations), and would this include forgivable loans or only scholarships)?
- Would prefer to tie it to courses rather than payments, but it is ultimately thought a combination might be best.