Hot Tax Topics and IRS Update

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AGENDA

• The IRS in the News
• Obama FY 2014 Budget
• Joint Committee on Taxation Update
• IRS Fiscal Year 2013 Workplan
• College and University Compliance Report
• 2012 Form 990 Changes
• Allegheny County Triennial Review
The IRS in the News

- Tea Party/Patriots Exemption
- The Anaheim Convention
- Social Security Numbers Compromised
- The Root of the Problem
  - Funding?
  - Management?
Tea Party/Patriots Exemption

- Social welfare organizations exemption at issue
- BOLLO Lists
- White House/IRS National Office/Cincinnati
- Testimony, resignations and administrative leaves
- Systematic failures vs. coordinated political attack against conservative groups?
Tea Party/Patriots Exemption

- Technical issue: Difficulty of determining the appropriate level of campaign activity that applicants of 501 (c)(4) status could be engaged in
- IRC Sec. 501(c)(4) standard: “Operate exclusively” to promote social welfare
- Treas. Regs.: Require that 501(c)(4) organizations must be "primarily" engaged in social welfare.
- No quantitative test
Tea Party/Patriots Exemption

- Interim Solution
  - Expedited processing
  - Self-declarers
  - 40% politics threshold
- Justice Department criminal probe
- EO paralysis
The Anaheim Convention

- IRS Convention for Small Business/Self-Employed (SB/SE) Division’s All Managers Conference, August 2010
- Monies intended to fund hiring of enforcement employees
- $4.1 million price tag
- IRS policy disregarded
- Conference videos of $50,187 but no receipts
- Fifteen outside speakers $133,350
- Local IRS employees claimed $30,000 per diem
Social Security Numbers Compromised

• Explanation sought by Iowa Congressman Tom Latham [R-Iowa] for unauthorized public disclosure of up to 100,000 social security numbers

• Social security numbers associated with Section 527 political organizations

• Posted on government websites

Obama FY 2014 Budget

- Budget request of $3.778 trillion released on April 10, 2013
- Contains mixture of revenue increases and spending cuts
- Roll-back of estate and gift taxes to 2009 levels
  - Estates:
    - Maximum rate of 45%
    - Life-time exclusion of $3.5 million
    - No index for inflation
- Flat tax on private foundations 1.35%
- E-filing of all Form 990 series returns
Obama FY 2014 Budget

• Cap would limit charitable deductions at 28% for high-income tax payers

• Impact on Charitable Giving
  – Reduce charitable giving by 1.6% to 3%
    • Center on Budget and Policy Priorities
  – Gap between tax rates and charitable contributions will widen
    – The American Enterprise Institute predicts that the cap will reduce giving by 4.5% initially, settling in at 9%
Obama FY 2014 Budget

- Elimination of charitable contributions for conservation easements on golf courses
- Value related to donated preservation easements for foregone upward development limited
Joint Committee on Taxation Update

- May 6, 2013 report summarizing tax-reform suggestions
- Compiled by the House Ways & Means Committee’s Tax Working Groups
- Selected suggestions pertinent to EO’s
  - Repeal PF net investment income tax or revise rate structure
  - Expand application of debt-financed income rules beyond colleges and universities
  - Convert charitable deduction to a credit
  - Modify charitable mileage rate
  - Require churches to file Forms 1023 and 990
IRS Fiscal Year 2013 Workplan

• Significant highlights include:
  – Continuation of compliance checks
  – Final year of employment tax compliance project
  – International activities:
    • Examinations of organizations with high amounts of foreign grant expenditures.
    • Continued examination of “Gifts-in-Kind” programs
  – Historic UBI losses
IRS Fiscal Year 2013 Workplan

• FY 2012 Workplan
  – Compliance checks of 400 organizations that reported UBI on Form 990 but had not filed Form 990-T
    • Resulted in filing of 140 delinquent returns and more than $260,000 in additional tax revenue
  
• FY 2013 Workplan
  – Increased compliance checks of organizations reporting substantial gross UBI for three consecutive tax years but reporting no income tax due for each year.
Final IRS College and University Compliance Report

- Compliance project launched in 2008
- Questionnaires sent to 400 randomly selected private and public schools
- 34 colleges and universities selected for examination because their responses indicated potential noncompliance
- Final report released on May 2, 2013
Examination Highlights

• Unrelated Business Taxable Income ("UBTI")

• Reasonable Compensation

• Employment Tax Issues

• Retirement Plans
Definition of UBTI

An activity will be subject to unrelated business income tax if it meets **ALL** three requirements*:

• Trade or business
• Regularly carried on
• Not substantially related to exempt purpose of the organization

*Excluding statutory exclusions and modifications
Lack of Profit Motive

• UBI is generated by a “trade or business” only if, among other things, the organization engaged in the activity with the intent to make a profit
• A pattern of recurring losses indicates a lack of profit motive
• Nearly 70 percent of examined colleges and universities reported historic losses from UBI activities
• More than $150 million of NOL’s were disallowed
UBTI

Examinations resulted in:

• Underreporting of UBTI by 90% of colleges and universities totaling $90 million
• Over 180 changes to the amount of UBTI reported
• Disallowance of more than $170 million in losses and net operating losses (NOL’s)
• Potential aggregate tax assessment of $60 million
• The IRS disallowed nearly $19 million in NOL’s due to:
  – Improper calculations
  – Unsubstantiated losses
UBI: Commerciality Doctrine

• Nonprofit administrative services organization
  – Human resources
  – Finance/accounting
  – Electronic health records development
  – Management
  – Information technology

• IRS ruled provision of commercially available services, which constitute unrelated business to unrelated charitable organizations is not a charity activity (PLR201315027)
Reasonable Compensation

• Organizations may pay no more than reasonable compensation to their disqualified persons (IRC Section 4958)

• Section 4958 applies to private, but not public, colleges and universities, and imposes an excise tax on:
  – Disqualified persons
  – Those persons who approved the arrangement
Rebuttable Presumption or Not?

- 20% private schools used inappropriate comparability data
  - Similarly situated?
  - Base compensation versus total package not specified
  - Selection criteria for comparables and why appropriate comparables not documented in studies

- Schools must vet comparability data
Unreasonable Compensation

- Issue: Compensation for prior years’ service where the employee was underpaid
- Holding: Approach to compensation award process was permissible provided:
  - Employee was actually underpaid in prior years, and
  - Current payments were intended as compensation for past services
- Total compensation need not be reasonable in the year paid
Employment Tax Issues

• The IRS reviewed employment tax returns at about a third of the colleges and universities examined

• All of the completed exams resulted in wage adjustments, tax assessments and penalty

• Wage adjustments approximated $36 million

• Tax and penalty assessments approximated $7 million
Employment Tax and Retirement Plans

Deferred compensation adjustments attributable to:

• Lack of substantial risk of forfeiture
• Loans from 403(b) plans that exceeded limits
• Excess annual deferrals
• Increased wage adjustments totaling $1 million
IRS Next Steps

• Broad Review of UBI
  – Recurring losses
  – Allocation of expenses

• Remember, reasonable minds can differ
2012 Form 990 Changes

• Form 1099-K reporting
• Noncash pledges
• Schedule D funds
• Fundraising/Special Event revenue
Allegheny County Triennial Review

The General Assembly may by law exempt from taxation:

- Actual places of regularly stated religious worship;
- Actual places of burial;
- Public property actually and regularly used for public purposes;
- Property owned and occupied by any branch, post or camp of honorably discharged servicemen or servicewomen used for benevolent, charitable or patriotic purposes; and
- Institutions of purely public charity, but only that portion of real property actually and regularly used for exempt purposes.
The Pike County Case

- Mesivtah Eitz Chaim of Bobov, Inc. v. Pike County Board of Assessment Appeals, (Pa. Apr. 25, 2012), the Pennsylvania Supreme Court effectively repealed the IPPCA by mandating the application of the HUP test before the IPPCA
- This case resulted in a much more stringent standard for organizations to meet in order to qualify as Institutions of Purely Public Charity
- Local and county governments actively challenged the tax-exempt status of realty
- Warren County denied real estate tax exemptions for a YMCA and local hospital
- In 2013, Allegheny County performed its first triennial review of tax exempt parcels of real estate pursuant to a 2007 ordinance passed by County Council
Allegheny County Triennial Review

• In 2013, the Allegheny County Office of Property Assessments sent out 2,800 letters

• The response consisted of two elements:
  – An explanation of how the organization satisfied the five elements of HUP; and
  – How the parcel in question was used to further the charitable purposes of the organization

• To date, 20 parcels have been voluntarily added back to the tax rolls
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