

The logo for SC&H Group is centered on a dark blue square. The letters 'SC&H' are in a white, serif font, with the ampersand being smaller and positioned between the 'C' and 'H'. Below this square, the word 'GROUP' is written in a smaller, white, sans-serif font, spaced out.

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EXPERTISE THAT WORKS

Tax Update

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Tax Update from the IRS

COLLEGE & UNIVERSITY COMPLIANCE PROJECT

- Began in October 2008 with compliance questionnaires to 400 tax-exempt colleges and universities
- 34 colleges and universities selected for further examination
- 90% of examinations completed
- Final report published on April 25, 2013

COMPLIANCE PROJECT

- Emerging trend used by the Tax Exempt division of the IRS
 - Tax-exempt credit counseling organizations
 - Tax-exempt hospitals
 - Colleges and universities
 - Exempt housing counseling
 - Self-certified tax exempts
- Focuses on specific industries or a single issue
- Allows IRS to gain information on an entire industry at once
- Helps IRS identify common areas of potential abuse
- More focused audits

COMPLIANCE PROJECT

- IRS review and research of industry or area Questionnaires
 - By mail
 - Can be lengthy
 - Informational
 - Not required, but failure to complete can lead to an audit (13 schools did not respond to the questionnaire, all audited)
- Examinations
 - IRS on-site
 - Can result in revocation

RESULTS OF COLLEGE & UNIVERSITY STUDY

- Non-Compliance in Two Major Areas:
 1. Unrelated business income
 2. Compensation

UNRELATED BUSINESS INCOME

- Unrelated business income is:
 - A trade or business for the production of income
 - Regularly carried on; and
 - Not substantially related to the organization's exempt purpose
- IRS focused on activities that generated losses for a number of years and concluded that these activities were not carried on as a trade of business for the production of income

UNRELATED BUSINESS INCOME

- Organizations must pay tax on their net unrelated business income
 - Gross unrelated business income
 - Less expenses directly related to the unrelated business activity
 - Less net operating losses
- Organizations with too much unrelated business income can have their tax exempt status revoked

RELEASE OF COLLEGE & UNIVERSITY STUDY

- Increases to UBTI for 90% of colleges and universities examined
- Over 180 changes to amounts of UBTI reported by colleges and universities
- Disallowance of more than \$170 million in losses and net operating losses which could amount to more than \$60 million in assessed taxes

COLLEGE & UNIVERSITY – UBTI ADJUSTMENTS

- Disallowing expenses that were not connected to unrelated business activities
- Lack of Profit Motive
- Errors in computation or substantiation
- Reclassifying exempt activities as unrelated
- Majority of adjustments came from:
 - Fitness, recreation centers and sports camps
 - Advertising
 - Facilities rentals
 - Arenas
 - Golf

EXECUTIVE COMPENSATION

- The IRS focus of the college and university examinations with executive compensation was primarily with IRC §4958, which provides that public charities can not pay more than reasonable compensation to their disqualified persons. Disqualified persons include: officers, directors, trustees and key employees (“ODTKE”) and others in a position to influence the organization.

INTERMEDIATE SANCTIONS

- §4958 penalties
 - Disqualified person must return amount of excess benefit, and pay 25% excise tax on the excess benefit
 - Disqualified person also subject to excise tax up to 200% of the excess benefit amount
 - Excise tax of 10% on each ODTKE that approved the excess benefit
- Revocation of exempt status is possible

EXECUTIVE COMPENSATION

- The regulations under IRC §4958 provide a safe-harbor process for executive compensation. If this process is followed, the compensation is presumed reasonable. The burden of reasonableness of compensation shifts from the organization to the IRS. The IRS must determine that the compensation is unreasonable.

REBUTTABLE PRESUMPTION §53.4958-6

- Compensation arrangement is approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest with respect to the arrangement
- The authorized body obtained and relied upon appropriate comparability data prior to making its determination
- The authorized body adequately documented the basis for its determination concurrent with its determination

REBUTTABLE PRESUMPTION AUTHORIZED BODY

- The organization's governing body
- A committee of the governing body to extent allowed under state law to act on behalf of the governing body
- Or by other parties authorized by the governing body to act on its behalf to the extent allowed under state law by following procedures specified by the governing body in approving compensation

REBUTTABLE PRESUMPTION COMPARABLE DATA

- Third party comparable market data
- Compensation for similar levels in similar organizations, both taxable and tax-exempt, for comparable positions
- Consider availability of similar services in the geographic area
- Current compensation surveys by independent firms
- Written offers from similar organizations for individual or similar individuals

REBUTTABLE PRESUMPTION DOCUMENTATION

- Terms of compensation
- Date approved
- Members of authorized body present and documentation of who approved
- Comparability data and how obtained
- Documentation why compensation was higher or lower than comparable data

ISSUES NOTED IN COLLEGE & UNIVERSITY REPORT

- Comparability data was not “similarly situated” – location, endowment size, revenues, total net assets, number of students
- Compensation studies did not document the selection criteria of the schools used in the survey
- Compensation surveys did not specify whether all types of compensation were included in total compensation, as required by §4958

COLLEGE & UNIVERSITY EMPLOYMENT TAX ISSUES IDENTIFIED

- The IRS looked at employment tax returns for about a third of the colleges and universities examined
- All exams resulted in adjustments in wages, leading to assessment of tax, and, in some cases, penalties.
- Wage adjustments totaled about \$36 million, with taxes and penalties of over \$7 million
- Issues with retirement plan reporting resulting in increases of wages and assessment of taxes and penalties

COLLEGE & UNIVERSITY - WAGE ISSUES

- Failure to include in income the value of the personal use of automobiles, housing, social club memberships and travel
- Misclassification of employees as independent contractors
- Failure to withhold taxes for wages paid to non-resident aliens
- Failure to include in income the value of certain graduate tuition waivers and reimbursements

RETIREMENT PLAN ADJUSTMENTS

- Contributions taken into income in current year because payments were not conditioned upon future performance of substantial services sufficient to convey a substantial risk of forfeiture under IRC §457(f)(3)(B)
- Loans from 403(b) plans exceeded IRC §72(p) limits so that deemed distributions were included in gross income
- Deferrals for a 403(b) plan exceeded IRC §402(g) limits
- Additions to a 403(b) plan exceeded IRC §415(c) limits

GUIDANCE THAT APPLIES TO ALL TAX-EXEMPTS

- Answer any compliance questionnaires received by the IRS
- Review sources of income for potential unrelated business income
- Consider the volunteer exception and convenience exception for activities unrelated to the organization's exempt purpose
- Document reasons why or why not revenue streams are related or unrelated
- Evaluate realizability of any net operating loss carry-forwards
- Consider setting up taxable subsidiaries for significant unrelated business income activities
- Review compensation policies
- Review procedures for selecting comparability data for compensation
- Review employee/sub-contractor classifications
- Document, document document!

IRS COMPLIANCE – WHAT’S ON THE AGENDA

- IRS will be looking at organizations that report unrelated business income on Form 990 but have not filed a Form 990-T based upon Form 990 responses
- Statistically valid sample of organizations reporting substantial gross UBI for three consecutive years, but reporting no income tax due for any of the three years
- Additional guidance for IRC 509(a)(3) supporting organizations
- Using Form 990 Information on Compliance Efforts—being diverted for non-charitable purposes – Charitable Spending Initiative, Compensation Transparency, Political Activities and UBI

CHANGES TO 2012 FORM 990

- Revision of reporting for income from partnerships and joint ventures. Organizations may now report according to their books and records
- Expansion of information required for organizations that use management companies
- Additional reporting for Organizations that have significant other non-employee compensation (Form 990 Part IX, line 11g)
- Must now report average hours work for both the reporting organization and related organizations for officers, directors, trustees, key employees and highly compensated employees
- Clarifies that grants and other assistance to U.S. organizations or individuals designated for foreign organizations must be reported on Schedule F
- Expanded information required related to tax-exempt bond holdings

New Tax Guidance Impacting Non-Profits

NEW TAX GUIDANCE

- Proposed regulations that provide guidance to hospitals on the community needs assessment requirements under the Affordable Care Act
- Proposed regulations providing guidance to hospital's on their financial assistance policies and billing and collection policies
- Final regulations for Supporting Organizations
- Proposed regulations providing guidance on clarifying "minimum value" for health care reform's premium tax credit

Healthcare Act

HEALTHCARE ACT – SIGNIFICANT PROVISIONS

- Individual Mandate requiring coverage (2014)
- Low-income tax credits for participating in health exchanges
- Employer penalties beginning in **2015** for certain employers for not offering minimum health coverage to full-time employees
- Tax credits for small employers offering health coverage
- Increased age limits for dependent coverage in employer health plans
- Excise tax on high-cost employer-sponsored health coverage beginning in 2017
- Cost of employer sponsored health coverage included on Form W-2 beginning in 2012 (**delayed until further notice for organizations with less than 250 W-2s in prior year**)

HEALTH CARE ACT – SIGNIFICANT PROVISIONS (CONT.)

- Additional employer reporting responsibilities for health coverage (2015)
- Additional Medicare tax for high wage workers (2013)
- Surtax on unearned income (2013)
- Lower limit on health FSA contributions (2013)
- Restricted definition of medical expenses for employer provided coverage
- Increased tax on non-qualifying HSA or Archer distributions
- Modified threshold for claiming medical expense deductions (2013)
- Deduction for employer Part D is eliminated (2013)
- Patient-Center Outcomes Research Trust Fund fee for issuers of health insurance policies and sponsors of self-insured health plans(2013)

Employer Mandate

APPLICABLE LARGE EMPLOYER

- Generally 50 or more full-time employees in the preceding calendar year
- Full-time equals 30 hours per week
- Looks at full time equivalents so part-time employees are taken into account in the calculation
- Seasonal worker exception

PENALTIES

- Applicable large employer is subject to excise tax determined on A monthly basis if:
 - At least one full-time employee is certified to have received an applicable premium tax credit or cost-sharing reduction during the period, **and**
 - Either; (a) employer does not offer the opportunity to enroll in minimum essential coverage to its full-time employees and their dependents, or (b) the employer does offer such coverage but the coverage does not meet the affordability or minimum value requirements for certain individual employees

FAILURE TO PROVIDE MINIMUM HEALTH INSURANCE

- Penalty calculated monthly
- Calculated by taking the number of full-time employees less 30 and multiplying by \$166.67 per month (\$2,000 on a yearly basis)
- If employer fails to offer coverage any day of a month to a full-time employee, that employee is treated as not being offered coverage for the entire month
- Penalty will be indexed for inflation after 2014
- Penalty is not tax deductible

PENALTY FOR EMPLOYERS THAT OFFER MINIMUM ESSENTIAL HEALTH COVERAGE

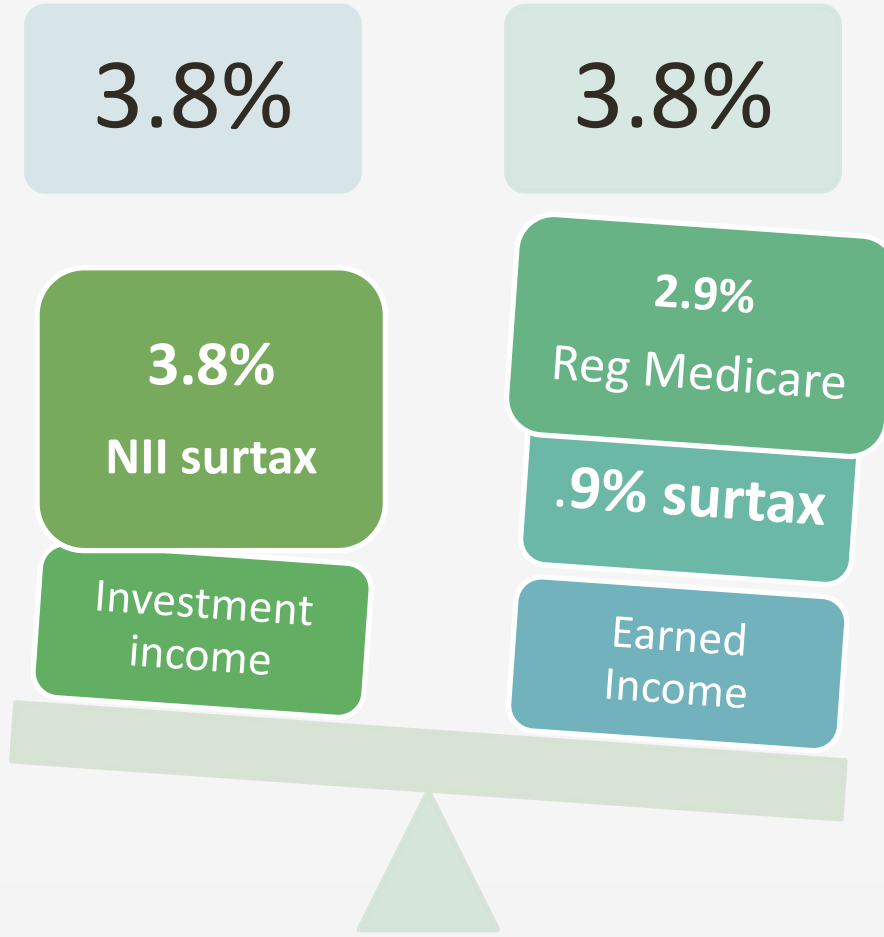
- Offers minimum essential coverage under a eligible employer-sponsored plan for any month to at least 95% of employer's full-time employees
- At least one full-time employee has been certified for that month in a qualified health plan offered through a Health Insurance Exchange and that employee is allowed an applicable premium tax credit or cost-sharing reduction is allowed or paid for the employee
- Penalty is calculated monthly and is not deductible
- Penalty is the number of full-time employees receiving a premium tax credit or cost-sharing subsidy for the purchase of health insurance through a state exchange for a month equal to \$250/month (\$3,000 yearly)
- Indexed for inflation after 2014
- Penalty not applicable if health insurance is affordable (less than 9.5% of individual's W-2)

Additional Medicare Tax for High Wage Workers

ADDITIONAL MEDICARE TAX

- Beginning in 2013, additional .9% tax imposed on taxpayers on wages and self-employment earnings in excess of :
 - \$250,000 for joint returns
 - \$125,000 for married taxpayers filing separate returns
 - \$200,000 for individuals, head of households
- Employer is obligated to withhold the additional tax on employee wages in excess of \$200,000.
- Employer is liable for the tax that it fails to withhold from wages or collect from the employee
- Employee is also liable for the additional .9% tax if not deducted and withheld by employer

MAGIC MATH



Excise Tax on Net Investment Income

SURTAX ON NET INVESTMENT INCOME

- Beginning in 2013, additional tax of 3.8% on individuals on the lesser of:
 - Net investment income or
 - Excess of modified adjusted gross income (“MAGI”) over the applicable threshold amount
- Threshold Amounts:

SINGLE & HEAD OF HOUSEHOLD	MARRIED FILING JOINT & SURVIVING SPOUSE	MARRIED FILING SEPARATE	ESTATES & TRUSTS
\$200,000	\$250,000	\$125,000	\$11,650

SURTAX ON NET INVESTMENT INCOME

- NII Includes Income From:
 - Interest
 - Dividends
 - Royalties
 - Annuities
 - Rentals
 - Passive Activities
 - Gains on Sales of Property (non-business)

SURTAX ON NET INVESTMENT INCOME

- NII Does Not Include:
 - Bullets
 - Wages
 - Social Security Benefits
 - Unemployment Compensation
 - Gains on sales of active businesses/assets
 - Distributions from qualified retirement plans
 - Income subject to self employment tax
 - Tax exempt income

NET INVESTMENT TAX (CONT.)

- Example One – Single individual with MAGI of \$175,000 and net investment income of \$50,000
no additional tax because not above the threshold
- Example Two – Single individual with MAGI of \$225,000 and net investment income of \$50,000 *net investment tax = 3.8% * \$25,000*
- Example Three – Single individual with MAGI of \$300,000 and net investment income of \$50,000 *net investment tax = 3.8% *\$50,000*

SURTAX ON NET INVESTMENT INCOME – PLANNING STRATEGIES

- Control Amount of NII
 - Tax Exempt Bonds
 - Annuities - for accumulation of income
 - Rental Real Estate
 - Oil & Gas Investments
 - Allocation of applicable expenses against income

SURTAX ON NET INVESTMENT INCOME – PLANNING STRATEGIES

- Maximize retirement plan contributions
- Increase participation in business enterprises to become active
- Generate passive activity losses to offset passive income (PIG/PAL)



CONTACT INFORMATION

Thank you for the opportunity to introduce SC&H Group.
Please feel free to contact us with any questions.

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POWERFUL MINDS
PASSIONATE TEAMS
PROVEN RESULTS

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