



# Tax Update for California Schools

The webinar will begin in a few moments

*NOTE: Participants will receive an email within 48 hours with a link to the slide deck and recording.*



# Learning Objectives



- **Assess** the direct and indirect impact of the Tax Act and other tax regulations on California schools.
- **Review** specific examples on how to keep your school in compliance.
- **Evaluate** reporting challenges for schools in 2020.



# PRESENTER

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## Martha Ambros

Executive Director, Cal-ISBOA

- Initiates and implements forward-looking programming to support sustained and steady growth in membership.
- Working closely with the Board, sets strategies, determines goals, and defines performance indicators.
- Develops and maintains effective internal and external relationships



# PRESENTER

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## Dean Quiambao

Partner, Armanino

- Provides unique benchmarking data and key financial operating ratios
- Enables clients to gain a distinct advantage over their competitors and brings to light where the best courses of action can be taken.
- Annual Speaker for Cal-ISBOA, NBOA, PAISBOA, and NAISBO
- Works with schools in CA, NJ, FL, TX, TN, HI





# PRESENTER

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## Katy Brown, CPA

Tax Partner, Armanino

- West Coast Nonprofit Tax Practice Lead
- BA from George Mason University (French) / MA from University of Arizona (French literature) / Master of Science in Taxation (MST) from Golden Gate University
- Member of AICPA, CalCPA, Washington Nonprofits & Center for Nonprofit Volunteerism & Leadership
- Board member of The Armanino Foundation and The Clifford Brown Jazz Foundation



# PRESENTER

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## Matt Petroski

Tax Director, Armanino

- Over 18 years of non-profit tax experience
- Past experience – 17 years at PwC in National Tax Services Exempt Organization Practice in Philadelphia and San Francisco. BA from University of Maryland (Finance)
- JD/MBA and LLM in Taxation from Villanova University
- Member of ABA Tax Section



# Agenda



1. Repeal of Parking & Commute benefits tax (YAY!!!)
2. UBTI
3. Compensation
  - + Common benefits and arrangements
  - + Executive compensation & excess parachute payments
4. Tax-exempt financing issues
  - + No more advance refunding of tax-exempt bonds
  - + Private Business Use
5. Section 529 plan funds may be used for K-12 tuition expenses
6. Schedule E Nondiscrimination policy disclosure changes & issues



# 1. Repeal of IRC 512(a)(7) Parking and Commute Benefits Tax



- President signed \$1.4 trillion spending bill on December 20, 2019 that included a repeal of IRC 512(a)(7).
- What you need to know
  - + Repeal is retroactive (enacted in Dec 2017, effective Jan 2018, repealed Dec 2019)
  - + Amended returns will be required to receive a refund of taxes/penalties paid
  - + Bipartisan support for this repeal
  - + Significant pressure from the nonprofit industry
  - + Never analyze your parking lots again





## 2. Unrelated Business Income Issues



### **Income/loss from different UBTI activities may not offset each other, including for NOL purposes**

- Section 512(a)(6) enacted with the TCJA in Dec 2017 for 2018 tax years and later
- Effective for tax years 2018 and later (FYE's beginning after Dec 31, 2017)
- Notice 2018-67 issued Aug 21, 2018
  - + Suggests using NAICS codes or maybe the first three digits to group activities – still no specific method required and no more specific guidance
  - + All partnership passthrough UBTI may be grouped (passive investment activities may be treated as one trade or business) if:
    - De minimus = 2% or less ownership
    - Lack of control = 20% or less ownership, no actual control



## 2. Unrelated Business Income Issues



### **Net Operating Losses are limited for tax years 2018 and later**

- Section 172(a) limits Net Operating Loss carryovers to 80% of taxable income
  - + NOLs generated in one UBTI activity will only be applicable to that activity
  - + Also subject to the 80% limitation
- Section 172(b) eliminates the two-year carryback provision
  - + All NOLs will carry forward 20 years
- Repeal of the corporate Alternative Minimal Tax
- Effective for tax years beginning after Dec 31, 2017 (2018 tax years)
- 2017 and earlier NOLs may apply to any/all UBTI revenue streams, but still limited to 80% of taxable income



## 2. Other Common Sources of UBI



- Advertising of any kind (consider qualified sponsorships)
- Passthrough UBTI on investment partnership K-1s
- Private business use of tax-exempt bond financed property
- Rental of facilities that includes significant services
- Rental of property other than real estate (personal property)
- Sales that are regularly carried on
- Gaming that is not a qualified raffle or qualified bingo



## 2. Reporting and Payment



### Report on Form 990-T

- New schedules to allow for siloing rules
- \$1,000 specific deduction

### Payment requirements

- Once you must make a payment of \$500+, EFTPS is required [eftps.gov](https://eftps.gov)
- 10 business days from online sign-up to ability to schedule online payments (48 hours to schedule phone payments)
- Quarterly estimate payments required if total amount due is \$1,000+



# 3. Compensation Issues



## Using compensation and benefits packages to attract and retain top talent

- Tuition remission plans – cannot discriminate in favor of executives or highly compensated employees
- Nontaxable housing – must be a condition of employment and have a significant business purpose
- 457(b) and 457(f) plans for executives
- Other nontaxable benefits





# 3. Compensation Issues



## Excess Compensation Excise Tax

- IRC Section 4960 – excise tax imposed on nonprofit employer
- Effective for tax years beginning after December 31, 2017
- Compensation in excess of \$1m paid to a "covered employee"
  - + Wages, less Roth contributions, plus 457(f) amounts vested
  - + Five highest compensated employees in any year after 2016
- Nonprofit corporations = 21% tax rate
- Consider 457 plan vesting events



# 3. Compensation Issues



## Excess Parachute Payments

- IRC Section 4960 – excise tax imposed on nonprofit employer
- Effective for tax years beginning after December 31, 2017
- Severance payments that exceed 3x the employee's average comp over the previous five years (the base amount)
- DOES NOT HAVE TO BE OVER \$1 MILLION!
- The entire amount in excess of the base amount is taxable
- Consider severance payments / arrangements (but not legal settlements)



## 4. Tax-Exempt Financing Issues



### **Changes to IRC Section 149(d) eliminate tax-exempt treatment of advance refunding bonds**

- Refunding = refinancing
- Advance refunding vs. Current refunding
- Eliminates an org's ability to receive refinancing funds in advance of paying off the original debt
- In line with current strict enforcement of use of tax-exempt bond proceeds & facilities financed with tax-exempt bonds



## 4. Tax-Exempt Financing Issues



### **Private Business Use (Section 150(b))**

Allowing a third party to use your financed-facilities in their own business purpose

- Compliance limitations – 5% over the life of the loan (and it includes costs of issuance taken from proceeds)
- Taxability of income – must be at least FMV; no deduction for interest paid on loan
- Debt vs. equity allocations must be done prior to construction taking place



## 4. Tax-Exempt Financing Issues



### Exceptions to Private Business Use

- Government or nonprofit use
- Renter uses facility on same basis as is available to the public (ex: teaching swim lessons at a public pool); arrangement must be limited to 200 days
- Incidental non-possessory use (ex: ATM, vending machine, cell tower)
- Temporary Use:
  - + Total term including renewal options is 100 days or less; would be “available to the public” on the same basis except that it’s too expensive (ex: stadium or airport runway); not primarily built for the external business use
  - + Total term including renewal options is 50 days or less; arm’s length negotiation at FMV; not primarily built for the external business use





## 4. Tax-Exempt Financing Issues



### **Arbitrage compliance**

Investment income earned in excess of the loan's interest rate must be paid back to the IRS

- + Must analyze every 5 years and pay any rebate due
- + Exceptions to rebate for spending loan proceeds quickly (for their intended exempt purpose)
  - 6-mo, 18-mo, 24-mo exceptions



## 5. Section 529 Plan Usage for K-12 Tuition



### ■ **IRC Section 529(c)(7) amended**

- + Special tax-advantaged savings programs
- + Some states allow pre-tax contributions or other tax incentives (not CA)
- + Originally only usable for qualified higher education expenses
- + Amended code allows up to \$10,000 per student per year to be withdrawn for K-12 tuition expenses
- + Schools receiving 529 funds as tuition payments do not need to do anything, and there is no reporting requirement for the school



## 5. Section 529 Plan Usage for K-12 Tuition



### IRC Section 529(c)(7) amended

- State conformity issues
  - + CA did not conform to remove the penalty on withdrawals for pre-college level expenses
  - + Tax penalty of 2.5% on the earnings portion, but not after-tax contribution amounts
  - + CA Bill AB350, introduced in Feb 2019, is the third attempt since 2015 to get a CA itemized deduction for contributions to a Section 529 plan (currently there is no deduction for federal or CA purposes), but it appears to be stalling out again



## 6. Schedule E Racial Nondiscrimination Policy



### Online posting of Racial Nondiscrimination Policy now meets the disclosure requirements

- Must be on the primary landing page and available at all times
- You must reasonably expect visitors to your homepage to notice it
  - + Consider size, color, and graphic treatment in relation to other parts of the homepage
  - + Is the notice unavoidable? Do other parts of the homepage significantly distract from it? Is it visible without a visitor having to do anything other than scrolling on the homepage?
  - + Specifically unacceptable:
    - A link on the homepage that takes you to another page where the policy is shown
    - A notice that appears in a carousel, in a dropdown menu, or by hover/mouseover



## 6. Schedule E Racial Nondiscrimination Policy



### Other requirements for Racial Nondiscrimination Policy

- Schools must state in their charter, bylaws, or other governing instrument, or in a board resolution, that it has a racially nondiscriminatory policy as to students and therefore doesn't discriminate against applicants and students on the basis of race, color, and national or ethnic origin.

#### **Notice of Nondiscriminatory Policy as to Students**

*The (name) school admits students of any race, color, national and ethnic origin to all the rights, privileges, programs, and activities generally accorded or made available to students at the school. It does not discriminate on the basis of race, color, national and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.*



## 6. Schedule E Racial Nondiscrimination Policy

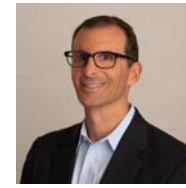


### Other requirements for Racial Nondiscrimination Policy

- Recordkeeping required if the same data is not already provided to a federal or state agency on at least an annual basis
- Must be kept for 3 years and be given to the IRS upon request
  - + Records indicating the racial composition of the student body, faculty , and administrative staff for each academic year
  - + Records sufficient to document that scholarship and other financial assistance is awarded on a racially nondiscriminatory basis
  - + Copies of all brochures, catalogues, and advertising dealing with student admissions, programs, and scholarships
  - + Copies of all materials used by or on behalf of the school to solicit contributions



# Final Reminders



- Taxpayer First Act (July 1, 2019) introduced mandatory e-filing of all Forms 990 and 990-T
  - 2 year transition for smaller nonprofits
  - 2 year transition for Form 990-T (not available yet)
- IRS is required to provide notice to organizations at risk of auto-revocation
  - + After an organization fails to file 2 years of Forms 990, the IRS is now required to send notification of the risk of auto-revocation
- Election Year reminder!
  - + 501(c)(3) organizations cannot campaign for or against any candidates for elected office – don't say anything about candidates
  - + Schools may attempt to influence the outcome of specific legislation, but it cannot represent a substantial part of their expenses





## Contact Us

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