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Exempt Organizations

Tax Law Changes for Exempt Organizations Raise Filing Concerns



By Robert Lee

Several tax law provisions for tax-exempt groups—including changes to unrelated business income and excise taxes—have prompted practitioner questions about potential revisions to forms and reporting requirements.

The biggest issue for the exempt organizations is how the Internal Revenue Service will modify Form 990, Return of Organization Exempt from Income Tax, to “implement the raft of new taxes” imposed by the 2017 tax act (Pub. L. No. 115-97), Alexander L. Reid, a partner at Morgan, Lewis & Bockius LLP, told Bloomberg Tax.

In particular, Reid said, he is curious about how the Form 990-T, Exempt Organization Business Tax Return, will be modified to implement the new law's changes to unrelated business income under tax code Section 512(a)(6) and 512(a)(7).

Section 512(a)(6) requires exempt organizations to report unrelated business income separately for each trade or business, and Section 512(a)(7) increases unrelated business taxable income (UBTI) by disallowed fringe benefits.

UBTI is income regularly generated by a tax-exempt group through a trade or business considered not substantially related to the group's charitable mission. Entities that are exempt can generate this income and become subject to the unrelated business income tax (UBIT).

AICPA Recommendations

The American Institute of CPAs offered 33 recommendations for revising the 2018 Form 990, filed by Section 501(c)(3) organizations, and its related instructions. Eighteen of the suggestions are considered of high importance and urgent, the group said in a May 7 letter addressed to IRS Exempt Organizations Director Margaret Von Lienen.

The recommendations include deleting terms and definitions from the glossary and certain sections in the instructions to reflect changes made by the new law. The terms include “endowment,” “permanent (true) endowment,” “SFAS 116,” “SFAS 117,” “temporarily restricted endowment,” and “FIN 48.”

The AICPA's Exempt Organizations Taxation Technical Resource Panel “did a thorough and highly detailed job not only in pointing out needed areas for improvement and refinement of the Form 990, but also in supplying the specific verbiage needed to effectuate the changes,” Jeffrey Tenenbaum, a nonprofit attorney with Lewis Baach Kaufmann Middlemiss PLLC in Washington, told Bloomberg Tax.

“The comments covered critical areas in need of attention, including donor-advised funds, endowments, disqualified persons, related-party transactions, the Uniform Guidance, retirement plans, and tax-exempt bonds, among others,” Tenenbaum said in an email. “Importantly, the AICPA's suggestions went well beyond accounting standards (which I particularly appreciate as an attorney) and dealt with issues involving consistency within the Form 990, clarity (including a strong push for needed examples), and cross-referenced external definition changes.”

Excise Taxes

Reid said he wonders how the new excise taxes on executive compensation and college endowments will be filed.

The law imposes a 21 percent excise tax on compensation over \$1 million per year paid to a nonprofit organization's five highest-paid employees, and a 1.4 percent excise tax on the net investment income of certain private colleges and universities.

One possibility is that they will be paid using Form 4720, Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code, which Reid called a “grab bag of excise taxes for different purposes with complicated instructions” and “different statutes of limitation periods.”

Snapshot

- Provisions spark questions about IRS revisions to forms
- AICPA offers 33 recommendations for Form 990

Alternatively, excise taxes on executive compensation may end up being paid on Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and college endowment excise taxes on an entirely new form, Reid said.

"Anyone who has had the unfortunate experience of filing a Form 4720 knows how buggy the system is. The machines regularly make errors such as failing to credit payments against a tax liability or crediting against the wrong account, charging interest and penalties against innocent parties, imposing liens that IRS agents can't easily remove, and generally running amok like the Sorcerer's Apprentice," Reid said. "I recommend scrapping the Form 4720 altogether and creating a series of new forms, one for each excise tax, with clear instructions that apply only to the tax in question."

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