

IRS releases college and university study final report

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In brief

The IRS has released its long-awaited final report summarizing its findings in its Colleges and Universities Compliance Project. The report details the findings of its multi-year examination of some of the largest and most complex organizations in the tax-exempt sector.

In detail

Background

In October 2008, the IRS sent compliance check questionnaires to 400 randomly selected public and private colleges that asked questions in the areas of compensation, unrelated business income, governance, and endowments. The IRS released an interim report in May, 2010 which provided an overview of questionnaire responses.

Based on questionnaire responses, the IRS identified 34 colleges and universities for IRS exam, and 31 of the 34 exams have closed. Aggregate results of these exams are incorporated in the final report. The audits focussed on unrelated business taxable income and compensation issues.

Unrelated Business Taxable Income

The IRS exams focused on unrelated business taxable income (UBTI) in part because of significant amounts of UBTI losses reported by colleges and universities. Examination results highlighted in the final report include:

- Increases in UBTI for 90% of the colleges and universities examined, totalling about \$90 million.
- Disallowance of more than \$170 million in losses and Net Operating Losses (NOL).

According to the report, the primary reasons for these adjustments were:

- Disallowance of expenses that were not connected to unrelated business activities, including losses claimed for activities that did not qualify as a trade or business due to

lack of profit motive, and improper expense allocation.

- Errors in computation or substantiation with respect to NOLs.
- Misclassification of unrelated activities as exempt.

The majority of adjustments came from activities such as fitness, recreation centers, and sports camps; advertising; facility rentals; arenas; and golf.

Executive Compensation

The examinations also focused on the practices and procedures used to determine compensation for the highest paid individuals of the colleges and universities, primarily with respect to the rebuttable presumption standard under IRC Section 4958. This provision only applies to private, not public, colleges and universities.

The IRS found that although most of the colleges and universities examined attempted to meet the rebuttable presumption standard, approximately 20% of schools failed to use appropriate comparability data in determining reasonable compensation.

Employment Taxes

In some of the examinations the IRS also reviewed employment tax and retirement plan reporting. The report notes that all of the examinations of employment tax returns resulted in adjustment of wages leading to the assessment of tax and in some cases penalties. The IRS also found problems with retirement plan reporting at about half of the colleges and universities where the plans were examined, resulting in increased wages and the assessment of taxes and penalties.

The takeaway

The IRS plans to continue to scrutinize unrelated business income reporting, including examining recurring losses and allocation of expenses, and employment tax reporting. In addition, the IRS will continue to encourage organizations to use appropriate comparability data when determining compensation through education and examinations.

Click [here](#) to access the college and university compliance project final report.

Click [here](#) to access the interim report issued in May 2010.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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