

HIGHER EDUCATION

A L E R T

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## REGULATORY FOCUS ON COLLEGES AND UNIVERSITIES IS INCREASING

By Marla K. Conley

In the last two weeks, both the IRS and Congressional officials announced major milestones in the increasing regulatory focus on colleges and universities.

First, the IRS emphasized misreported taxable income and employee compensation in its [Final Report from the IRS Colleges and Universities Compliance Project](#), released on April 25, 2013 (the “Final Report”).

Chairman Charles W. Boustany, Jr. (the “Chairman”), of the Subcommittee on Oversight of the Committee on Ways and Means (the “Subcommittee”), then announced that the Subcommittee would hold a hearing on the Final Report on Wednesday, May 8, 2013. In his comments announcing the hearings, the Chairman expressed great concern about alarming widespread noncompliance suggested by the Final Report.

This focus on colleges and universities follows reviews by the IRS of several other particular segments of the tax-exempt sector, which reviews often lead to increased regulations and oversight. For example, the IRS issued its [Final Report on its Hospital Compliance Project](#) in February 2009, after releasing an [Interim Report on the Tax-Exempt Hospitals and Community Benefit Project](#) in July 2007. Closely following this Hospital Final Report, the Affordable Care Act (the “ACA”) was enacted in March 2010, adding new requirements that hospitals must satisfy in order to be described in section 501(c)(3), as well as new reporting and excise taxes. The IRS has been working since the adoption of the ACA to revise the IRS Form 990 and the related Schedule H to allow hospitals to report the necessary information, resulting in an enormous administrative burden for both the IRS and the reporting hospitals.

Colleges and universities have been waiting for the Final Report since the related [Interim Report](#) was released in May 2010. The Final Report states that “[t]he multi-year project, begun in 2008, included a questionnaire sent to 400 colleges and universities and subsequent audits of 34 selected academic institutions. The final report focuses on the results of these examinations, especially in the areas of

unrelated business income and executive compensation.” Out of these 400 colleges and universities, “[t]he IRS selected 34 of the 400 for examination because their questionnaire responses and Form 990 reporting indicated potential noncompliance in the areas of unrelated business income and executive compensation.”

Examinations of these 34 colleges and universities demonstrated significant underreported, or misreported, Unrelated Business Taxable Income (“UBTI”), resulting in:

- Increases to UBTI for 90% of colleges and universities examined totaling about \$90 million.
- Disallowance of more than \$170 million in losses and Net Operating Losses (NOLs, i.e., losses reported in one year that are used to offset profits in other years), which could amount to more than \$60 million in assessed taxes.
- Over 180 changes to UBTI reported for 30 different specific activities, most of which were:
  - Fitness, recreation centers and sports camps
  - Advertising
  - Facility rentals
  - Arenas
  - Golf

The Final Report also raises questions about the approval of compensation for highly compensated employees. It states that, “although most private colleges and universities examined attempted to meet the rebuttable presumption standard, about 20% of them failed to do so because of problems with their comparability data.” In the details of the compensation analysis, the Final Report includes a myriad of data points for compensation paid to various levels of employees at each of small, medium, and large colleges and universities, although the Final Report is careful to note that this data does not represent a statistically valid sample.

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The Final Report notes other errors found in employment tax and retirement plan issues. It also provides data and analysis on endowment funds, which other critics have argued adopt unreasonably low spending rates. These critics seek to impose payout requirements on the endowments of colleges and universities similar to those imposed upon private foundations.

The Final Report and the Subcommittee hearings could have repercussions for both college and universities as well as other segments of the tax-exempt sector. The Final Report notes that its problematic UBTI and compensation findings could be indicative of misreporting across the sector. It suggests, therefore, looking at these issues more broadly. The Chairman also noted that the hearing would be “an excellent opportunity to discuss the results of the compliance project and examine areas for improvement in oversight, with an eye toward comprehensive tax reform.”

The upcoming Subcommittee hearing will likely affect the direction of further regulatory focus, and we encourage our clients to stay updated on the discussion. ♦

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*For more information about Schnader’s Higher Education Practice Group or to speak with a member of the Firm, please contact:*

*Marilyn Z. Kutler, Co-Chair  
215-751-2684  
mkutler@schnader.com*

*Marla K. Conley  
215-751-2561  
mconley@schnader.com*

*Jonathan R. Flora  
215-751-2347; 415-364-6727  
jflora@schnader.com*

*Barbara E. Little  
215-751-2458; 856-482-5758  
blittle@schnader.com*

[www.schnader.com](http://www.schnader.com)  
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