Tax Forum 2012

Joint Ventures and Alternative Investments: What You Need to Know

Rick Klee, University of Notre Dame
Mark Krcmaric, University of Notre Dame
Travis Patton, PwC LLP
Ron Schultz, PwC LLP

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1:15 to 2:30 pm
Agenda

• Introduction
• IRS perspective and background
  – UBI in overall tax reform
  – Recent IRS interest in UBI and international focus
  – Form 990 partnership and foreign investment reporting
  – Looking ahead
• Notre Dame and PwC perspectives
  – Due diligence on investment managers (tax covenants, side letters, etc.)
  – Communications between the Tax and Investment offices
  – What other schools are doing
  – Practical approaches to managing compliance
Agenda

• Panel conversation
  – Future outlook
  – Inter/intra agency government collaboration - Is it possible?
• Q&A with audience participation
UBI in overall tax reform

- Role of exempt organizations in a reformed federal income tax system
- Income from exempt activities
- Investment income
- Debt financed property rules
- C corporation blockers
- Offshore income
Testimony at July 2012 House Ways and Means Oversight Committee Hearing

• Deputy Commissioner Miller testimony
  – “Trade or business” and “regularly carried on” requirements are generally administrable
  – “Substantially furthers” requirement and expense allocation rules are difficult to administer

• Professor Columbo testimony
  – Eliminate “substantially furthers” requirement
  – Tax all income from a trade or business regardless of whether it furthers exempt purposes – e.g., fee for services
    • Hospitals and education
  – Resurrect commensurate in scope doctrine as originally intended

• Eve Borenstein testimony regarding Form 990, Schedules F & R
Recent IRS interest in UBI

- Overall Form 990-T reporting, nonfilers and number of entities reporting UBI losses
- College and university study (2008-present)
  - Types of activities with potential UBI exposure
  - Expense allocations
  - Profit motive and how to measure “profit”
  - K-1 investment income
  - Recurring losses in investment partnerships
- Section 512(b)(13) study (2006 mandate by Congress; study is pending)
  - Types of payments
  - Arm’s length nature of payments
  - Prevalence of controlled entity arrangements
IRS-wide international focus

• Commissioner Shulman set the tone IRS-wide at the beginning of his term nearly 5 years ago.

• Major international initiatives in his term include
  – Foreign bank accounts – unreported income and accounts including Offshore Voluntary Disclosure Initiatives
  – Transfer pricing and advance pricing agreements
  – Restructuring of IRS international operations
  – Global high wealth unit and focus on “enterprise” audits rather than single entity audits
  – Joint audits across taxing jurisdictions

• All IRS functions, including EO, were charged with exploring international enforcement and education/outreach initiatives
Form 990 matters

Historical overview of Form 990 reporting of partnership investments

• Based on books and records/financial statement reporting
• 2008 Form 990 redesign reporting regime retained this reporting regime
• Specific exceptions for Schedule H referring to Schedule K-1 items
2011 proposal regarding partnership investment reporting

- 2011 Form 990 instructions – depart from book reporting and follow K-1s for income and assets relating to partnership investments
- Generated significant comments regarding burden, impeding transparency, inconsistent reporting within the Form 990
- Ultimately made optional for 2011 tax years; pending further IRS statements regarding future of the proposal
- AICPA recently submitted comments suggesting it be made optional on a permanent basis
Form 990 matters

Schedule F reporting of investments

• General rules regarding reporting foreign investments
  – Threshold is investments valued at $100,000 or more
  – Information required to be reported
  – How to determine investment amount
• Reporting foreign investments by region
  – How to determine the region of the investment
  – Foreign investments held through domestic entity
• Investments through a foreign corporation
• Investments through a foreign partnership
• Additional reporting of foreign forms regarding funds flows and investments
Form 990 matters

Foreign investments – Potential reporting for 2011

- Form 926 transfers to a foreign corporation
- Form 3520 interests in a foreign trust
- Form 5471 ownership interest in a foreign corporation
- Form 8621 return by shareholder of a PFIC
- Form 8865 interest in a foreign partnership
- Form 5713 operations in or related to a boycotting country
Looking ahead – Things to watch for

- Final IRS report of college and university study of findings and any recommendations on what IRS learned
- Form 990 partnership investment reporting (2011 reporting proposal abandoned, modified or made optional permanently?)
- UBI as part of broader tax reform
- Continued focus on tax and nontax financial reporting of foreign investments by U.S. entities, including by exempt organizations
- Tangential impact – Section 501(r) and joint venture guidance
Joint ventures

- Rev. Rul. 98-15 and whole hospitals
- Rev. Rul. 2004-51 and ancillary joint ventures
- Notice 2011-20, Fact Sheet FS-11-2011 and Accountable Care Organizations
- Control of charitable aspects and UBI
- General no-rule position
Other reporting considerations

• Unique Reference Identification Numbers (URIs)
  – Forms 5471 (interest in foreign corporation), 8858 (information return with respect to interest in foreign disregarded entities) and 8865 (interest in foreign partnership)
  – Optional for tax years beginning in 2011, required thereafter

• Foreign Bank Account Reports (FBARs)

• Reporting of foreign accounts and assets
  – TIC Form SHC
Other reporting considerations

- State income tax reporting of UBI
  - General filing requirements
  - Determining states in which UBI is sourced and to be reported
  - Nexus
  - Allocation of expenses
Notre Dame perspective

Investment office due diligence

- Review of fund legal documents
- UBTI disclosures and expectations
- Side letter provisions to provide information
- Quality of fund auditors and legal counsel
- Review fund manager operations staff strength and depth
  - Implies tax compliance capability
  - Expressly discuss FCPA compliance due to recent enforcement focus and size of penalties/settlements
Inter-office communication

- Begins with tone at the top-2 VP’s who understand the importance of the reporting
- Annual gathering (typically June/July) of all members of both departments involved in the process (including data staff)
  - Review of prior year process-what worked well, what were challenges
  - Forms/instruction changes for coming year
  - Any data enhancements available to improve speed/accuracy of information communicated between Tax/Investments
- K-1 communication includes master lists kept by both departments
  - Tax spreadsheet is alphabetical, with an Endowment section and a (much smaller) Development section
  - Last year’s tax spreadsheet had over 42,000 data elements, including sections to track:
    - Federal UBI characteristics
    - Related supplemental form filing data
    - State information
    - Review and communication status
K-1 spreadsheet key attributes

- Federal UBI characteristics
  - UBI, ST/LT Capital Gain/Loss, Sec. 1231 Gain, Oil & Gas info., contributions and AMT items
- Related supplemental form filing data
  - Yes/No for each potential foreign and/or reportable transaction filing form (8621/5471/8865/8886)
  - Any data enhancements available to improve speed/accuracy of information communicated between Tax/Investments
- State information
  - Column for each state/highlighting states with no filing requirements
  - Reconciliation of “unsourced” income
- Basic demographic information, review & communication status
  - Formal LP name and EIN
  - Preparer/ reviewer check columns
  - Information outstanding (UBI, state information, reportable transaction information)
Notre Dame perspective

Investment office data tracking

- Exact legal name of fund entity, right down to commas and periods (to avoid confusion with similarly named entities created by the fund sponsor)
- EIN of entity (again to assure tracking of the right entity, a unique identifier)
- Jurisdiction of formation
  - For 990 attachments on foreign filings, only needed to divide the world into US and Non-US
  - With Schedule F, FRB-NY filings, track specific country
- Tax status of entity
  - Taxed as corporation = 926, 5471 possible
  - Taxed as partnership = 8865 possible
- Percentage ownership throughout the year
- Voting / non-voting ownership
- Cash contributions to the fund
- Whether the fund is a CFC or CFP
- Existence of AIVs, and then all the same info as outlined above
Three-way communication:
• Tax department
• Investment office
• Fund manager

Basics for K-1 management
• One principal K-1 contact in both Investments and Tax
• No time during the year that is not K-1 receipt time
• Most funds are calendar year end, and majority of them arrive by June 30, so it is easy to begin again as soon as PYE is done
• Last data not received typically until February (fund of funds)
• Quality of information received
• Streamlining how we receive the missing information
Notre Dame perspective

Special Considerations Regarding Foreign Investment Filings

- Challenges with percentage ownership
- Identifying foreign AIVs
  - Capital calls
  - Financial statements
  - K-1s
- All voting rights are not created equal
Process Considerations

• Investment office prepares Foreign Entity Schedule that lists all foreign investments including foreign partnerships and corporations.

• Tax department compares with prior year schedule, and:
  – If fund is no longer listed, verify that fund was closed during prior FYE.
  – If new fund, verify new investment during current FYE.

• Tax department compares foreign LP's listed on schedule with Schedule K-1's received
Process Considerations

- Foreign Entity Schedule lists fund name, investment begin date, entity classification (Corp, LP, LP taxed as corp), whether capital contributions were made, whether capital contributions exceeded $100,000 in current FY, whether ownership exceeded 10% or 50%.
- If capital contributions exceed $100,000, indicates 926 or 8865 is required to be filed.
- If over 10% ownership, carry fund to summary schedule for 5471 or 8865 to determine whether we are required to file under specific categories. This detailed analysis is performed with the Investment Office.
- Once filing requirements are known, follow up with Investment Office and investment managers is often required in order to gather information to prepare a complete form (CFC and CFP determination).
Reporting foreign activity

- Multiple initiatives related to foreign activity
  - Foreign activity 990 attachments – Forms 926, 8865, 5471 – constitute a large portion of return volume
  - Schedule F geographic regions of investments
  - FRB-NY filing series
    - BEA reporting offshoot
  - FBAR
  - FATCA compliance burden at fund level reduces investor return
Notre Dame perspective

Reporting foreign activity

• Coding of the same piece of information for different purposes
  – Foreign activity 990 attachments
  – Schedule F
  – FRB-NY filing series
  – Schedule R related entity reporting
  – Financial reporting issues

• Anomalies in required information
Notre Dame perspective

Other process considerations – the aftermath

• State considerations – What can happen after you start filing the return(s):
  – Deciding how many years to file
  – After the first filing, dealing with:
    • Notices
    • Extensions, and;
    • Estimates
  – Other potential consequences of state filing
  – State registration (DOR and/or SOS)
  – Charitable solicitation registration
• Hours and volumes
Notre Dame perspective

Other process considerations – the aftermath

• What can we work on as an accounting community?
  – Process concentrated in the hands of a few firms
  – Standardization could be a win/win-more efficient info processing by C&U member, less contact of partnerships and their accountants
  – Information that could be standardized:
    • Federal UBI
    • State information/apportionment
    • Oil and Gas-IDC and depletion calcs
    • Other-information reporting, etc.
  – Limitations:
    • Fund of funds = LCD
    • TE partner typically a small player (% ownership) in the overall investment pool-lack of leverage
Panel discussion

Possible topics

- Investment reporting on Form 990, particularly Schedule F
- Foreign information returns
- Joint ventures
- Dreaming big – Outlook for a simpler future
Q&A – Audience participation

Possible topics

- Are there any particular issues of concern or frustrations not already addressed?
- Are audience members dealing with compliance filing obligations internally or outsourcing compliance?
- What has been your experience with managers offering elections to use domestic blocker corporations? What are the pros and cons?
Your speakers

- **Rick Klee**, Tax Director  
  University of Notre Dame  
  (574) 631-3288, rklee@nd.edu

- **Mark Krcmaric**, Managing Director & COO, Investment Office  
  University of Notre Dame  
  (574) 631-3685, krcmaric.1@nd.edu

- **Travis Patton**, Partner  
  PwC LLP  
  (202) 414-1042, travis.patton@us.pwc.com

- **Ron Schultz**, Managing Director  
  PwC LLP  
  (202) 346-5096, ronald.j.schultz@us.pwc.com