



September 30, 2019

Ms. Janine Cook  
Deputy Associate Chief Counsel, Tax Exempt & Government Entities  
Internal Revenue Service

Ms. Elinor Ramey  
Attorney-Advisor, Office of Tax Policy  
U.S. Department of Treasury

Mr. Jeff Van Hove  
Senior Advisor, Office of Tax Policy  
U. S. Department of Treasury

Re: IRS REG-106877-18

Dear Ms. Cook, Ms. Ramey, and Mr. Van Hove:

On behalf of the National Association of College and University Business Officers (NACUBO) and the undersigned higher education associations, I am writing to offer comments on the [Notice of Proposed Rulemaking](#) (NPRM) regarding implementation of the excise tax on certain private colleges and universities imposed by section 4968 (84 FR 31795).

Enacted as part of H.R. 1 (commonly known as the Tax Cuts and Jobs Act of 2017, or TCJA), section 4968 of the Internal Revenue Code imposes a 1.4 percent excise tax on the net investment income (NII) of private educational institutions with at least 500 tuition-paying students, of which more than 50 percent of the tuition-paying students are located in the United States, and which have assets (other than those used directly in carrying out the institution's exempt purpose) of at least \$500,000 per student.

We remain strongly opposed to this tax. It is an unprecedented and damaging attack on the tax-exempt status of higher education institutions and their students. It will diminish charitable resources available for financial aid, research, academic support, public service, and innovation. As public charities and educational entities, colleges and universities dedicate their efforts and resources to the public good through education and scholarship. The NII creates a new tax liability for private institutions that, by definition, will reduce resources available to improve access and invest in scholarship.

As you develop final regulations, we urge you to please consider the following issues addressed in the NPRM and our recommendations.

NACUBO, founded in 1962, is a nonprofit professional organization representing chief administrative and financial officers at more than 1,900 colleges and universities across the country. NACUBO's mission is to advance the economic vitality, business practices, and support of higher education institutions in pursuit of their missions.

Today, we are writing to specifically draw your attention to our recommendations in the following areas:

- Considerations for attempting to treat institutions of higher education *identically*, rather than *similarly*, to private foundations for purposes of implementing section 4968;

- The exclusion of income derived from institutional student loans in the calculation of NII;
- The exclusion of housing payments from “rents” treated as NII;
- Removal of the proposed 1.5 percent safe harbor as a benchmark for cash that an institution may exclude from its non-charitable use assets in determining whether it is subject to tax; and
- Removal of the proposals requiring colleges to gather property basis information from donors of gifts of appreciated property as well as from partnerships.

## **COLLEGES AND UNIVERSITIES ARE NOT STRICTLY COMPARABLE TO PRIVATE FOUNDATIONS**

Law- and policy-makers have long sought to draw comparisons between private foundations and the endowments of higher education institutions. The NPRM takes this approach to an extreme, proposing to apply the rules for private foundations to colleges and university endowments, rather than proposing implementation requirements that reflect the structure, nature, and practical operation of college endowments. In the broadest sense, private foundations and college and university endowments both exist for the financial support of charitable missions. However, as regulators examine ways to implement the new excise tax, it is important to recognize that existing rules that work well for private foundations are not inherently suitable for colleges and universities.

Private foundations are typically funded and controlled by a small group of individuals or a single family and receive support from a limited number of sources. Many private foundations do not accept outside donations and instead choose to rely on investment income earned from the principal funding. Because private foundations are less open to public scrutiny than public charities, they are subject to a variety of restrictions and excise taxes to ensure that assets devoted to a charitable mission are used appropriately. Further, non-operating private foundations do not directly perform charitable programs or services; rather, they grant funds to outside organizations that advance causes the private foundation supports. The exempt status of private foundations flows from their financial support of charitable goals.

In contrast to private non-operating foundations, colleges and universities are tax-exempt entities because of the direct educational, scientific, and charitable activities they engage in – teaching students, performing research, and addressing problems affecting communities, states, and the nation. Like the activities of other public charities (and unlike those of private foundations), these activities are funded through various sources, including endowment payout, charitable gifts, tuition, sponsored research grants, and other sources.

Further, unlike private foundations that are required to disclose limited information on the Form 990-PF, private colleges and universities — through comprehensive reporting on the Form 990 — annually share detailed information about the institution, its governance, financial status, compensation structure, programs, and how donated funds are used. The volume of information reported on the annual return provides the general public a wealth of information about a higher education institution’s funding and operations.

There are profound structural differences between most private foundations and colleges and universities. A private foundation typically exists primarily to make grants to meet the founder’s charitable goals and a foundation’s funds generally remain under the control of the donor or donor’s family. In contrast, a university’s endowment is built through gifts from potentially tens of thousands of donors to form an array of investments pooled and managed to fund an institution’s financial aid, academic programs (instruction and research), community service, the campus physical plant, and other programs in perpetuity.

In terms of oversight, special rules in the Code were implemented governing private foundations and distinguishing them from public charities intentionally to impose oversight and accountability into a potentially insular, family-controlled environment. In contrast, college and university endowments are

typically overseen by a finance committee of the institution's governing board. Trustees, students, faculty, alumni, residents, and other institutional stakeholders are closely tied to an institution's actions and act to ensure that it manages its finances and activities appropriately. Trustees' decisions about prudent investing and endowment expenditures are also governed by their state's version of the Uniform Prudent Management of Institutional Funds Act.

For purposes of the new excise tax, the TCJA suggests that an applicable educational institution's NII shall be determined under rules similar, rather than identical, to the private foundation rules of section 4940(c). *As final rules implementing section 4968 are developed, we respectfully ask you to consider the inherent differences between foundations and institutions of higher education and promulgate guidance that reflects an understanding of how colleges and universities are structured, operate, and are governed.*

### INTEREST ON STUDENT LOANS

The rules of section 4940(c) specifically include student loan interest as NII of a private foundation. However, in the case of a college or university, the loans that the institution makes to its own students are in no way offered in the interest of making an investment in anything other than the student borrower who may need additional support to access and complete his or her studies. Making such a loan is in keeping with the college's primary exempt purpose of educating students. As the NPRM states, "student loans provided directly by an applicable educational institution to its students arguably can be viewed as a form of deferred tuition which will be paid when the student enters the workforce" and can therefore be distinguished from investment income.

Most, if not all, colleges and universities that provide institutional loans to students, do so at below the market rate of private loans. In addition, some institutional student loans are offered as a "loan of last resort" for students that aren't eligible for private loan programs and will typically feature relaxed eligibility requirements, as well as more flexible repayment options for borrowers than are available from private lenders.

The provision of loans by colleges and universities is a mechanism to help students fill gaps in their college funding, not to create investment returns. *We strongly urge you to exclude institutional student loan income from the calculation of the institution's net investment income.*

### TREATMENT OF HOUSING FEES AS INVESTMENT INCOME

While NACUBO recognizes the interest in keeping the rules associated with the NII excise tax of private colleges and universities similar to existing rules governing private foundations, fees for housing or dormitory for students should be excluded from the calculation of NII under IRC section 4968(c). Student fees for housing or dormitories differ significantly from traditional rents.

Rental income from investment property entails a landlord/tenant arrangement where the investor in the property is counting on a regular stream of income with an anticipated gain on the disposal of the investment property. There is a lease governing the arrangement, and tenants have certain rights under its terms.

Higher education institutions acquire or build student housing with an intent to house future generations of students rather than generate gain or income upon disposal. The sole purpose of dormitories is to further a student's education by immersing them into their academic life and facilitating the transition to independent adulthood. Many higher education institutions require (or at least strongly encourage) their freshmen and, sometimes, upper class students to live on campus. Residential life on campus in most

cases is designed to support students' success — academic, social, and sometimes spiritual — as well as their overall health and wellbeing. Student housing creates non-classroom opportunities for students to engage with individuals with a similar academic focus as well as those with diverse perspectives and backgrounds, which promotes development of social skills. This direct interaction facilitates learning, collaboration, community, and strong relationships.

Fees associated with dorms typically offset some expenses associated with the current dorm operations, such as maintenance, personnel, repairs, utilities, common facilities, technology, and security. Many institutions provide scholarships toward room and board or waive dorm fees for some students. Most institutions provide resident advisors on site available at all hours for students.

Typical residential rental agreements provide secure access to a specific location for the tenant's use provided by the landlord. The tenant has the right to continuous occupancy and use of the specified space over the term of the lease. In contrast, students sign up for housing but typically do not sign leases. They are assigned a space, within a room usually shared by at least one other individual, frequently a stranger. Residence halls and student apartments or houses are typically not available year-round, but only during academic terms. Housing space is contingent on enrollment at the educational institution, and students that withdraw from the institution must vacate their room. Guest access to student residences is often monitored or restricted. Finally, housing costs are generally not set based on market rates but on actual cost. Student housing is a critical component of most higher education institutions' educational mission and exempt purpose.

***Accordingly, we urge the exclusion of income from student housing fees from NII under IRC section 4968(c) and the corresponding assets (such as dorms, houses, etc.) should likewise be treated as assets used directly in carrying out the institution's exempt purpose for purposes of determining the institution's ratio of assets per student.***

#### **THE 1.5% OF NON-CHARITABLE USE ASSETS TO BE EXCLUDABLE FROM TAX**

The NPRM proposes a safe harbor providing that an amount equal to 1.5 percent of the fair market value (FMV) of the institution's non-charitable use assets will be deemed a reasonable cash balance treated as used directly in carrying out the institution's exempt purpose and therefore excluded in determining whether the institution's non-charitable use assets are equal to at least \$500,000 per student. We recommend that the safe harbor be removed. The safe harbor appears to be based on the private foundation rules for the calculation of the minimum investment return as described in Treasury Regulation section 53.4942(a)-2(c)(3)(ii)(e), which provides an exclusion for assets used (or held for use) directly in carrying out the foundation's exempt purpose, including the reasonable cash balances necessary to cover current administrative expenses and other normal and current disbursements directly connected with the foundation's charitable, educational, or other similar exempt activities.

Treasury Regulation section 53.4942(a)-2(c)(3)(iv) elaborates on cash held for charitable activities. The reasonable cash balances that a private foundation needs to have on hand to cover expenses and disbursements described in such subdivision will generally be deemed to be an amount, computed on an annual basis, equal to one and one-half percent (1.5%) of the FMV of all assets in a manner that appears similar to the proposed regulation's definition of an educational institution's non-charitable use assets. Treasury Regulation section 53.4942(a)-2(c)(3)(iv) goes on to provide a private foundation with the option to show that, based on all facts and circumstances, an amount in addition to 1.5 percent is necessary for payment of such expenses and disbursements, in which case such additional amount may also be treated as assets used (or held for use) directly in carrying out the foundation's exempt purpose.

The Treasury Department's preamble to the proposed regulations recognizes that differences exist in the section 4968 and 4942 rules and requests comments on whether a different percentage for determining a reasonable cash balance under section 4968 may be more appropriate.

Colleges and universities affected by the excise tax vary widely in size and focus. Some are expansive research institutions; some are small colleges; some have medical schools and teaching hospitals. Education delivery methods — drivers of operating expenses and corresponding cash outflow and timing — similarly vary. Some institutions, for example, may have a summer session with a lower attendance (therefore requiring less resources) as compared to their traditional fall or spring sessions. Accordingly, those institutions may have a lower cash balance at their fiscal year end which may fall in the middle of summer or as activities are winding down for the year.

While the 1.5 percent of non-charitable use assets limitation of cash treated as exempt use assets may be appropriate for a private foundation — essentially a grantmaking entity — this percentage would be unreasonably low for most educational institutions. Some institutions subject to the tax have noted that ratings agencies would downgrade their credit rating based on such a minimal amount of cash on hand.

Salary expense is typically one of the largest, if not the largest, operating expenses for most educational institutions, which would represent one category of operating cash outflows that are directly related to exempt purposes. Educational institutions must have faculties comprised of highly educated employees in order to fulfill their teaching and research missions. By comparison, private foundations rarely, if ever, require the volume of employees that colleges do to support their exempt purposes.

Not far behind the expense for an institution's human resources is the cost of operating an expansive physical plant. Unlike foundations, university facilities are comprised of multiple buildings and grounds, sometimes covering several square miles. In addition to classrooms, providing postsecondary education to students entails operating libraries, laboratories, dining halls, medical treatment centers, meeting spaces, art studios, theatres, gymnasiums and playing fields. Facilities planning, operations, and energy management is mission-critical at a college or university and on a scale that is simply not comparable to the physical operation of a private foundation.

Some higher education institutions have issued bonds for large, exempt purpose-driven projects. Proceeds from the issuance of bonds must be held in liquid assets until used for their intended purpose. In many instances, bond-financed projects are long term in nature, such as construction or renovation of exempt purpose use buildings. Therefore, this cash (including permitted liquid investment, such as Treasury bonds) should not be subject to the 1.5 percent limitation and should be considered related use assets regardless of their amount.

Following bond issuance, the institution must also make periodic payments to bond holders. Depending on the size of the bond issue, the bond holder payment can be sizable. Cash on hand for such payments should also be considered an exempt purpose asset.

***We recommend removal of the safe harbor and a regulatory approach that allows an institution's reasonable cash balance to be determined on a facts and circumstances basis, as permitted by the private foundation rules.*** This results in similar rules between private foundations and colleges and universities, and recognition of the structural, financial, and operational differences between the two types of entities, as well as the breadth of diversity amongst education institutions.

## **REQUIREMENT TO ACQUIRE BASIS INFORMATION FROM DONORS OF GIFTS OF APPRECIATED PROPERTY**

The preamble to the NPRM requests comments on whether a special rule excluding any appreciation in a gift of donated property that occurred before the date of receipt by the applicable educational institution should be included in the final regulations and how such a rule would be consistent with section 4968. We are generally concerned that a requirement to obtain basis information would have a chilling effect on gifts of appreciated property. In addition, for the following reasons explained below, a special rule should be included in the final regulations.

- 1) It is impractical, if not impossible, for colleges and universities to obtain the donor's basis in all donated property.
- 2) Institutions have no means to collect this information reliably, creating inconsistencies among educational institutions and uncertainty as to what type of documentation would be acceptable to support a basis determination.
- 3) Even without those hurdles, the administrative burden of obtaining donor basis is wholly disproportionate to the additional tax to be collected.
- 4) Tax on donated appreciated property erodes the value of the donation despite lack of investment intent on the part of the educational institution.
- 5) Finally, a special rule would not be inconsistent with section 4968's requirement that guidance be similar to section 4940(c) since an exception in section 4940(c) would not be necessary for private foundations.

Given the volume and types of donated property received by colleges and universities, it is impractical for an educational institution to obtain the donor's basis in all donated property. Most gifts of appreciated property are in the form of securities. There is no standard process in place for transferring ownership of securities. For instance, paper stock certificates can be transferred by simply delivering the certificate, whereas the process for transferring electronic stock shares varies depending on the brokerage company. Beyond the volume of gifts and this lack of a standard process, colleges and universities will be forced to rely on donors to provide information on their basis which will stress donor relationships and create substantial confusion around what is necessary and what is reliable. If solicitation of donor basis information is unsuccessful, the only options for the institution would be to reject and return the gift or to accept it and pay the excise tax on the full gain from the sale assuming a zero basis.

Since the tax under section 4968 has been imposed, donors have begun asking colleges about the impact of the tax on their donations. Institutions typically sell donated appreciated property upon receipt and use the cash received to fund operations. Typically, there is no intent for the institution to invest these funds further. Therefore, it generally makes little difference to the institution whether the donor provides cash or appreciated property.

Without a special rule for donated appreciated property, there will be reduced amounts available for the educational institution to spend on operations. A donation of appreciated property would be diminished by the amount of excise tax on the gain upon sale. Donors are keenly interested in how much of their donation supports the exempt activities of the organization. This tax cuts into the amount of the donation and reduces the value of that donation's ability to fund exempt activities, which is principally at odd with donors' intent when making gifts to exempt organizations.

A special rule would not be inconsistent with the statutory language of section 4968 requiring that the calculation of net investment income be similar to the rules under section 4940(c). Section 4940(c) provides that net investment income is determined under the principles of subtitle A except to the extent it is inconsistent with the provisions of section 4940. Section 4940(c) provides one exception to subtitle A in calculating the gain on property held by a private foundation before a specific date. This exception applies to a foreseeable scenario in which a private foundation would be subject to net investment income excise tax on the gain from the sale of a piece of property that it held prior to the enactment of section 4940. However, the scenario in which a private foundation would be subject to net investment income excise tax on the income from the sale of a piece of donated property could be avoided by the private foundation granting the property to a charity. Therefore, an exception to this rule under subtitle A (specifically section 1015) would not be necessary within 4940 since other means are available to the private foundation to reduce the tax. Additionally, the fact that an exception was provided in section 4940(c) for the calculation of gains on the sale of property owned by the private foundation lends support to the argument that, were there no other means to reduce the impact of the tax on the sale of property (donated appreciated property, in this case), an exception may have been included. Since there is no method for educational institutions to reduce the impact of the tax on donated appreciated property, a special rule would be warranted and not inconsistent with section 4968's mandate that NII is to be determined under rules similar to those under section 4940(c).

***We recommend that final regulations include a special rule excluding the gain on the sale of donated appreciated property from tax under section 4968.***

#### **REQUIREMENT TO GARNER BASIS INFORMATION FROM INSIDE PARTNERSHIPS**

The NPRM states that, for purposes of determining NII, the basis of an asset in a partnership (including through one or more tiers of partnerships) held continuously since at least December 31, 2017, will be not less than the FMV of such asset on December 31, 2017 (as subsequently adjusted under the general basis rules). The FMV of the institution's interest in the partnership itself is typically called the "outside basis" and the basis of the assets held by the partnership is typically referred to as the "inside basis." The outside basis and the FMV of an educational institution's interest in the partnership as of December 31, 2017, is obtainable. The inside basis of the partnership assets, on the other hand, is not readily accessible to the institution. The NPRM proposes to require institutions to obtain inside basis information from partnerships in order to substantiate the claim for a step-up in basis for assets held by partnerships. For many reasons, this requirement is not administrable in any meaningful manner and it may ultimately be impossible to obtain documentation with respect to such basis that has any degree of accuracy.

Colleges and universities invest in a wide variety of partnerships. Many of these partnerships have multiple tiers of partnerships and other vehicles through which they operate and invest on behalf of their partners. For discussion purposes, consider the following example.

Example: Educational institution invests in Partnership A. Partnership A has the following assets and investments:

1. Asset 1
2. Asset 2
3. Asset 3
4. Partnership B, which has the following:
  - a. Asset 4
  - b. Partnership C, which has the following:
    - i. Asset 5
    - ii. Partnership D, which has the following:

1. Asset 6
2. Partnership E, which has the following:
  - a. Asset 7
  - b. Partnership F, which has the following:
    - i. Asset 8

Each partnership must report its income and assets up to its partners. Thus, in the above example Partnership E reports information on its assets to Partnership D, which reports information received from Partnership E plus information on its assets up to Partnership C, and so on up to Partnership A. Partnership A then reports the consolidated underlying information received from Partnership B plus information regarding its own assets to the educational institution partner. The accuracy and level of detail in the information reported by each partnership can be expected to vary significantly based on the knowledge, preferences, and interpretations of the partnership personnel reporting the information. This structure creates impracticalities in requiring the educational institution to receive documentation from Partnership A on all the assets of the underlying partnerships, particularly the further down the tier they reside.

There is no specific method for supplying the basis information of underlying assets as of any specific date to partners. The rules for reporting partnership income and assets only require that the partner supply sufficient information for the partners to calculate income tax. This general rule creates a wide degree of variation on the extent of information each partnership supplies to its partners. Further, the partnership allocates the value of items among partners and there is a degree of flexibility in the allowable allocation methods. Generally, there are already existing inconsistencies in reporting partnership income among partnerships. A requirement to report inside basis would complicate things further and create even deeper inconsistencies and inaccuracies in reporting.

For instance, in the example above, Partnership E might report the FMV of an asset to Partnership D based on an estimate by the CEO and equally allocating the value to each partner, whereas Partnership C might obtain an independent appraisal of its assets and allocate value based on profit ownership of the partners. The ultimate information provided to Partnership A would be difficult to aggregate and by the time it gets to Partnership A may have been allocated in five different ways. Thus, even if the information could somehow be collected and reported, the clarity and value of the information would be diminished.

Further, a partnership would typically only supply information to a partner that is applicable to, or requested to be supplied by, that partner. This means that, in the above example, Partnerships B through F would not supply asset information to Partnership A as of December 31, 2017, because Partnership A is not an applicable educational institution. However, Partnership A would need to supply this information to its applicable educational institution partner. Therefore, Partnership A will need to request such information on behalf of its applicable educational institution partner(s) down to Partnership B, which would make another request down to Partnership C, and so on down through Partnership F. Most likely, this would all occur after Partnership A delivers its K-1 to the educational institution and the institution requests this information to complete its tax return. A partnership would not inherently be aware of the existence of the excise tax, nor would it know whether an educational institution is subject to the tax. Even if it knew about the tax, it would not be familiar with or necessarily prepared to adopt any unique new reporting obligations.

Finally, partnerships are not required to value assets at different dates, so providing the asset FMV as of December 31, 2017 for all assets may not be information that is readily available to the partnerships.

***We strongly recommend that the requirement that an applicable educational institution obtain documentation from a partnership in order to support a basis step-up for assets held by such partnership as of December 31, 2017, be removed in the final regulations.***

We are grateful for the opportunity to share our recommendations with you as you continue to develop guidance implementing the TCJA and welcome communication between our organizations as you continue to work on provisions affecting colleges and universities. Please contact Mary Bachinger, director of tax policy, at 202-861-2581, [mary.bachinger@nacubo.org](mailto:mary.bachinger@nacubo.org) or Liz Clark, vice president, policy and research, at 202-861-2553, [liz.clark@nacubo.org](mailto:liz.clark@nacubo.org).

Sincerely,



Susan Whealler Johnston  
President and Chief Executive Officer

On behalf of the following associations:

American Association of Medical Colleges  
American Council on Education  
Association of American Universities  
Association of Governing Boards of Universities and Colleges  
Association of Jesuit Colleges and Universities  
Council for Advancement and Support of Education  
Council for Christian Colleges and Universities  
Council of Graduate Schools  
National Association of Independent Colleges and Universities  
United Negro College Fund

cc: Hannah Hawkins, Deputy Tax Legislative Counsel, U.S. Department of the Treasury  
Victoria Judson, Associate Chief Counsel (EEE), Internal Revenue Service  
David Kautter, Assistant Secretary for Tax Policy, U. S. Department of the Treasury  
Amber MacKenzie, Office of Associate Chief Counsel (TE/GE), Internal Revenue Service  
Melinda Williams, Office of Associate Chief Counsel (TE/GE), Internal Revenue Service