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Analysis that matters from Washington National Tax

IRS Issues Proposed Regulations for University Excise Tax

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Tax reform created an excise tax on the net investment income of some private colleges and universities. Which educational institutions are subject to the new tax? How is net investment income calculated? Proposed regulations leave many difficult questions unanswered.

New section 4968, which imposes an excise tax of 1.4 percent on the net investment income of certain private colleges and universities and their related organizations, was added to the Internal Revenue Code by the law often referred to as the "Tax Cuts and Jobs Act."[1] On June 28, 2019, Treasury and the IRS released proposed regulations providing guidance on the new excise tax.[2] The proposed regulations generally address two issues: how to determine whether an educational institution ("EI") is an "applicable educational institution" ("AEI") that is subject to the tax, and, for those that are AEIs, how to calculate net investment income ("NII"). This article summarizes how the proposed regulations address these issues primarily through wholesale cross-references to the private foundation rules and the Higher Education Act of 1965 ("HEA"),[3] but leave many questions unanswered.

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1 *See* An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, Pub. L. No. 115-97, § 13701. Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code"), or the applicable regulations promulgated pursuant to the Code (the "regulations").

2 REG-106877-18, 84 Fed. Reg. 31795 (July 3, 2019).

3 Pub. L. No. 89-329.

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What Is an AEI?

Under section 4968, to be an AEI, an EI must meet the following criteria:

— It must be an "eligible educational institution" within the meaning of section 25A(f)(2) that is not a public institution described in section 511(a)(2)(B);

— It must have had at least 500 "tuition-paying" students during the preceding tax year;

— More than 50 percent of its tuition-paying students must be located in the United States; and

— The aggregate fair market value ("FMV") of its assets and those of certain related organizations at the end of the preceding tax year (other than assets used directly in carrying out the EI's exempt purpose) must be at least $500,000 per student.

Eligible Educational Institution

An "eligible educational institution," as defined in section 25A(f)(2), generally includes any accredited public, nonprofit, or proprietary college, university, vocational school, or other postsecondary educational institution that is eligible to participate in a federal financial aid program under Title IV of the HEA.[4] The preamble to the regulations notes, in essence, that Treasury assumes that these organizations know who they are.[5] However, public EIs described in section 511(a)(2)(B)—including those that are agencies or instrumentalities of any government or political subdivision, as well as those operated by any government agency or instrumentality—cannot be AEIs. The breadth of this definition could catch some EIs off-guard; for example, a medical school or nursing school affiliated with a large hospital system could be an AEI, and subject to tax, but may not think to check, since the tax has commonly been associated with large undergraduate institutions.

Tuition-Paying Students

The proposed regulations define a "student" as "a person enrolled in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an institution, and who is not enrolled in an elementary or secondary school."[6] The preamble explains that this definition "generally follow[s] the standard in section 484(a)(1) of the HEA," which defines, in part, which students are eligible to receive certain federal student aid and education tax credits. However, it does not explain why this should be the definition used for purposes of section 4968, except to note that the definition of an "eligible educational institution" came from this statute.[7]

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[4] Section 1.25A-2(b).

[5] 84 Fed. Reg. 31796. However, Treasury and the IRS request comments on whether further guidance is needed for purposes of applying section 4968.

[6] Proposed section 53.4968-1(a)(3)(i).

[7] 20 U.S.C. 1091(a)(1); 84 Fed. Reg. 31797.

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This definition applies both for purposes of the 500 tuition-paying student threshold and the $500,000 assets-per-student threshold—and while a lower number is better for purposes of the former, a larger number is preferable for purposes of the latter. The statute states that the number of students must be "based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis)."[8] And the proposed regulations indicate that "[t]he standards for determining part-time students, full-time students, full-time equivalents, and daily average are determined by each educational institution."[9] This broad discretion is limited only by a provision noting that the standards "may not be lower than the applicable standards established by the Department of Education under the [HEA]."[10]

The proposed regulations define "tuition-paying" to mean the payment of any tuition or fees required for the enrollment or attendance of a student for a course of instruction at an EI—but it does not include payments for supplies or equipment or payment of room and board or other personal expenses.[11] However, if the charges for the latter are bundled with the former, the student is considered tuition-paying.[12] The proposed regulations also provide that while scholarships provided and work-study programs operated directly by an EI are not taken into account as tuition payments, scholarship payments provided by third parties (even if administered by the EI) are.[13] The proposed regulations do not define "third parties" for this purpose, leaving open to question whether scholarships awarded by related organizations or federal grants and other student aid would be considered payments of tuition by third parties.

Located in the United States

The proposed regulations define the phrase "located in the United States" broadly, stating that a student is considered to have been located in the United States if the student resided in the United States for any portion of the time the student attended the EI during its preceding tax year.[14] The preamble provides an example of a student who is a foreign citizen being considered a student located in the United States if the student resided in the United States at any time while attending the EI.[15] The regulations do not, however, define what it means to "reside" or "attend" for these purposes, and it is unclear how this rule might apply to EIs with foreign campuses or to particular attendance arrangements between a United States EI and a foreign institution.

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8 Section 4968(b)(2).

9 Proposed section 53.4968-1(a)(3)(iv).

10 *Id.*

11 Proposed section 53.4968-1(a)(3)(ii)(A).

12 Proposed section 53.4968-1(a)(3)(ii)(B).

13 Proposed section 53.4968-1(a)(3)(ii)(C).

14 Proposed section 53.4968-1(a)(3)(iii).

15 84 Fed. Reg. 31797–31798.

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Fair Market Value of Assets per Student

To determine whether an EI has crossed the $500,000-per-student threshold, the EI must divide the value of its non-exempt-use assets by the number of students (defined the same as described above). The preamble to the regulations makes clear that whether a student is "tuition-paying" is irrelevant for purposes of determining the FMV of assets per student,[16] and the proposed regulations suggest that whether the student is "located in the United States" is as well.[17] In calculating the value of its non-exempt-use assets, the biggest question raised is the meaning of the phrase "assets which are used directly in carrying out the institution's exempt purpose"; i.e., those assets excluded from the relevant asset base. This phrase is not defined in section 4968. However, a similar phrase is used in section 4942, which generally requires private foundations to annually pay out five percent of assets not "used (or held for use) directly in carrying out the foundation's exempt purpose,"[18] and Treasury and the IRS "propose generally to follow" the regulations under section 4942—copying word-for-word in many instances.[19] Like those regulations, the proposed section 4968 regulations provide that:

— An asset is used directly in carrying out an EI's exempt purpose only if the asset is "actually used" by the EI in carrying out its purpose;[20]

— "Assets that are held for the production of income or for investment" are not assets used directly in carrying out the EI's exempt purpose, even if the income from the assets is used for that purpose;[21] and

— If the exempt use of an asset represents 95 percent or more of the total use, the property is considered to be used exclusively for an exempt purpose, while if the exempt use is less than 95 percent, a reasonable allocation between exempt and non-exempt uses must be made.[22]

The proposed regulations also lift five illustrations of exempt-use assets largely verbatim from the regulations under section 4942:

— Administrative assets used by the EI directly in the administration of its exempt activities;

— Real estate or the portion of any building used by the EI directly in its exempt activities;

— Physical property such as paintings or other works of art owned by the EI, which are on public display; fixtures and equipment in classrooms; research facilities and related equipment, which

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[16] 84 Fed. Reg. 31797.

[17] Proposed section 53.4968-1(a)(3)(i).

[18] Section 4942(e)(1).

[19] 84 Fed. Reg. 31798 (specifically referencing Treasury regulations section 53.4942(a)-2(c)(3)). Comments are requested regarding "whether the use of the principles of the section 4942 regulations for this purpose creates any concerns." *Id.*

[20] Proposed section 53.4968-1(a)(4)(i).

[21] Proposed section 53.4968-1(a)(4)(iii)(A).

[22] Proposed section 53.4968-1(a)(4)(i).

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under the facts and circumstances serve a useful purpose in the conduct of the EI's exempt activities;

— The "reasonable cash balances" necessary to cover current administrative expenses and other normal and current disbursements directly connected with exempt activities, with actual cash balances at the end of the year of up to 1.5 percent of the value of the EI's non-exempt-use assets being deemed reasonable;[23] and

— Any property the EI leases to other persons at no cost (or at a nominal rent) to the lessee in furtherance of the EI's exempt purposes.[24]

This last example is curious, because the same example in the section 4942 regulations also included property leased to others for a program-related purpose (without any restriction on rent), but the proposed regulations omit that part of the example without explanation.[25] This, combined with minor changes to the section 4942 examples that result in a blanket reference to "leased real estate" being a non-exempt use asset,[26] create some uncertainty regarding whether these are drafting oversights, or whether Treasury and the IRS intend that all property leased by an EI for more than nominal rent (including, for example, dormitories) should be treated as non-exempt use assets, regardless of whether they further the EI's exempt purposes.[27]

The proposed regulations also omit two other examples of exempt-use assets that are included in the examples in the section 4942 regulations: interests in functionally related businesses and interests in program-related investments.[28] Although there is no explanation for the latter omission, the preamble to the proposed regulations notes that Treasury and the IRS are unclear "how the concept of a functionally-related business would apply to an educational institution" and requests comments both on how EIs use functionally related businesses in conducting their operations and on whether examples of

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[23] The preamble notes that this 1.5 percent safe harbor was adopted "[f]or consistency with the 4942 rules," but requests comments on whether "another percentage or other measurement should be deemed to be a reasonable cash balance…." 84 F.R. 31798. It is reasonable to expect that the cash that a major operation like a university would need on hand to cover its administrative and operational expenses would be a much higher percentage of its non-exempt-use assets than the cash a typical private foundation would need. Accordingly, EIs should provide comments on what an appropriate safe harbor would be.

[24] Proposed section 53.4968-1(a)(4)(ii).

[25] *Compare* section 53.4942(a)-2(c)(3)(ii)(f) and proposed section 53.4968-1(a)(4)(ii)(E).

[26] The proposed regulations rearranged the presentation of the examples from the section 4942 regulations of assets that are not used directly to further exempt purposes, setting them out in a new paragraph surprisingly titled "Exceptions," rather than "Examples." See proposed section 53.4968-1(a)(4)(iii). The proposed regulations also alter the existing example in the section 4942 regulations that notes investment assets "generally" include leased real estate by omitting the word "generally." Compare section 53.4942(a)-2(c)(3)(i) and proposed section 53.4968-1(a)(4)(iii)(A).

[27] It seems unlikely that the proposed regulations, which the preamble notes generally follow the section 4942 regulations, would include such a significant departure from those rules without any explanation. Rather, where, as here, the preamble has no explanation of a change, perhaps it is more reasonable to assume that no significant substantive change was anticipated or intended.

[28] *See* section 53.4942(a)-2(c)(3)(ii)(d).

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these businesses should be included in final regulations.[29] The term "functionally related business" includes any business that is not an unrelated trade or business, as well as any activity (including an unrelated business activity) carried on within a larger set of activities that are related to the EI's exempt function, and it seems clear that colleges and universities have many such businesses.[30] Therefore, EIs should provide Treasury and the IRS with relevant examples that could be included in the final regulations. In addition, although the term "program-related investment" is defined and technically only applied in the private foundation context in the Code,[31] the Form 990 requires other exempt organizations, including EIs, to report program related investments (i.e., those made primarily to further exempt purposes, and without a significant profit motive) on their annual returns. Thus, some EIs may treat and report low-interest student loans and other investments made to further educational or other exempt purposes as program-related investments, and the examples of exempt-use assets in the final section 4968 regulations should also capture these investments.

The proposed regulations differ from the section 4942 regulations in a couple of other notable respects. First, there is no allowance for assets that an EI plans to put to an exempt use reasonably soon, but not immediately. These assets are excluded from the non-exempt-use asset base under the private foundation regulations,[32] but are absent from the proposed regulations, presumably because section 4960 does not explicitly state that assets "held for use" in the EI's exempt purpose should also be excluded.[33] However, just as it is reasonable in the private foundation context to treat assets intended for an exempt use and held for a limited period of time (generally less than one year) while arrangements are made for their conversion, so here it would be reasonable to interpret 4968 to treat such assets as used directly in carrying out an EI's exempt purpose, whether or not explicitly directed to do so by the statute. Second, the proposed regulations say nothing of pledges and contributions receivable or other types of assets that, under the section 4942 regulations, are also excluded from that non-exempt-use asset base.[34] These may be significant assets for EIs, but because they are not mentioned in the proposed regulations, it is unclear whether the omission was an oversight or intentional—or whether Treasury and the IRS intended more generally that the section 4942 rules, with reasonable modifications, would provide answers to many questions left unaddressed by the proposed regulations.

Finally, for valuation of non-exempt-use assets, the proposed regulations direct EIs to use the regulations under section 4942 and to make reasonable and necessary adjustments to value assets as of the last day of the preceding tax year, as required by the statute, rather than at the times permitted or required by those regulations.[35]

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[29] 84 F.R. 31799.

[30] *See* section 53.4942(a)-2(c)(3)(iii).

[31] *See* section 4944(c).

[32] *See, e.g.*, section 53.4942(a)-2(c)(3)(i).

[33] *See* 84 F.R. 31798 (noting the intent for the proposed regulations to generally follow the section 4942 regulations "without regard to provisions relating to private foundation assets 'held for use'").

[34] *See, e.g.*, section 53.4942(a)-2(c)(2)(iv).

[35] Proposed section 53.4968-1(a)(4)(iv) (citing section 4942(e) and section 53.4942(a)-2(c)(4)).

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Related Organizations

In identifying the EI's non-exempt-use assets, the statute provides that assets of "related organizations"—those that control or are controlled by the EI; that are controlled by persons that also control the EI; or that are supporting organizations of the EI—are generally to be treated as assets of the EI, with two exceptions.[36] First, no amount is taken into account with respect to more than one EI. Second, if the related organization is not controlled by or a supporting organization to the EI, then only those assets intended or available for the use of the EI must be included, and the allocation must be "made in a reasonable manner, taking into account all facts and circumstances, and must be used consistently across all related organizations."[37] And notwithstanding that the statute provides no obvious relief for supporting organizations of EIs, the proposed regulations helpfully expanded this ability to allocate assets to include supporting organizations that were "Type III" supporting organizations ("Type III SOs") to the EI as of December 31, 2017.[38] The proposed regulations further provide that using the percentage of the Type III SO's total net income that was distributed to the EI to calculate the value of the Type III SO's underlying assets that are intended or available for the use and benefit of the EI each year will be deemed reasonable.

For determining an EI's related organizations, the proposed regulations define "control" by borrowing from section 512(b)(13) and the associated regulations, a provision that taxes certain otherwise excludable interest, rents, royalties, and annuities paid by controlled subsidiaries to their tax-exempt parents to the extent the payments reduce the subsidiaries' taxable income.[39] Following those regulations, with respect to stock corporations, partnerships, and trusts, the proposed regulations define control as ownership (either directly or indirectly by applying the principles of section 318) of more than 50 percent of an entity's stock (by vote or value), profits or capital interests, or beneficial interests, respectively. In the case of nonstock organizations (including governmental entities), control means that either: (1) more than 50 percent of the directors or trustees of the EI or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity; or (2) more than 50 percent of the directors or trustees of the nonstock organization are either representatives of, or are directly or indirectly controlled by, one or more persons that control the EI. For these purposes, the proposed regulations indicate that a "representative" means a trustee, director, agent, or employee, and control includes the power to remove a trustee or director and designate a new trustee or director.

This definition of control is exceedingly broad as applied to nonstock organizations. Under this definition, a nonprofit organization started by two university professors who constitute two of the nonprofit's three board members would be considered "controlled by" the university and the nonprofit's assets would automatically be considered assets of the university. The proposed regulations offer no

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[36] Section 4968(d). In addition, the statute provides that supported organizations of an EI are related organizations. However, as it would be unusual for an EI to be a supported organization of another EI, this article will not address the potential implications of that relationship.

[37] Proposed section 53.4968-1(c)(2)(ii)(B)(2).

[38] Proposed section 53.4968-1(c)(3)(ii).

[39] Proposed section 53.4968-1(c)(1); section 1.512(b)-1(l).

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justification (and cite no authority) for adopting such a far-reaching definition of "control" in this entirely different context.

Finally, although the preamble recognizes that an EI may already include its ownership interests (e.g., stock) in a controlled taxable entity in its non-exempt-use asset base, such that requiring the EI to include the assets of the taxable entity in its non-exempt-use asset base as well could result in double counting, the proposed regulations contain no exception for controlled taxable entities and the preamble requests comments on "how to account for this difference without double-counting the assets."[40]

What Is Net Investment Income?

Section 4968 defines NII only by stating that it "shall be determined under rules *similar to* the rules of section 4940(c)."[41] Section 4940(c) defines NII for purposes of the excise tax on NII earned by private foundations as "gross investment income" plus capital gain net income, less deductions for related expenses and less any such income that is unrelated business taxable income ("UBTI"). Unlike private foundations, however, section 4968 provides that NII of any "related organization" with respect to an AEI is generally to be treated as NII of the AEI (see discussion of related organizations above).[42] Specifically, NII of a related organization is included in an AEI's NII on the same basis, and to the same extent, as assets of related organizations are taken into account in calculating the $500,000-per-student threshold. In defining NII for purposes of section 4968, the proposed regulations do little but cross-reference the section 4940(c) regulations with minor modifications, again largely failing to take into account the significant differences between the operations and sources of income of a college or university and those of a private foundation. They also fail to recognize the many ways investment activity has changed over the nearly 50 years since the regulations under section 4940 were issued—in particular, the increase in investment activity conducted through partnerships.

Gross Investment Income

"Gross investment income" includes the gross amount of income from interest, dividends, rents, royalties, payments with respect to securities loans, and similar sources, but does not include interest from tax-exempt bonds or any UBTI.[43] Because neither the section 4940 regulations nor the proposed regulations define income from similar sources (a relatively recent addition to section 4940(c)(2)), there is some ambiguity regarding inclusion of certain kinds of income.[44] Surprisingly, the proposed

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[40] 84 Fed. Reg. 31801.

[41] Section 4968(c) (emphasis added).

[42] Section 4968(d).

[43] Section 4940(c)(2), (5).

[44] The reference in section 4940(c)(2) to income from similar sources was added to the Code by the Pension Protection Act of 2006. Pub. L. No. 109-280, § 1221(a)(1). The regulations under section 4940 have not been updated to reflect this change, though the relevant Joint Committee on Taxation explanation describes such "similar" items as including "income from notional principal contracts, annuities, and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner." *See* Joint Committee on Taxation, Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," (JCX-38-06), at 321-322 (August 3, 2006).

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regulations do not deviate from the regulations under section 4940(c) to exclude income from charitable activities.[45] Thus, gross investment income could encompass much more than just income from endowments, as many AEIs may have been anticipating. Examples of income that AEIs could have to include in NII include interest on student loans, rents from dormitories and faculty housing, rents from leasing university facilities for various events, and royalties earned from research activities, college athletics, and use of a school's name and logo.[46]

The preamble requests comments on whether "specific types of income should be excluded" from NII and asks commenters to explain why the specific characteristics of the income would "warrant deviating from the rules provided in section 4940 and the regulations," which seems to reveal Treasury's default assumption that the rules drafted for private foundations, which typically have little, if any, income from charitable activities, should nevertheless generally apply to colleges and universities.[47] Even if including income from exempt-use assets within section 4968's ambit would not significantly increase NII after all expenses allocable to such income are deducted, the inclusion will undoubtedly increase the administrative burden of tracking income and allocating expenses.

Capital Gain Net Income

Section 4940 and the related regulations state that capital gain net income consists of capital gains less any capital losses, with no capital loss carryovers or carrybacks and no ability to use excess capital losses against gross investment income in the same taxable year.[48] AEIs may be surprised to find that capital gain net income may include not just gains and losses from the sale of investment assets, but also "capital gains and losses from the sale or other disposition of assets used to further an exempt purpose."[49] Thus, under the proposed regulations referencing section 4940, capital gain net income would presumably include gain realized on the sale of classroom buildings and other assets used to further an AEI's educational purposes.

To determine capital gain net income for purposes of the section 4968 excise tax, AEIs will need to track their basis in their assets. This may be a complicated exercise in practice, as AEIs are unlikely to

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[45] The section 4940 regulations state that NII takes into account "interest, dividends, rents, and royalties derived from assets devoted to charitable activities." *See* section 53.4940-1(d)(1).

[46] For example, section 53.4940-1(d)(1) specifically provides interest received on a student loan as an example of income includible in gross investment income.

[47] 84 Fed. Reg. 31800. In explaining why a type of income should be excluded, commenters are also asked to "state specifically how the proposed exclusion is still 'similar to' the rules of section 4940(c) . . . ."

[48] Section 4940(c)(4); section 53.4940-1(f)(1), (3). As with gross investment income, capital gain net income does not include any gain or loss taken into account in computing UBTI. In addition, the proposed regulations provide that overall net losses from sales or other dispositions of property by one related organization (or by the AEI) reduce (but not below zero) overall net gains from sales or other dispositions by other related organizations (or by the AEI). *See* proposed section 53.4968-1(b)(3)(v).

[49] Joint Committee on Taxation, Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," (JCX-38-06), at 324 (August 3, 2006). The relevant regulations have not been updated to reflect this change and continue to provide that "gains and losses from the sale or other disposition of property used for the exempt purposes of the private foundation are excluded." *See* section 53.4940-1(f)(1).

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have much of the information the proposed regulations would require. For example, the proposed regulations' preamble and cross-reference to the section 4940 regulations seem to make clear that the basis in donated assets should be the donor's basis (except that if the basis is greater than the FMV of the asset at the time of the gift, then the basis will be the FMV at the time of the gift for purposes of determining a loss), even though there is no requirement for a donor to disclose their basis to the AEI.[50] Additionally, the proposed regulations and Notice 2018-55, issued in June 2018, make clear that section 4968 is not intended to tax AEIs on appreciation in the value of property that occurred before December 31, 2017.[51] More specifically, Notice 2018-55 provided that, for purposes of determining gain subject to the section 4968 excise tax, the basis of property held by an AEI on December 31, 2017 and continuously thereafter would be no less than the FMV of the property on that date, plus or minus all subsequent adjustments. The proposed regulations implement this basis "step-up" by cross-referencing a similar basis step-up for private foundations provided in the section 4940 regulations and substituting "December 31, 2017" as the applicable date.[52]

Unlike private foundations in the 1960s, however, AEIs now earn much of their NII through investment vehicles taxed as partnerships for federal income tax purposes. The proposed regulations leave difficult questions of how to calculate NII in a partnership context unanswered. As a general matter, partnerships report investment income to partners on Schedule K-1 in a variety of ways, often in the aggregate, making calculation of NII from partnerships challenging at best. In addition, because a partnership is often considered an aggregate of its assets for federal income tax purposes, the application of provisions written with corporate stock investments in mind may not be entirely clear.

For example, Notice 2018-55 was silent regarding whether the 12/31/17 basis step-up to FMV was limited to an AEI's "outside basis" in its partnership interests or, rather, could be extended to the partnership's "inside basis" in its assets. Because an AEI may recognize gain either on a sale of its partnership interests[53] or when a partnership sells its assets,[54] AEIs were rightfully concerned that "stepping up" only the outside basis in partnership interests would not shield them from tax if the partnership sold the appreciated assets. The proposed regulations attempt to address this by providing that if an AEI holds a partnership interest on 12/31/17, and continuously thereafter, and the partnership held assets on 12/31/17, and continuously thereafter to the date of disposition, then the partnership's basis in an asset with respect to the AEI may be adjusted to take into account appreciation prior to 12/31/17.[55] The proposed regulations note, however, that "to avail itself of this special partnership basis rule, an institution must obtain documentation from the partnership to substantiate the basis used." In practice, this rule seems all but inadministrable. Even if an AEI could obtain documentation of the FMV of assets owned by the partnership (and all lower-tier partnerships) at 12/31/17, the AEI would also

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[50] Section 53.4940-1(f)(2); section 1.170A-16(d)(5)(iii)(C).

[51] Proposed section 53.4968-1(b)(2); 2018-26 I.R.B. 773.

[52] Proposed section 53.4968-1(b)(2), (3).

[53] Section 741.

[54] Section 702(a).

[55] Proposed section 53.4968-1(b)(3)(iv).

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generally need continuous reporting from partnerships on an asset-by-asset basis to trace gain flowing from assets the partnership held on 12/31/17—information that is unlikely to be available.

Conclusion

The proposed regulations make little effort to take into account the significant differences between the operations of a university and a typical private foundation, leaving significant room for EIs to exercise judgment as to how best to reasonably comply with the statute, but also several questions. Affected EIs—and those that may find themselves affected in coming years—should provide Treasury and the IRS with practical suggestions for how the proposed regulations could be adjusted to appropriately take into account differences between EIs and private foundations, as well as the realities of modern investment activity, without imposing undue administrative burden on AEIs. The rules in the proposed regulations are not effective until and unless they are included in final regulations; however, AEIs may choose to rely on the proposed regulations before the final regulations are published, if desired.[56] Comments on the proposed regulations, and requests to participate in a public hearing, are requested by October 1, 2019.

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[56] *See* proposed section 53.4968-1(d). Interestingly, unlike other recent guidance items interpreting new statutory provisions specifically applicable to tax-exempt organizations, the proposed regulations do not expressly state that taxpayers may base their positions upon good-faith, reasonable interpretations of the statute until further guidance is issued. *See, e.g.*, Notice 2018-67, 2018-36 I.R.B. 409; Notice 2019-09, 2019-04 I.R.B. 403.

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