

Final "Net Investment Income" Excise Regs

09.21.20 | Linda J. Rosenthal, JD



Not to put too fine a point on it: The [Tax Cuts and Jobs Act of 2017](#) was a mess.

At the time the Senate majority rushed it through Congress in late December 2017, we reported in detail on the [chaos, confusion, speed, and rancor that dominated the process](#). Making matters worse, the leadership omitted the customary transition period between a presidential signature and the law's taking effect. Even in legislation that is well-crafted and thoughtfully debated, there are inevitably kinks and problems which Congress can quickly remedy with technical-corrections amendments or other relief.

In the TCJA '17, the nonprofit sector took quite a hit from several unexpected provisions. These new laws either "fixed" problems that never existed or addressed with a sledgehammer legitimate issues. Almost at once, our sector made pleas to revoke or rework the most troublesome and confusing of these statutes and has continued this pressure in the two and a half years since then.

We've had success on at least one front: In late December 2019, lawmakers retroactively repealed the "[hugely unpopular](#)" tax on parking and other transportation-related fringe benefits paid by nonprofits for their employees. It "[never made sense to anyone](#) and ... forced thousands of front-line nonprofits to divert two years of attention and millions of dollars away from their missions." This lovely holiday gift was accomplished by legislators quietly tossing it into an eleventh-hour compromise appropriations bill. See [Poof! The Nonprofit Parking Tax is Gone](#) (January 7, 2020).

As for the remaining (controversial) changes that directly affect the nonprofit sector, the Treasury Department and the IRS are proceeding, under their lawful regulatory authority, to interpret and implement them. They have drafted and published proposed regulations, inviting public comment for sixty days or – sometimes – longer. The philanthropy community, professional advisors, and academics are participating robustly in this process.

New: Final 4968 Excise Tax Regs

There have been proposed regulations pending for some time on several items:

- Excise tax on net investment income of certain higher education institutions (IRC sec. 4968)
- Excise tax on excess compensation (IRC sec. 4960)
- New rules on the unrelated business income tax (IRC sec. 512(a)(6))

On September 18, 2020, the federal tax authorities announced release of final regulations for determining the section 4968 excise tax that applies to the “net investment income of certain colleges and universities. The new statute imposes on each “applicable educational institution” an excise tax equal to 1.4% of the institution’s “net investment income.”

The final regulations under section 4968 “include guidance on the scope of applicable educational institutions to which the excise tax applies, including determining who will be counted as a ‘tuition-paying student,’ which institutions will be treated as ‘located in the United States,’ and which assets will be included in determining whether an institution meets the \$500,000 per student threshold in the statute.”

Each of these points was vague and confusing under the language of new section 4968. Without adequate clarification, it would work a hardship on all potentially affected institutions as well as on the government in its monitoring and enforcement efforts. These final regulations include considerable changes and improvements by the tax authorities over the rules set out in the earlier proposed regulations.

Among the highlights of the concessions made by the government are:

- Expanding the definition of “student” to include not only those in degree programs but also individuals taking courses for academic credit;
- Clarifying the definition of “tuition paying”: includes students with 3rd-party scholarships but excludes ones receiving only government grant funds;
- Making it easier to calculate “net investment income” and differentiating it from the rules that apply to private foundations under section 4940;
- Modifying certain “capital gains net income” calculations;
- Providing guidance on rules for treating specified assets and net investment income of certain related organizations.

Conclusion

These final regulations under section 4968 will apply beginning with the publication date in the Federal Register.

Still outstanding are the government’s final regulations under Internal Revenue Code sections 4960 and 512(a)(6). There has been considerable pushback – via the public-comments route – to both sets of proposed rules.

There is another announcement (unrelated to the Tax Cuts and Jobs Act of 2017) that the nonprofit sector awaits. After about forty years, the government issued a proposed revenue procedure earlier this year revising the existing rules for obtaining and maintaining group tax exemptions. So far, the reaction – in the submitted public responses reported so far – can fairly be characterized as comprehensive and stinging.

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