

IRS Finds Extensive Non-Compliance Among Tax-Exempt Colleges and Universities

On April 25, 2013, the Internal Revenue Service (IRS) posted the final report summarizing findings of a multi-year project studying trends in business income and executive compensation non-compliance of tax-exempt colleges and universities. This 5-year project was initiated in October 2008 as “part of a larger effort by the IRS to review ...one of the largest segments of the tax-exempt community in terms of revenue and asset size.”¹ The final report encompasses findings from questionnaire results of 400 randomly selected colleges and universities in the United States, as well as from more in-depth analysis of 34 of these entities.² The data presented in the final report serves as an updated and more thorough examination of the selected entities than that presented in the interim report, published in 2010.

The findings included non-compliance associated with inappropriate determination of unrelated business income tax (UBIT); failure to comply with reasonable compensation for disqualified employees of the organization; and, issues associated with employment tax and retirement plans.³ UBIT is a form of income that is not taxed, as it contributes to an organization’s exempt purpose(s). Upon investigation, over 180 changes were made to entities’ UBIT reporting, which accounted for approximately \$90 million in adjustments by the IRS. Multiple problems were identified during examination of UBIT, many of which were related to misclassification of activities or expenses.⁴

With regard to reasonable compensation of key employees (e.g., officers, directors, etc.), unsurprisingly, in 80% of colleges or universities polled, the president or chancellor was the highest paid official with an average annual base salary of \$452,883 and total compensation of \$623,267.⁵ Of the surveyed entities, eleven selected for further

examination generated \$167,243 in penalties; an increase of over \$35 million in taxable wages; and, over \$7 million in employment taxes. Further examination of eight entities’ retirement plans found that approximately 50% had compliance issues resulting in over \$1 million in adjustments.⁶ The problem of overcompensation of university employees is not a new issue; a previous issue of HC topics from May 2013 examines one example of exorbitant compensation in a tax-exempt medical center associated with a university.⁷

Following the publication of the final report, a May 8, 2013 meeting of the U.S. House of Representatives Ways and Means Subcommittee on Oversight convened to discuss the findings and implications; the observations of “almost universal noncompliance” regarding UBI and compensation issues prompted planning of a more extensive project for 2014 to determine whether the same non-compliance is exhibited across other arenas of the tax-exempt sector.⁸ Among the various recommendations for tax-exempt entities stemming from findings of the final report are suggestions to closely examine methods and policies determining executive compensation, and utilize methods to compare internal practices and policies with similar entities.⁹ Given the widespread non-compliance found among entities during the Colleges and Universities Compliance Project, it is expected that the IRS will continue projects and assessments regarding tax and compensation non-compliance among tax-exempt organizations in the future.

¹ “Colleges and Universities Compliance Project: Interim Report”, by the Internal Revenue Service, May 7, 2010, p. 1

² “Colleges and Universities Compliance Report: Final Report”, by the Internal Revenue Service, April 25, 2013, p. 1

³ *Ibid*, Internal Revenue Service, April 25, 2013, p. 1-6

⁴ *Ibid*, Internal Revenue Service, April 25, 2013, p. 12-13

⁵ *Ibid*, Internal Revenue Service, April 25, 2013, p. 16

⁶ *Ibid*, Internal Revenue Service, April 25, 2013, p. 20-21

⁷ “IRS Proposes Requirements to Make Charitable Hospitals more ‘Charitable’”, by Health Capital Topics, Vol. 6, Issue 5, May 2013

⁸ “Lessons from the IRS Nonprofit College and University Compliance Project: Final Report Offers a Wealth of Information for all Tax-Exempt Organizations”, by Rohlffing et al., Venable LLP, July 2013, p. 6

⁹ *Ibid*, Rohlffing et al., July 2013, p. 7



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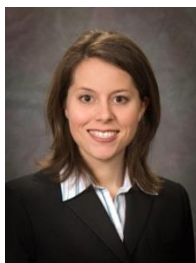
Mr. Cimasi holds a Masters in Health Administration from the University of Maryland, as well as several professional designations: Accredited Senior Appraiser (ASA – American Society of Appraisers); Fellow Royal Intuition of Chartered Surveyors (FRICS – Royal Institute of Chartered Surveyors); Master Certified Business Appraiser (MCBA – Institute of Business Appraisers); Accredited Valuation Analyst (AVA – National Association of Certified Valuators and Analysts); and, Certified Merger & Acquisition Advisor (CM&AA – Alliance of Merger & Acquisition Advisors). He has served as an expert witness on cases in numerous courts, and has provided testimony before federal and state legislative committees. He is a nationally known speaker on healthcare industry topics, the author of several books, the latest of which include: *“Accountable Care Organizations: Value Metrics and Capital Formation”* [2013 - Taylor & Francis, a division of CRC Press], *“The Adviser’s Guide to Healthcare”* – Vols. I, II & III [2010 – AICPA], and *“The U.S. Healthcare Certificate of Need Sourcebook”* [2005 - Beard Books]. His most recent book, entitled *“Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services”* will be published by John Wiley & Sons in the Fall of 2013.

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