CHAPTER ONE

Awareness

Discovering What Kind of Taxes Your University Is Subject To—How to See the Forest, Not Just the Trees

As a tax manager for three different universities, I had the best job in the world. After all, we were tax exempt. What would I do all day? Colleges and universities are tax exempt, aren't they? I loved entering into discussions with people that had this view of universities.

DEFINING TAX EXEMPT

Let's explore what tax exempt means and what it doesn't mean. Technically, according to the IRS, if you are a state institution then your exemption is found in a certain section of the IRS code. If you're an independent, private university then you are exempt under a different section of the Internal Revenue Code. It's that simple.

However, it's important to note that regardless of whether you're a state institution or private, independent institution both are considered nonprofit organizations by the Internal Revenue Service. That may sound like a simple statement. But what I find is that many people in higher education consider themselves to be separate and distinct in some manner and do not really pay much attention to the IRS when they talk about nonprofit organizations. Perhaps they're thinking the IRS means organizations like the YMCA, the American Red Cross, or the Big Brothers, Big Sisters.

However, the same rules that apply to those organizations also apply to higher education.

Also, as a tax-exempt organization, whether public or independent, you may be exempt from paying sales tax on purchases in your home state and several (not all) of the other states.

THE SIX STEPS OF TAX COMPLIANCE

So does this mean we do not pay any tax in higher education? How about taxes like social security tax, Medicare tax, sales tax, unrelated business income tax, hotel and motel tax, excise tax, or oddities like a severance tax in West Virginia?

It is also important to note, that like any other organization, tax-exempt organizations like colleges and universities act as a "withholding agent" for the IRS. What that means in the eyes of the IRS is that you are knowledgeable of all taxable events on campus and further that the university is held responsible for the payment of those taxes. That's right, the university is responsible, not the individual, if the university failed to withhold or pay over the tax due to the IRS. We are also a collection and withholdings agent for state sales tax, federal excise tax, employee payroll tax, payments to independent contractors, a receipting agent for charitable gifts from donors, and reporting agent for educational tax credit items—things like scholarships, grants, and tuition-related payments.

Many of the training courses the new business officers receive, like those from their regional or national Association of Business Officers failed to offer any education about the Chief Financial Officer's (CFO) role and taxes for the university. These courses cover many other topics for the Chief Business Officers but pay little heed to the importance of taxes and the consequences of not getting it done right—and on time.

When something goes wrong between your university and the IRS, the buck will stop on the CFO's desk. It just goes with the title in the position. That's why they make the big bucks.

Yet, I find that many new and even experienced CFOs, Associate Vice Presidents of Business and Finance, or Controllers have a limited knowledge about how taxes are to work at their university and the impact taxes can have on their university. This is especially interesting to me in that more than half of one class of new business officers came to higher education from other sectors, including health care, public accounting, or real estate and have no knowledge of nonprofit taxation. It's critical for you to know your campus, the activities that occur that may be subject to taxation—and to know what the IRS requires from your department.

This book will help you to develop an effective tax compliance program for your university by taking you through six steps. Along the way you'll see some tips and techniques to help you establish this tax compliance program. Achieving these steps will make your division more operationally efficient and save your university dollars. See Exhibit 1.1.

The first step is awareness. This chapter gives you some tips on how to build your awareness of your tax obligations at your university. Without this awareness you are destined for difficulty with the IRS and your university. There are approximately 4,000 universities in the United States and some have not yet been audited or it may have been a long period of time since they were last audited. Do you want to play audit roulette with your school's and your personal reputation?

EXHIBIT 1.1

Six Steps of Tax Compliance: Awareness.

THE FIVE THINGS YOU NEED TO DO FIRST

If you are new to things, there are five things you need to do first before all else. These will be helpful regardless if you are a new CFO or have many years of experience. The rest of this chapter outlines these important tasks.

Task 1: Look at Management

Determine who is managing your tax compliance program for your school. Find out who is responsible on your campus for being knowledgeable of tax issues affecting your institution and managing/preparing tax returns and reporting to the IRS.

At a smaller institution without a tax manager or a designated tax person you may find tax compliance is disbursed throughout the organization. For instance, you may find your employment tax is being deposited by the payroll department as well as the employment tax returns being prepared, signed, and filed by the payroll department. You may find that 1099 forms (for payments to independent contractors) are being prepared and filed by the Accounts Payable department and you may find the forms necessary for every student attending a class prepared and filed by your student financial aid department.

At a larger school where there may be a tax manager and even a tax department, have a meeting with your tax manager and ask them what they view as the biggest tax risk to the university. Ask them to develop a visual university tax risk matrix for you. It can be something as simple as the image in Exhibit 1.2.

This type of presentation will show you areas for improvement. It appears from Exhibit 1.2 that your first efforts should be to look at the areas of Sales Tax and the Unrelated Business Income Tax. Ask your tax manager or the person responsible for these areas what they see as the first steps to take and what obstacles are in front of them. Then take steps in your position as CFO to remove those obstacles. In many cases, an obstacle will be gaining the cooperation of the various departments.

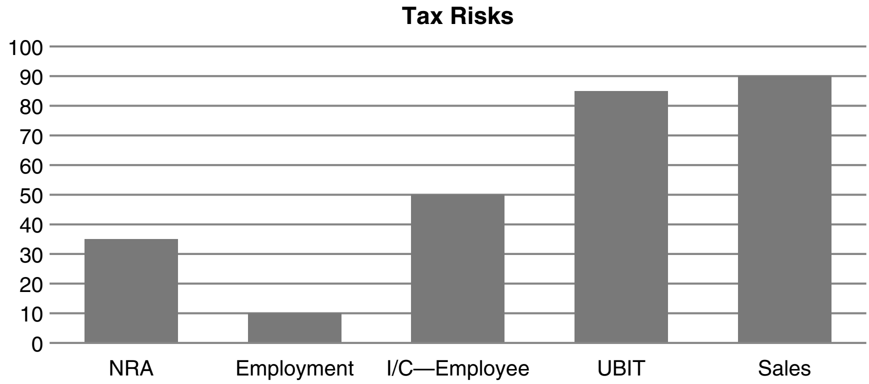

EXHIBIT 1.2

Tax Risks.

I suggest the meeting be between you and the tax manager, not the supervisor of the tax manager and the tax manager, as a tax manager may be reluctant to press their true feelings in the presence of the supervisor.

Task 2: Assess the Current State of Your Tax Compliance Program

Make an assessment of where your tax compliance program is now. Rate yourself on the scale in Exhibit 1.3.

If you feel your score is to the left of the scale then you are in the random phase of tax compliance. This is where you, as a CFO, have

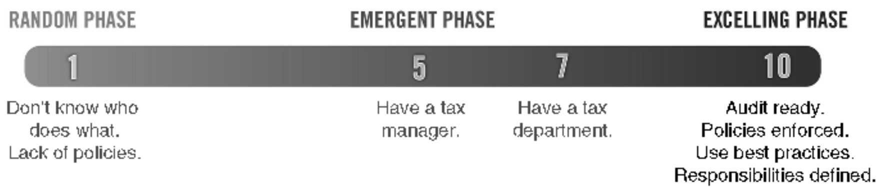

EXHIBIT 1.3

Tax Scale.

no or very little knowledge of what it takes to comply with the various tax laws. You don't know who is preparing tax returns, who is making the tax deposits, or there may be a lack of policies and procedures surrounding the tax environment of your school.

Or you may feel that all is being done correctly and on time and your university is in compliance with the federal, state, and local tax laws, but you may have no way to prove it. Further, you may feel this way because you are not advised of the university's tax issues. This happens more than you think.

If you are in the middle of the scale, or the Emergent Phase, you have a tax manager who takes care of all of the tax issues. If you are somewhere between the left side and the middle you may have a designated tax person who has tax responsibility as an "other duty as assigned." Most often this falls to the controller or the associate vice president of the institution. If this is the case, you should meet with them and develop a sense of their awareness of tax issues and also to determine how they keep up with tax law changes that affect the university. You'll want to ask about what types of controls are in place to see that there are no late deposits or missed filings of tax returns.

At the right end of the scale you are in the Excelling Phase and nearest to the top of the tax compliance program pyramid in what I refer to as Tax Nirvana. Here you are fully aware of all tax issues, know how to address them, and are prepared for an audit at any time. This is the place for thought leaders in operational efficiency in Business and Finance departments.

Using my tax pyramid will move your organization up the scale of tax compliance. The six steps contained in this book will give you practical and easy-to-use methods to take your school to Tax Nirvana.

The tax compliance program is not for wimps. It will require collaboration and communication with all of the permits in your school's academic and administrative departments. It will need executive-level support from you. Be that support or bear the consequences upon an IRS audit. It takes a village, but where the tax compliance program is concerned, you will be able to create that village.

Task 3: Develop a Team Approach

Consider starting quarterly tax update meetings involving Payroll, Accounts Payable, Human Resources, Athletics, Student Financial Aid, Accounting, and Procurement. All of these departments and others may be included on your team because there are tax consequences for each and all of these departments. Start a yearly tax calendar for your institution. List all known tax filings and who is responsible and the due dates for all returns and deposits. Review this calendar at each quarterly meeting to ensure no filings or deposits are missed.

I cannot overcommunicate the value of the tax compliance program at your university. You may need to tailor your advocacy of the tax compliance program to the departments. You need to provide an answer to their question of "What's in it for me?"

You can count the efficiencies in processing that will be of benefit to them (for example, that there will be less time to receive approval or payments). Or you may state that money saved as a result on payments to taxing authorities could be better spent on education in dealing with academic departments. To further demonstrate your commitment to a tax compliance program, consider hosting a tax conference for surrounding schools at your institution.

Overall, this book begins by asking you to be a change agent in the area of tax management at your school. You can expect resistance to this, as with all change, but you can use enhanced technology, such as workflow approvals, to speed up processing.

Getting a Hold on the Process. Getting a hold on taxes is important because the IRS is your largest vendor. I make this pronouncement at many of my presentations around country to business officers just like you. It gets their attention because many of them are not aware of this. I challenge them to run a very simple query in the accounts payable software: simply ask your accounts payable manager to run a very simple query that produces the vendor with the largest amount of dollars sent to them from your university. In another exercise, I hold up a $20 bill and offer to give that to any business officer if they can tell me how much tax their university pays out to the federal, state, and local levels of taxation. Needless to say, I've had that same $20 bill for a long time now. The amount of funds flowing out of your school for tax liabilities can be the equivalent of 15 percent of your total budget. Many CFOs assume an attitude that is very much like, "We have to pay taxes anyway, what can I do about it?" The thrust of this book is for you to develop a program, or have a strategy, to insure this is being done in a timely manner and correctly and also without large penalties and interest charges resulting from an error.

I had one CFO, a very philosophical thinker, who said the IRS is not a vendor. I asked him if the IRS was in the vendor database, to which he agreed. He countered and said his institution did not receive anything from this vendor called IRS. I asked him to think of the IRS as a subsidiary of the federal government and consider all the funds his institution received from the Department of Education. Regardless of whether or not the IRS meets the definition of vendor it is still the largest single organization to which money flows outward from your institution in most cases. Further it's the vendor (the IRS) that has the power to audit and make additional assessments and add penalty and interest to those assessments, often times amounting to more than the original amount of tax.

The University of Michigan reports that the university files more returns with the IRS than the Ford Motor Company. A university with no one overseeing the tax collection, reporting, and monitoring process is an invitation to disaster. This occurs at times even when there is a tax manager position within the university, as tax is simply not brought to the table when another department assumes responsibility for filing forms without the input of a tax manager or tax department.

Many times I find CFOs and others think of the potential financial exposure as only being the tax amount that might be due. They fail to consider the penalties and interest, which can be severe. Recently the penalties for failure to file informational returns increased to $100 and include informational returns, such as the 1099 form your accounts payable department probably prepares, or the 1098T forms your bursar or registrar might complete. The penalty is $100 for *each* return to the individuals and $100 for the same return that was to be filed with the IRS. This is a penalty of $200 per return. So, if your school is filing a 1098T form for each student and you have a student population of 2,000 or 20,000 or 35,000, the penalties can be $40,000 or $400,000 or $700,000 for the filings of just this one return with the IRS. But, don't worry; there's a $1.5 million cap on this penalty for each year. Who manages the filing of returns that can cost the university this kind of money? Do you know?

I'm not the only one standing on a soapbox talking about taxes to business officers. See the article "Tax Takes a Front Seat" featured on the front cover of the *NACUBO Business Officer* magazine, October 2008. You can also see an article in *Chronicle of Higher Education* called "IRS Steps up Scrutiny of Nonprofits"; an article I imagine was not read by many business officers because it said nonprofits instead of higher education.

There is a simple query you can make that will give you an idea of how much money flows outward from your school. Determine all taxes paid: the withheld federal, state, and local taxes (employer share and employee share if Social Security tax is paid), taxes withheld and paid for your international students, sales tax, excise taxes if applicable, unrelated business income tax, and even highway use tax if you have large trucks on your campus. Also, count PILOTS (payments made in lieu of tax to cities) as a tax. You'll then know the kind of money we are talking about.

The IRS Is Paying Attention. Higher education is more than just on the radar screen of the Internal Revenue Service. They are now beginning to devote resources specifically addressed to nonprofit organizations, which includes higher education. I don't want to tell you how many five-year plans from the IRS Commissioner(s) I have reviewed, but the most recent five-year plan issued by IRS Commissioner Shulman included the first time I ever saw nonprofits mentioned as a goal and objective of the IRS Commissioner's office. And when the IRS Commissioner speaks, the IRS listens.

And then we have Senator Grassley from the State of Iowa who has taken an intense interest in nonprofits in higher education. Many people in higher education feel that nonprofit tax is a different tax area than what impacts colleges and universities, or that higher education is special to the IRS. Higher education is under the realm of nonprofit taxation. Senator Grassley is responsible for the IRS issuing a questionnaire on endowments held by universities and other nonprofits. Senator Grassley is behind the redesign of the Form 990. I believe Senator Grassley also led to the IRS issuing a questionnaire specifically to higher education on unrelated business income tax.

There is the case of American University, the "Enron of higher education." I use it as a case study in what could go wrong when I speak. It's fascinating reading and if you want to know more about this please let me know and I will forward this information to you. At American, located in Washington, DC., there was a complete lack of internal controls, monitoring, and compliance. When things blew up there, the news was on the front page of the *Washington Post* for about three weeks. Without getting into the details here, American's staff basically exercised the power of their position to willfully and blatantly ignore tax law and it put the university in a precarious position with the IRS. Afterward, the president was asked to leave; there were student protests when he received a large severance package because tuition had increased each year for the prior six years he was there.

Unfortunately, this is not an uncommon situation or way of thinking. Many CFOs and vice presidents indicated that controllers are not aware that it is the responsibility of the university to collect and pay the tax to the IRS. The IRS will look to the university to make this payment on behalf of all of the individuals who receive payments without the proper withholding by the university. The IRS will not pursue the individuals who were undertaxed or taxed incorrectly. This liability becomes one for the university.

And then there is the Smithsonian Institution (located, again, right in Washington, DC). It also found itself on the front page of the *Washington Post*. Our congressmen do read the newspapers and so do their staff. It appears from the story that the executive director of the Smithsonian and one of his deputies had received large increases in salary of which the board was not aware. When investigators began to look at it more, which is what publicity does, they found that the director and his deputy actually spent very little time performing their jobs. And this, I believe, was the basis of Congressional interest in governance of all nonprofit organizations. Higher education is considered a nonprofit organization by the IRS and by Congress. Consequently the bright light is shining on nonprofit organizations and higher education. They are not permitted to be in the shadows. In fact, these institutions have been highlighted by the IRS.

The IRS focus on higher education has been demonstrated by the IRS sending out four specific questionnaires in recent years just for colleges and universities. One questionnaire went to 400 universities and 40 universities were audited from the results of that questionnaire. I believe the Internal Revenue Service is trying to better understand higher education. They're continuing to analyze the information submitted on the questionnaires and in some areas are scratching their heads because results of the questionnaires indicated a lack of understanding and therefore a lack of compliance with tax laws. This has led the director of the exempt organization division within the IRS to state that it is now time to move from project to process. Translation: this means more examinations of colleges and universities by the IRS.

All private independent universities are required to file the Form 990. They focus a lot of attention on the Form 990 as it is reviewed by the board. (Side note: at one University, we presented the Form 990 to the Board of Governors on an iPad.) However, there is more to taxation for higher education than just the Form 990. The 990 is generally the "star" of taxation at private, independent colleges because it is a public document. Anyone with internet access can bring up a copy of the 990 that has been filed. I've often said that anyone that looks at your 990 is not your friend. The media looks at it—the student newspapers take great delight in reviewing and reporting on the compensation of the officers that is disclosed. Nonprofit watchdog organizations look at the 990 to determine if the contributions are going to program efforts or into salary and perks for the officers. Donors look at the 990 before they decide to make a gift to the university.

The changes to the Form 990 have been dramatic. It was the form's first redesign in over 50 years and a direct response to questions about governance that Congress had about nonprofit organizations. The IRS is analyzing this data and recently stated it found, not surprisingly, that organizations with good governance were more tax compliant. Interestingly enough, the IRS does not have the authority to require you to answer questions about governance on the Form 990 and states just that on the tax return, in small print. There is an effort by Congress to grant the authority to the IRS to require answers to the large amount of governance questions. While I do not have any particular research data, I still sincerely believe that those little boxes that are checked "No" to the questions of governance makes a return more eligible for examination by the IRS.

A recent study by KPMG disclosed that 73 percent of tax risk was primarily the risk of noncompliance with tax law. It went on further to say that 60 percent of the respondents claimed that tax-risk assessment and management became more of a priority for the leadership of the organization. But that only 20 percent had a formal tax-risk management strategy. It is a purpose of this book to give you that tax-compliance management strategy.

In any case, the IRS has had, at the time of this writing, three years to digest the information reported on the new Form 990 to the IRS. I have visited the IRS national office of tax-exempt and governmental entities many times in my role on the Advisory committee to the Tax-Exempt/Governmental Entities Division. I've seen the rows of cubicles of IRS employees analyzing the data that has been reported to them on the 990 and from the various questionnaires issued to colleges and universities. The IRS is struggling to understand higher education, but don't worry . . . they'll get it.

Why You Should Care. The reputational damage that can result to a university from an IRS examination becoming public knowledge is, in my opinion, often greater than the financial costs. While many universities attempt to keep an examination by the IRS as quiet as possible it always seems to find a way to make it to the front page of the newspaper. As shown by the previous examples, reputational damage has an impact on donors, student enrollment, and jobs (including yours).

The financial costs of an exam by the IRS can be harsh, especially when considering the amounts of penalty and interest accrued to the assessment. Remember, the IRS can audit for three years prior plus the current year, which, in reality means that a $1 million per year IRS assessment can be up to $4 million on one issue alone.

There are colleges that claim bankruptcy protection, such as the 131-year-old Morris Brown College (which is more than $30 million in debt and facing foreclosure), which was forced to close its doors or to merge with other institutions. In the case of such a university, I can't claim it was entirely for tax reasons, but rather for general administrative mismanagement. Yet, this closing had an impact on every student who was attending and had attended that college and could have been avoided through prudent financial management and the institution could be thriving today. As an example tax-wise, there will surely be tax repercussions to this bankruptcy if the tax-exempt bonds are declared not to be tax exempt by the IRS.

Task 4: Assess Your Risk

Many colleges and universities now perform a university wide risk assessment. I participated in some of these and reviewed several other risk assessment questionnaires. These assessments address a wide range of potential risks for the university. But what amazes me is a general consistency to ignore the tax risk the university faces. Some universities will only ask for completion of the risk assessment at the director level and above. Oftentimes even if the school does have a tax manager, the tax manager is not aware of the risk assessment questionnaire. If there is no tax manager at the university then it's clear the tax risk will not be reflected in the risk assessment for the university.

The risk assessment should ask for the strongest and weakest tax compliance risks that exist for the university. For instance, it may reflect those areas of taxation, such as payroll tax, reporting, student or nonresident alien tax, sales tax, unrelated business income tax, and independent contractors, rated as a high, medium, or low risk for the university.

Exhibit 1.4 shows examples of some tax risks that may apply to your institution. This list is not all-inclusive, but gives you a good idea of the most common types.

I have conducted some informal surveys at universities, asking several different people, "What is the degree of tax risk at the

Exhibit 1.4

The Different Tax Risks.

Issue	Department	Mitigation (Policies)
Tax-exempt bond compliance	General Counsel Treasurer	Guidelines on debt
Tuition/educational assistance program	Human Resources Benefits administration	Employee handbook Policy—taxation of employee tuition benefits
Prizes and awards to employees	Accounts Payable Payroll Services Tax Department	Policy—taxation gifts, prizes, and awards to employees
Record retention for tax records	Tax Department	Policy—records management
Employee versus independent contractor	Tax Department Procurement Accounts Payable	Policy—worker classification
Federal and state payroll tax withholding and reporting	Payroll Services Tax Department	Policy Tax calendar
W-2 and W-3 reporting	Tax Department Payroll Services Information Systems	Tax calendar
Nonresident alien taxes, withholding NRA reporting	Tax Department Payroll Services International Students Procurement	Policy Tax calendar

W9 collection	Accounts Payable	Policy—supplier registration
1099 reporting	Accounts Payable	Tax calendar
Taxability of fellowships and other forms of financial aid	Tax Department Student financial assistance Office of graduate student support Accounts payable	Policy—taxable and nontaxable payments to students
Imputed interest on employee loans	Payroll Services	Policy—employee loan policy
Taxability of meals and lodging furnished to an employee	Tax Department Payroll Services Accounts Payable Procurement	Policy
Accountable plan—business expense reimbursement	Accounts Payable Tax Department Payroll Services	Policy—travel and entertainment Procurement card
Allowable automobile mileage rates	Accounts Payable	Policy—travel and entertainment
Personal use of university-owned automobiles	Payroll Services	Employment Taxes and Fringe Benefits
Unrelated business income tax	Tax Department	Policy—unrelated business income tax Tax calendar
Advertising income	Tax Department	Policy—commercial advertising Unrelated business income tax
Sales tax	Tax Department	Policy—sales tax collection reporting and remittance Tax calendar

(*continued*)

EXHIBIT 1.4

(*continued*)

Issue	Department	Mitigation (Policies)
Exempt organization tax return	Tax Department	Policy—I 90 disclosure procedure Tax calendar
Form 990		
Charitable contributions	Development Tax Services	Policy Gift acceptance Gift processing
Tuition reporting—Form 1098	Student accounts office Tax Services	Tax calendar
Reporting receipt of cash more than 10,000	Cashier's Office Tax Department	Policy
Foreign bank account reporting	Tax Department	Policy
Political activity prohibition	Tax Department	Policy
Cell phones, iPads, laptops	Tax Department	Policy
Sales tax exempt purchases	Tax Department Accounts Payable	Expenditure of funds

university?" On a scale of 1 to 10, I received responses as low as 3 and as high as 10.

I then asked who should set the degree of risk for the university. Of course, everyone I asked who was in a managerial position—whether assistant VP, VP, or controller—all thought they should be setting the degree of risk for the entire university. In my opinion, it's a board matter. It's not the controller. It's not the vice president of business and finance. It's an issue for the board to consider. The most inappropriate time I can think of to let the board know of a potential tax risk is when you are notified the IRS is coming to your university.

Task 5: Review IRS Communications

Who is getting the mail from the IRS, the state, and local taxing authorities at your institution? It should all be directed to your attention, or the CFO, in the absence of a tax manager position. And if you do have a tax manager, they should be directed to show you each and every piece of correspondence from any taxing authority.

At one institution where I was a director in the business and finance division with tax as one of my departments, the tax department had built up a credit of approximately $50,000 sitting with the IRS. The tax department received a deposit penalty notice in the amount of $4,000. The now-former tax manager brought the IRS bill to me and suggested that the $4,000 be deducted from the $50,000 overpayment. He further suggested that there was no need for the oversight of failing to make a timely deposit and costing the university $4,000 to be taken any higher up on the chain of command. He further explained that this deposit penalty had occurred before and no one was aware of it. The moral of the story is that things are occurring without your knowledge that cost you money.

At another institution I worked at, there was a $500,000 overpayment or credit balance sitting with the IRS year after year. This amount was just in case we missed a deposit or had a tax due at some point in the future. Just for fun, I had a friend in the treasurer's office compute the opportunity cost of having a $500,000 earning no interest. Again, the CFO, controller, and vice president had no knowledge of this credit balance.

Open Them! I've worked with universities that have brought me as many as 40 envelopes from the IRS nicely packaged with a rubber band around them, all unopened. Sometimes people become fearful of their jobs and do not want to bring their mistakes to the attention of their supervisor. Without a centralized address to receive all correspondence from the IRS and other taxing authorities, this situation can occur at your university. Please do not include the name of the person to which the IRS should respond. Include only the title or office to which IRS correspondence should be directed. This avoids the mailroom attempting to decide where a piece of mail is delivered. I received envelopes from the IRS with handwriting all over the front stating, “Please Forward to Accounts Payable,” “Please Forward to Student Financial Reporting,” “Please Forward to the Accounting Department,” when finally, after many days and months, the IRS notice, often filled with sensitive time frames and deadlines to respond to, arrived on my desk as tax manager.

It’s necessary to respond to the IRS and take action. One cannot ignore letters or notices from the IRS. Once it is in the computer it’s not going to go away. The IRS has a memory bigger than elephants.

The tax office should be the only point of communication, either written or verbal, with the Internal Revenue Service or other taxing authorities. This prevents confusion and misunderstandings and discussions with the IRS about who is to take the next step and what that next step should be. If your school does not have a designated tax manager position then I recommend that the CFO or controller assume the role of singular communication with the IRS.

Communicate the important IRS issues upward. Let the president know about those issues that will impact the entire university. As a manager, I’ve always stressed that I need to know bad news first. I do not want to be blindsided by hallway conversation or by finding out about a tax situation from the newspaper or other general gossip at the university.

Get outside help if it gets serious. When does it get serious? Actually, I feel it gets serious when the first IRS notice is received. It also gets serious when the letters threaten enforced collection by the IRS. I represented one university that only called me when they received a letter stating the IRS was going to file a lien and place a levy on their bank account. This was a state institution with the governor of the state on its board of directors. A lien is public knowledge, a document filed in the courthouse stating, in this case, that $3 million was owed to the IRS. Further the IRS notice stated intent to levy upon the bank account of the university, which meant paychecks for over 13,000 people would’ve bounced.

I strongly advise to get qualified help on any serious tax issues that might involve large sums of money or an audit. One state institution sought tax help from the State Attorney General’s office.

No one in the state's AG office had ever worked with the IRS on an audit, so they eventually brought in outside assistance also.

Statistics on Tax Staff. A recent NACUBO survey on tax positions at colleges and universities showed that 76 percent of those colleges and universities responding do not have positions solely devoted to tax management. Another 22 percent had positions solely devoted to tax and 2 percent did not answer that question (maybe they didn't know the answer). Research institutions reported the highest number of positions devoted solely to tax, with an average of 1.93 total tax positions, including support and professional tax positions. Small institutions as defined by the survey had an average of .42 total tax positions.

For institutions with a student population of less than 4,000, the survey reported .49 FTE (full-time equivalent) staff dedicated to tax management. Whereas for institutions with more than a 15,000 student population the survey reported 1.96 average number of FTE staff dedicated to tax management. These figures indicate to me that the smaller schools aren't in more need of attention to a tax program after school. Strangely enough, public institutions have a higher number of FTE staff devoted to tax management then private institutions. Many institutions had titles for tax responsibilities of assistant controller, controller, CFO, or CBO (chief business officer), but almost 42 percent listed "other title" as the job title for those with tax responsibilities for their school. This is a clear indication to me that they don't know who is in charge of tax at their school.

Can't afford to have a tax manager position? My answer is that you can't afford not to. If it's not possible to justify a new tax position because of budget issues, then centralize the tax functions to the extent that you can. For instance, I found one university with business in three states that had a tax department, (that is, a tax manager and two tax accountants) where the sales tax returns (over $13 million annually being sent to the three states) was prepared and filed by the Accounts Payable department. This included the responsibility on behalf of Accounts Payable to make timely deposits of all the sales tax. Yet, no one in Accounts Payable had received any training on sales tax. This was at an institution located in three states and a return was only filed in the state in which the main campus was located.

I believe it is incumbent upon the CFO to at least be aware of who has the responsibility for making deposits, for preparing returns, for filing returns, and communicating with the IRS and within the university, and then following up on these responsibilities at meetings throughout the year. When responsibility for taxes is decentralized as it is at most schools, this might be more of a task. But it is your task to see that all tax obligations are fulfilled, even when the return is not prepared by your department or in your span of control.

THE DIFFERENT KINDS OF TAX

The first five things you need to consider as a new—and even experienced—CFO will help you form the basis and foundation for the building of your future tax compliance program at your university. Now that you have those under your belt, let's discuss the different kinds of taxes.

There are many different kinds of taxes that you need to be aware of at your institution. They all have different filing requirements, different due dates, and different deposit dates. Not only do you need to list all of the various kinds of taxes, you need to find out who is responsible for completing each one of these. This list is not going to be comprehensive for all colleges and universities but covers the most basic ones that are pretty general and apply. The first is the employment tax.

Employment Tax: The First Tax to Know about Because It's the Largest One for Your University

The Employment Tax is a tax is withheld from your employees' wages and the payroll department typically performs this function. Determine who is responsible for making deposits and while you're at it, see if they've ever missed a deposit and incurred a penalty. Once a quarter, returns are required to be filed. Determine who prepares and who signs this form and, while you're at it, ask if it's ever been late or incurred any penalties. Also ask if they've ever had to file a corrected form for withholding taxes.

This tax area is generally taken for granted and just assumed that it will be done and done on time. However, this tax is the most visible and most often, in my opinion, the tax that receives the most penalty assessments by the IRS. I worked at one university where a deposit was one day late and the penalty was $50,000!

Unrelated Business Income Tax (UBIT): Not a Distant Cousin Tax but a Close Relative to You Tax

Another really common form of tax that may apply at your university is called the Unrelated Business Income Tax, or UBIT, for short. This is a tax on all the revenues of your university that are not substantially related to your purpose of education, medical, scientific or research, and includes activities such as room rentals, facility rentals, advertising, and even cell phone towers. There are many activities that occur around campus that may become subject to UBIT.

Nonresident Alien: In this world, not outer space, another tax your university may become liable for is a tax on what the IRS calls nonresident aliens. Nonresident alien tax is IRS talk for all of your foreign students, scholars, and researchers. Most every university I know of has nonresident aliens or foreign students. These foreign students, professors, and researchers have an entirely different kind of tax applied to them. Keep in mind that the university is liable for the tax, not the individual, as you are the withholding agent and required to withhold the tax. Everything you know and love about the United States tax code does not apply to your foreign students.

Sales Tax: It Is Close to Home

If anyone on your university campus sells anything it may become subject to sales tax in your state. I know of universities that operate in multiple states and yet only file in one state where their main campus is located. This exposes them to liability in the other states in which they operate.

Excise, or Exercise-Your-Checkbook Tax

Some other kinds of taxes your university may be liable for may include excise tax. If you have diesel fuel for your vehicles on campus such as buses, or if your university has an airport you will have jet fuel. We'll talk more about excise tax a little later, as this chapter mainly focuses on awareness, designed to get you thinking about all of the various kind of taxes your institution may be liable.

Borrowed Money Can Mean Tax, Too

If your institution issues tax-exempt bonds, there is another tax risk of compliance for you. The IRS can audit your bond issuances. In this case it is necessary to keep records for the life of the bond. Sometimes this can extend for a period of 30 years.

Overseas (International) Tax

Just about every university I work with wants to have an international presence. I can understand all the reasons for this and I only want to make you aware of the potential tax and legal considerations of overseas operations. First, don't think that because you are a nonprofit here in the United States that you will be considered a nonprofit entity overseas. However, in some jurisdictions, you may apply for tax-exempt status in that country, which is not a problem with the IRS. I translate the thoughts of the IRS on this as domestic organizations can do anything abroad they would do in the United States as long as it is consistent with the organization's exempt purpose.

It takes only a single employee to cause significant legal and financial obligations for the university. Formal registration might be required with an appropriate government ministry. You may create what's known as a "permanent establishment," which can, in some countries, subject all the revenue earned in that country to tax in that country.

If a college requires the services of a local national, like a language instructor, to conduct the activity, then his or her legal employment may require an employer-identification number. That number cannot be obtained without formal registration with the local government. As a general rule, the retention and compensation of a local national in a foreign country will very likely trigger a duty to register.

American employees working overseas are not usually considered tourists. Get them in the country on the correct visa. Ask your International Student department for their views on this and then seek immigration counsel to verify what you have been told. Beginning work in a foreign country without proper work authorization is illegal. It's just like here in the United States, with the uproar over employing people who did not enter the country legally. Sending a faculty member to work in a foreign country without proper work authorization can result in his or her immediate detention or even deportation, potentially leaving students without supervision. Moreover, many nations, including the United States, impose a 10-year bar on re-entry for serious immigration violations.

The magic number is 183 days, as employees who reside in a country for more than this amount typically become tax residents of that country. That means, for the employee, they may need to file and pay taxes in that country and for your university that means you may have mandatory income tax withholding obligations.

If you hire a foreign national in their country, you may become subject to that country's sometimes-generous health, retirement, and social welfare plans. Sometimes these other costs can add up to be 50 percent of the salary. In some countries, if an employee dies while working, an employer has to give the employee's family five years' worth of salary. Many foreign countries also have thirteenth- and fourteenth-month bonuses. If you challenge any of these additional costs in their country, most of the decisions fall in favor of the employee. Beware, even when trying to avoid this by hiring a foreign national in their own country, as when their services are no longer required, they can appeal to the government and ask to be considered an employee, making you liable for 50 percent of the other benefits.

Also, remember to consider local labor unions in foreign countries. Even U.S. citizens who work overseas may be eligible to argue for the mandatory benefits these labor unions offer.

It doesn't always work to think that you can deposit the paycheck of a U.S.- based employee working overseas into an American bank account. If the employee is there for over 183 days and is deemed a tax resident of that country, your institution must still deduct and pay to the foreign authorities the appropriate amounts for income tax and other required payroll-related items. It's necessary to try and think at the federal level and the state level, and sometimes even the local level. And also at the international level; for instance, one university had a university press and sold subscriptions to journals in Canada. This made the university subject to the Canadian goods and use tax.

IN SUMMARY: BUILD YOUR VILLAGE

It's not necessary for you alone and personally to have an in-depth knowledge of all these taxes. I would suggest that after developing your team you ask each and every one of your departments in business and finance what taxes they currently file and pay. And then ask one more question: Are you aware of any other taxes that we should be filing and paying? You may be surprised at the answers. I've encountered situations where people in the departments are aware of a tax filing but nobody's ever told them to do it, or when they asked about it, they were told not to worry about it.

This chapter provided you with the first five things you should do. Begin to work on them, going down the list one by one. Figure out who's doing what. Then make an evaluation of where you stand in complying with all the IRS rules and tax laws. Assemble your team. Then take the risk assessment that includes all potential tax liabilities. Last, make it clear that you are to receive copies of all letters or notices from any and all taxing authorities. The risk assessment should include all the various taxes listed and any others that may be unique to your university.

Once all this is done, you need to then be the advocate for tax compliance on your campus. Which sounds simple in theory, but in reality, it is not. Chapter 2 discusses the second of the six steps of tax compliance: identification.