

Public Finance TAX UPDATE

A NEWSLETTER HIGHLIGHTING RECENT FEDERAL INCOME TAX DEVELOPMENTS AFFECTING THE PUBLIC FINANCE INDUSTRY

December, 2008

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❶ **Form 990 – Frequently Asked Questions.**

This article sets forth the answers released by the IRS to frequently asked questions related to the redesigned Form 990.

❷ **Collegiate Student Housing.**

This article briefly discusses a recently released private letter ruling addressing whether an entity organized to provide collegiate student housing would qualify as a Section 501(c)(3) organization.

Form 990 – Frequently Asked Questions

On November 19, 2008, the IRS released answers to frequently asked questions related to the Form 990 redesign. The questions and answers provide information that may assist tax-exempt organizations in their preparation and completion of the redesigned Form 990 for the 2009 filing season. The questions and answers included the following:

Why did the IRS redesign the form?

Form 990 has not been significantly revised since 1979, and it is universally regarded as needing major revisions. It has failed to keep pace with changes in the law and with the increasing size, diversity, and complexity of the tax-exempt sector. As a result, the current form fails to meet the IRS's tax compliance interests and the transparency and accountability needs of the states, the general public, and local communities served by the organization.

When will the new form be effective?

The new form will be effective for 2008 tax year returns filed beginning in 2009 (the 2008 calendar year or fiscal year beginning in 2008). However, special transition rules apply for 2008 and 2009. Most organizations with gross receipts of less than \$1,000,000 and total assets of less than \$2,500,000 may choose to file the new Form 990 or a Form 990-EZ for the 2008 tax year. Similarly, most organizations with gross receipts of less than \$500,000 and total assets of less than \$1,250,000 may choose to file the new

Form 990 or a Form 990-EZ for the 2009 tax year. Beginning with the 2010 tax year, the Form 990-EZ thresholds will be permanently set at less than \$200,000 in gross receipts and less than \$500,000 in total assets. In addition, special transition rules are available for organizations that must file the form's new hospital and tax-exempt bond schedules.

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Collegiate Student Housing

In Private Letter Ruling 200833022, the IRS determined that an organization established to own and operate student housing for colleges and universities (including public universities) through disregarded entity limited liability companies did not qualify for exemption as an organization described in Section 501(c)(3) of the Internal Revenue Code. This ruling represents an affirmation of the position the IRS took in its 2001 Exempt Organizations Continuing Professional Education article entitled College Housing.

The organization was formed as a state nonprofit corporation to own and operate student housing for colleges and universities through disregarded entity LLCs. A 501(c)(3) organization with the purpose of lessening the burdens of government with the funding of public and semi-public buildings and works sponsored the organization's creation. The organization's purpose was advancing education by providing housing for enrolled students of public and private colleges and universities. The organization's articles of incorporation state that it is organized and

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Form 990 – Frequently Asked Questions

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How does an organization know which portions of the form or schedules it must complete?

Each organization that files the new form must complete all portions of the core form (Parts I through XI) and provide certain narrative responses on Schedule O. By completing Part IV, Checklist of Required Schedules, the organization will be able to determine which additional schedules, if any, that it must complete.

What are the most significant changes to the 2007 form?

The new form is a significant redesign in format and content compared to the 2007 form. Major changes include a front page summary that provides a snapshot of key financial and operating information, a governance section, and revised compensation and related organization reporting. To increase reporting compliance, the new form replaces existing “unstructured attachments” with formal schedules. Other schedules were added for the reporting of foreign activities, non-cash contributions, hospitals, and tax-exempt bonds, to collect information not required by the current form.

How does the new form promote tax compliance?

The transformation of unstructured attachments in the 2007 Form 990 to formal schedules in the new 2008 form promotes uniform and complete reporting of requested information. Modifications to reporting of compensation and related organization activities will provide more complete information regarding complicated compensation and financial arrangements that may raise concerns about private inurement, excess benefit, and private benefit. The new schedules for foreign activities, hospitals and tax-exempt bonds will provide new information about how an organization conducts activities consistently with its exempt purpose. The schedule for non-cash contributions will allow the IRS to more closely scrutinize

particular types of contributions for compliance with valuation and charitable deduction requirements.

Is the new form more burdensome than the 2007 form?

Organizations with complicated compensation arrangements, related entity structures, and activities that raise compliance concerns can expect to see an increase in the time and effort required to complete the form. This increase could be significant in some cases. However, the new form may not increase the burden for many smaller organizations. The new 2008 form is more user-friendly and streamlined, and the instructions contain several new tools to help filers complete the form more easily, such as a glossary of key terms, the Checklist of Required Schedules, a compensation table, a sequencing list with a recommended order for completing the form, appendices designed to assist different types of filers, and more examples and illustrations to help clarify how to answer various questions.

Will organizations be able to use the 2007 form, rather than the new form, for the 2008 tax year?

No. The 2007 Form 990 will be used only for the 2007 tax year (returns filed in 2008), but will not be available for use beginning with the 2008 tax year.

May those organizations that are members of a group that has a group ruling continue to file as part of a group return?

Yes, the present filing eligibility requirements for group returns have not changed. Appendix E (core form instructions), Group Returns—Reporting on Behalf of the Group, explains how group return filers should complete the form and schedules.

What can I do now to prepare for the 2009 filing season?

Each organization should consider taking steps before the end of its 2008 tax year to be fully prepared for the new form’s changes. These steps include reviewing the new Form 990-

EZ filing amounts to determine whether the organization may file the short form instead of the new Form 990 for the 2008 tax year. Other steps include reviewing the draft form, schedules and instructions available on the IRS website to become familiar with the new form, schedules and instructions. Organizations may want to begin identifying those schedules they may be required to complete, and their related organizations, officers, directors, trustees, and key employees, which require special reporting. The organization's management and governing body should consider reviewing Part VI, Governance, Management, and Disclosure, to become familiar with that part's new governance reporting and to determine whether the organization wishes to make any changes to its existing governance policies and practices before the end of its 2008 tax year.

Collegiate Student Housing

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operated "to advance, support, promote, and assist schools, colleges and universities fulfill their educational purposes, to aid students at such institutions in attaining an education, and to foster community development" by: (i) providing housing for enrolled students of public and private nonprofit colleges and universities lacking adequate facilities for such purposes, in collaboration with such institutions and with the communities in which they are located, and to sponsor, encourage, promote, advance and otherwise assist with the provision and improvement of housing facilities for students of such institutions; (ii) providing financial assistance to such institutions or the communities in which they are located, to the extent funds are available for such purposes; and (iii) providing housing scholarships and general scholarships to low-income students, to the extent funds are available, and otherwise providing educational assistance to students supplemental to college and community activities, including working with prospective students in low-income areas to help them locate additional financial aid for tuition, books, housing and fees.

The organization would meet with representatives of interested communities and educational institutions to determine the need for housing and, if such need exists, the

organization will form an LLC to own and operate each housing project. The organization would be the sole member of each LLC, and each LLC would constitute a disregarded entity for tax purposes. Each LLC would have a five-member management board, including one member from the college or university where the housing project is located, two community members and two members selected by the 501(c)(3) organization that sponsored the organization's creation.

Each LLC would purchase and renovate existing housing property, convert property to student housing or purchase land and construct and develop housing facilities. Each housing facility would be owned and operated by the LLC, and the facility would be managed by the educational institution or by an unrelated property management company. Any net cash flow after payment of operating costs and debt service would be contributed to the college or university or to the city in which the educational institution is located, used to fund scholarships for low-income students or used to subsidize rent or other living expenses of low-income student renters.

The organization would create an LLC to provide student housing at a public university. The organization would collaborate with the university, the city, proposed developers and a property manager to develop a student housing project that would be owned and operated by the LLC. The organization did not conduct any studies to confirm the need for student housing at the university.

The housing project was to be financed through the issuance of tax-exempt obligations, the proceeds of which would be loaned to the LLC pursuant to a loan agreement. The obligations would be secured under a mortgage and security agreement. The university would not be under any obligation to repay the obligations. Rental rates would be set at an affordable level sufficient to cover the operating expenses and debt service on the obligations.

The organization would enter into a support agreement setting forth the duties of the LLC to assist and support the university in

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providing housing by developing, constructing and operating housing facilities and setting forth covenants of mutual cooperation and participation between the LLC and the university. The LLC would be responsible under the agreement for developing and operating the facility in a manner that is consistent with the student life plans and student housing properties owned and operated by the university. The university's obligations under the agreement would include, among other things, providing a description of the project to students seeking housing in its distribution materials, allowing advertisements through the university's website and agreeing that the university would not acquire or construct or permit the acquisition or construction of any additional student housing for the university's exclusive use within a three-mile radius of the facility within five years of occupancy.

The draft support agreement stated that a partnership or joint venture is not created by the agreement. The university would have the right, among other rights, to review and confer with the LLC on decisions made with respect to project management and to appoint a consultant to make recommendations regarding the operation, management and promotion of the project that are consistent with the university's master plan and business operations, which the LLC would be obligated to follow. The agreement also would provide that the university had no right or responsibility regarding the LLC's operations or the project. The university had the option to purchase the property at any time at a fixed price plus the amount necessary to provide for defeasance of all obligations and the payment of any other amounts owed by the LLC with respect to the project. Upon final repayment of all financial obligations, the LLC would "donate" the property to the university or a university-designated 501(c)(3) organization.

The IRS determined that the organization failed to establish that its operations would further a charitable purpose and that the organization would not be operated for a substantial nonexempt private purpose. The

IRS concluded that, absent special facts and circumstances, the organization's manner of providing student housing is a trade or business that is not a charitable activity.

The IRS recognized that an organization providing student housing may qualify for exemption if certain facts and circumstances exist, such as serving a class of students recognized as a charitable class. The IRS noted that the organization did not restrict its services to a charitable class of students such as low-income, nor did it provide free housing or below-cost services. In addition, relying on the reasoning set forth in prior revenue rulings, the IRS stated that providing services at cost and solely for exempt organizations is not sufficient to characterize the activity as charitable.

The IRS further noted that, unlike certain prior revenue rulings granting exemptions when organizations providing assistance to specific colleges were subject to an element of control by exempt organizations, the LLC structure through which the organization would operate housing facilities prevented the organization from being controlled by any one educational institution or by any one community. The IRS stated that the organization is independent and not created by the community or in conjunction with the educational institution with which it intends to be affiliated. In addition, the IRS noted that while community and university members would be included on the LLC boards, no evidence existed that community members or educational institution directors would have any significant involvement in, contribute to, or otherwise participate in, the organization's actual operations.

Lastly, the IRS concluded that the organization's primary role was that of a developer operated for the substantial nonexempt purpose of marketing and designing housing projects and to act as a vehicle for financing the projects through tax-exempt bonds. According to the IRS, the essential facts and circumstances of the revenue rulings granting exempt status to organizations providing student housing—i.e., community control, college involvement and below-cost operation—are absent from the organization's structure and operations.

Chapman and Cutler LLP Public Finance Tax Update

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