Guidance on the Calculation of Net Investment Income for Purposes of the Section 4968 Excise Tax Applicable to Certain Private Colleges and Universities

Notice 2018-55

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (the Treasury Department) and the Internal Revenue Service (the IRS) intend to issue proposed regulations providing clarification regarding the calculation of net investment income for purposes of section 4968(c) of the Internal Revenue Code (Code). Taxpayers may rely on section 3 of this notice until further guidance is issued.

SECTION 2. BACKGROUND

Section 13701 of Pub. L. No. 115-97, an Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, imposes on each applicable educational institution, as defined in section 4968(b)(1), an excise tax equal to 1.4% of the institution's net investment income for the taxable year. Section 4968(c) provides that net investment income is to be determined under rules similar to the rules of section 4940(c). Section 4968(d)(1) provides that certain assets and net investment income of related organizations described in section 4968(d)(2) are treated as assets and net investment income of the educational institution. Section 4968 applies to taxable years beginning after December 31, 2017.

Section 4940(c)(1) provides that net investment income is the amount by which the sum of the gross investment income and the capital gain net income exceeds allowable deductions. Except to the extent inconsistent with the provisions of section 4940, net investment income is determined under the principles of subtitle A of the Code.

Section 4940(c)(2) provides that, for purposes of section 4940(c)(1), gross investment income means the gross amount of income from interest, dividends, rents, payments with respect to securities loans (as defined in section 512(a)(5)), and royalties, but not including any such income to the extent included in computing the tax imposed by section 511. Investment income also includes income from sources similar to those specifically listed in the preceding sentence.

Section 4940(c)(3) provides that, for purposes of section 4940(c)(1), there is allowed as a deduction all the ordinary and necessary expenses paid or incurred for the production or collection of gross investment income or for the management, conservation, or maintenance of property held for the production of such income, determined with the following modifications: (i) the deduction provided by section 167 is allowed, but only on the basis of the straight line method of depreciation; and (ii) the deduction for depletion provided by section 611 is allowed, but such deduction shall be determined without regard to section 613 (relating to percentage depletion).

Section 4940(c)(4) provides that, for purposes of section 4940(c)(1): (A) no gain or loss from the sale or other disposition of property is taken into account to the extent that any such gain or loss is taken into account for purposes of computing the tax imposed by section 511; (B) in the case of property held by a private foundation on December 31, 1969, and continuously thereafter to the date of its disposition, the basis for determining gain shall be deemed to be not less than the fair market value of such property on December 31, 1969; (C) losses from sales or other dispositions of property are allowed only to the extent of gains from such sales or other dispositions, and there shall be no capital loss carryovers or carrybacks; and (D) except to the extent provided by regulation, under rules similar to the rules of section 1031 (including the exception under subsection (a)(2) thereof), no gain or loss is taken into account with respect to any portion of property used for a period of not less than 1 year for a purpose or function constituting the basis of the private foundation's exemption if the entire property is exchanged immediately following such period solely for property of like kind which is to be used primarily for a purpose or function constituting the basis for such foundation's exemption.

Treasury Regulations § 53.4940-1(f)(2)(i) provides that basis for purposes of determining gain from the sale or other disposition of property shall be the greater of: (A) fair market value on December 31, 1969, plus or minus all adjustments after December 31, 1969, and before the date of disposition under the rules of Part II of Subchapter O of Chapter 1, provided that the property was held by the private foundation on December 31, 1969, and continuously thereafter to the date of disposition, or (B) basis as determined under the rules of Part II of Subchapter O of Chapter 1, subject to the provisions of section 4940(c)(3)(B) (and without regard to section 362(c)). Treas. Reg. § 53.4940-1(f)(2)(ii) provides that for purposes of determining loss from the sale or other disposition of property, basis shall be determined under the rules of Part II of Subchapter O of Chapter 1, subject to the provisions of section 4940(c)(3)(B) (and without regard to section 362(c)).

Section 4940(c)(5) provides that, for purposes of section 4940, net investment income is determined by applying section 103 (relating to State and local bonds) and section 265 (relating to expenses and interest relating to tax-exempt income).

SECTION 3. BASIS FOR DETERMINING GAIN OR LOSS ON DISPOSITION OF PROPERTY

Similar to the rules found in section 4940(c), the Treasury Department and the IRS intend to propose regulations stating that, in the case of property held by an applicable educational institution on December 31, 2017, and continuously thereafter to the date of its disposition, basis of such property for determining gain shall be deemed to be not less than the fair market value of such property on December 31, 2017, plus or minus all adjustments after December 31, 2017, and before the date of disposition consistent with the regulations under section 4940(c). In addition, for purposes of determining loss, basis rules that are consistent with the regulations under section 4940(c) will apply.

SECTION 4. NETTING CAPITAL GAINS AND LOSSES

Similar to the rules found in section 4940(c)(4)(C), the Treasury Department and the IRS intend to propose regulations stating that losses from sales or other dispositions of property generally shall be allowed only to the extent of gains from such sales or other dispositions, and there shall be no capital loss carryovers or carrybacks. The Treasury Department and the IRS also expect that with respect to related organizations described in section 4968(d)(2), overall net losses from sales or other dispositions of property in one related organization (or from the applicable educational institution) will be allowed to offset overall net gains from such sales or other dispositions from other related organizations (or from the applicable educational institution), but request comments on this issue.

SECTION 5. RELIANCE

Before the issuance of the proposed regulations described in this notice, applicable educational institutions described in section 4968(b)(1) may rely on the rules described in section 3 of this notice.

SECTION 6. REQUEST FOR PUBLIC COMMENTS

The Treasury Department and the IRS request comments on the issues addressed in this notice, including comments on what other guidance under section 4968(c) is needed and whether, and what type of, transitional relief may be necessary.

Written comments may be submitted by September 6, 2018, to Internal Revenue Service, CC:PA:LPD:PR (Notice 2018-55), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, or electronically to Notice.Comments@irscounsel.treas.gov (please include "Notice 2018-55" in the subject line). Alternatively, comments may be hand delivered between the hours of 8:00 a.m. and 4:00 p.m. Monday to Friday to CC:PA:LPD:PR (Notice

2018-55), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, D.C. Comments will be available for public inspection and copying.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Amber Mackenzie of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Amber Mackenzie or Melinda Williams at (202) 317-5800 (not a toll-free number).