Transfer Pricing Issues for Tax-Exempt Organizations in a Post-Tax Reform World

Presenters:
Brian Todd | Partner (Moderator)
Mike Engle | Partner | Tax Exempt
Will James | Partner | Transfer Pricing

I. Introduction

II. Overview of transfer pricing rules
   a. What is transfer pricing?
      i. Involves transactions between related entities (both domestic and foreign)
   b. Application of the arm's-length standard
      i. Transactions between related parties need to be conducted as if the parties were unrelated to each other
      ii. Subject transactions can include: sale of tangible goods; provision of services, license of intangible property rights and financing
   c. How the transfer pricing rules apply to tax-exempt organizations
      i. Has application to transactions between tax-exempt organizations and their related for-profit entities
      ii. The for-profit entity is taxable and its taxable income could be affected by its dealings with its related tax-exempt organization – hence, the amount of taxes it pays would be affected
      iii. Transfer pricing regulations are often used to determine the profits related to unrelated business income (UBI) and determine fair market value when no market price is available
   d. Applicable transfer pricing rules
      i. Section 482 of the Internal Revenue Code
   e. Types of tax-exempt organizations that can be impacted by transfer pricing issues
      i. Universities and colleges
      ii. Associations and other membership groups
      iii. Hospital systems
      iv. Insurance
      v. Power cooperatives
      vi. Foundations
      vii. Religious organizations
f. Transfer pricing documentation rules
   i. Taxpayer is required to prepare annual documentation before the tax return is filed for that year (so-called 'contemporaneous documentation requirement')
   ii. Documentation also has to be provided to the IRS within 30 days of their request for such documentation
   iii. IRS agents are required to request the documentation during an exam
   iv. If there is an adjustment to taxable income during an examination, penalties of 20% or 40% of the additional tax can be levied by the IRS if the taxpayer does not have contemporaneous documentation

g. Specific considerations pertaining to tax-exempt entities involving transfer pricing
   i. Related-party services can trigger UBI or not be considered UBI
      1. If the services are an integral part of the tax-exempt entity’s exempt activities, they are not considered UBI
      2. Need to determine if the costs will be transferred at cost or with a markup
   ii. Need to consider if rents, royalties, interest and annuities are UBI to exempt entities

III. IRS enforcement efforts
   a. IRS has indicated it perceives there are abuses by tax-exempt organizations in allocating expenses related to UBI
   b. IRS has indicated it perceives there are abuses by tax-exempt organizations in relation to their dealings with their for-profit entities
   c. IRS has been focusing on profit motive and limiting NOL carryforwards

IV. Changes to the tax-exempt entity rules as a result of the Tax Cuts and Jobs Act
   a. Activity-by-activity reporting of UBI
      i. Losses can only be used to offset income from the same activity
      ii. Allocation of expenses between activities becomes even more important

V. Benefits of preparing a transfer pricing analysis
   a. Safeguarding tax-exempt status
   b. Potential tax savings through proper transfer pricing planning
   c. Avoidance of adjustments to taxable income, penalties and interest
   d. Avoidance of adverse publicity associated with a potential adjustment to income of a related taxable entity