NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 PH 518.463.3200 www.nysba.org

TAX SECTION

2026-2027 Executive Committee

LAWRENCE M. GARRETT
Chair
Ernst & Young LLP
5200 Town Center Circle, Suite 601
Boca Raton, FL 33486
202/327-6987
LUCY W. FARR
First Vice Chair
212/450-4026
DAVID M. SCHIZER
Second Vice Chair
917/882-6238
SARA B. ZABLOTNEY
Secretary
212/446-4772
COMMITTEE CHAIRS:
Attributes
Andrew M. Herman
Stephen M. Massed
Bankruptcy and Operating Losses
Stuart J. Goldring
Brian Krause
Compliance, Practice & Procedure
Megan L. Brackney
Elliot Pisem
Consolidated Returns
William Alexander
Shane J. Kiggen
Corporations
William A. Curran
Vadim Mahmoudov
Cross-Border Capital Markets
Jason R. Factor
Craig M. Horowitz
Cross-Border M&A
Adam Kool
Ansgar A. Simon
Debt-Financing and Securitization
John T. Lutz
Eschi Rahimi-Laridjani
Estates and Trusts
Austin Bramwell
Alan S. Halperin
Financial Instruments
Jeffrey Maddrey
Elena V. Romanova
"Inbound" U.S. Activities of Foreign Taxpayers
W. Wade Sutton
S. Eric Wang
Individuals
Brian C. Skarlatos
Libin Zhang
Investment Funds
James R. Brown
Pamela Lawrence Endreny
New York City Taxes
Alysse McLoughlin
Irwin M. Slomka
New York State Taxes
Paul R. Comeau
Jack Trachtenberg
"Outbound" Foreign Activities of U.S. Taxpayers
Kara L. Mungovan
Peter F. G. Schuur
Partnerships
Meyer H. Fedida
Amanda H. Nussbaum
Pass-Through Entities
Edward E. Gonzalez
Eric B. Sloan
Real Property
Marcy Geller
Jonathan R. Talansky
Reorganizations
Joshua M. Holmes
David M. Rievman
Spin-Offs
Tijana J. Dvornic
Michael T. Mollerus
Tax Exempt Entities
Jill Manny
Stuart Rosow
Taxable Acquisitions
Richard M. Nugent
Davis J. Wang
Treaties and Intergovernmental Agreements
David R. Hardy
William L. McRae

MEMBERS-AT-LARGE OF EXECUTIVE COMMITTEE:

Y. Bora Bozkurt
Erin Cleary
Matthew J. Donnelly
Kristen Gamboa
Lorenz F. Haselberger
Kevin Jacobs
Rafael Kariyev
Rebecca Lee
Lulu Ma
Elizabeth Pascal
Arvind Ravichandran
Jennifer Ray
Yaron Z. Reich
Rachel B. Reisberg
Stephen E. Shay
Michael B. Shulman
Patrick E. Sigmon
Raymond J. Stahl
Joseph Tootle
Thomas F. Wood

Report No. 1529
June 7, 2026

The Honorable Scott Bessent
Secretary of the Department of the Treasury, and Acting Commissioner of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Kenneth J. Kies
Assistant Secretary (Tax Policy) of the Department of the Treasury, and Acting Chief Counsel of the Internal Revenue Service
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: NYSBA Tax Section Report No. 1529 - Report on Amendments to Section 4968

Dear Secretary Bessent and Assistant Secretary Kies:

Please see attached Report No. 1529 of the Tax Section of the New York State Bar Association (the "**Report**") commenting on amendments to Section 4968 of the Internal Revenue Code enacted by Public Law 119-21, commonly referred to as the "One Big Beautiful Bill Act" (the "**OBBBA**"). The changes to Section 4968 made by the OBBBA include the introduction of a graduated excise tax regime, the modification of the definition of an applicable educational institution, and the expansion of the categories of income subject to the excise tax. These statutory changes raise a number of significant interpretive and administrative issues for affected institutions and related organizations.

The Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") have previously issued important regulatory guidance under Section 4968 (Treas. Reg. §§ 53.4968-1 through -4). Given the breadth and complexity of the recent OBBBA amendments, and their

FORMER CHAIRS OF SECTION:

Peter L. Faber
David Sachs
J. Roger Mentz
James M. Peaslee
Peter C. Canellos
Michael L. Schler
Richard L. Reinhold
Steven C. Todrys
Harold R. Handler
Robert H. Scarborough
Samuel J. Dimon
Andrew N. Berg
Lewis R. Steinberg
David P. Hariton
Kimberly S. Blanchard
Patrick C. Gallagher
David S. Miller
Erika W. Nijenhuis
Peter H. Blessing
Jodi J. Schwartz
Andrew W. Needham
Diana L. Wollman
David H. Schnabel
Stephen B. Land
Michael S. Farber
Karen Gilbreath Sowell
Deborah L. Paul
Andrew H. Braiterman
Gordon E. Warnke
Robert Cassanos
Philip Wagman
Jiyeon Lee-Lim
Andrew Walker

effective date for taxable years beginning after December 31, 2025, we believe that additional, timely guidance is warranted to facilitate consistent and administrable application of the rules. The Report identifies several areas where further guidance would be particularly helpful, including the definition of an applicable educational institution, the definitions of "student" and "tuition-paying student," the treatment of royalties and federally-funded intellectual property, the treatment of student loan interest, certain basis determinations, and the scope of any anti-abuse rule.

We appreciate the opportunity to comment on the OBBBA amendments and thank Treasury and the IRS for considering the views of the Tax Section. If you have any questions or would like to discuss any aspect of the Report, please do not hesitate to contact us. We would be pleased to assist in any way.

Respectfully submitted,

Lawrence M. Garrett
Chair

Enclosure

cc:

Kevin Salinger
Deputy Assistant Secretary (Tax Policy)
Department of the Treasury

Krishna Vallabhaneni
Tax Legislative Counsel
Department of the Treasury

Amber MacKenzie
Attorney Advisor
Office of Tax Policy
Department of the Treasury

Lynne Camillo
Deputy Associate Chief Counsel for Exempt Organizations
and Employment Taxes
Internal Revenue Service

Chelsea Rubin
Special Counsel
Office of the Associate Chief Counsel (Employee Benefits,
Exempt Organizations, and Employment Tax)
Internal Revenue Service

Report No. 1529

NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON AMENDMENTS TO SECTION 4968

June 7, 2026

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

TABLE OF CONTENTS

Page

I. **SUMMARY OF RECOMMENDATIONS**……………………………………………5

A. Definition of Applicable Education Institution……………………………………5

B. Definition of Student…………………………………………………………5

C. Royalties……………………………………………………………………..6

D. Student Loan Interest and Student Loans……………………………………………7

E. Basis Step Up for Existing Properties……………………………………………..7

F. Anti-Abuse Rule………………………………………………………………...7

II. **OVERVIEW OF SECTION 4968 AND BACKGROUND**………………………...7

A. General Background……………………………………………………………7

B. Summary of the Final Regulations…………………………………………………10

C. Changes Enacted by OBBBA……………………………………………………13

III. **RECOMMENDATIONS**…………………………………………………………...14

A. Definition of Applicable Education Institution…………………………………...14

B. Definition of Student……………………………………………………………..18

i. Academic Credit…………………………………………………………19

ii. Tuition Commensurate with the Rate Charged to Students Enrolled for a Degree…………………………………………………………………20

iii. Scholarships from Related Organizations………………………………..20

C. Royalties……………………………………………………………………21

i. Rules for Determining When IP is Considered "Federally Funded"……..22

ii. Assets Used Directly in Carrying Out Exempt Purpose………………….25

iii. Gain from the Sale of IP…………………………………………………26

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

iv. Expenses Incurred to Derive Royalties……………………………………...28

D. Student Loan Interest and Student Loans…………………………………………30

i. Treatment of Student Loan Interest Derived by Related Organizations….31

ii. Assets Used Directly in Carrying Out Exempt Purpose………………….32

iii. Expenses Incurred to Derive Student Loan Interest……………………….32

E. Basis Step Up for Existing Properties……………………………………………33

F. Anti-Abuse Rule……………………………………………………………………34

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

REPORT OF THE TAX SECTION OF THE NEW YORK STATE BAR ASSOCIATION

This report ("Report")[1] of the New York State Bar Association Tax Section comments on the amendments made to Section 4968[2] by Public Law 119-21, commonly known as the One Big Beautiful Bill Act ("OBBBA").[3] That Section imposes an annual excise tax on the net investment income of an "applicable educational institution," as defined in Section 4968(b) and, as described in Section 4968(d), a portion of certain net investment income of certain related organizations, for the taxable year. The changes enacted under OBBBA included the replacement of a flat 1.4% excise tax rate with a graduated tax rate, a modification to the test for determining whether an institution is subject to the tax, and an expansion of the type of income included in gross investment income subject to the tax, among others.[4] These changes are effective for taxable years beginning after December 31, 2025.[5]

This Report follows our prior report dated October 1, 2019 (the "Prior Report"), which discussed proposed Section 4968 regulations[6] and our initial report dated June 7, 2018 (the "2018 Report"), which discussed certain provisions that affect exempt organizations, including Section 4968.[7]

Part I of this Report lists our principal recommendations for guidance from the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS"). Part II describes Section 4968 generally, including the changes to Section 4968 enacted by OBBBA. Part III provides a detailed discussion of our comments and recommendations.

---

[1] The principal drafters of this Report are Jean Bertrand, Jill Manny, and Stuart L. Rosow, with substantial assistance from Lylah Paine. Helpful comments were provided by Kimberly S. Blanchard, Robert Cassanos, Lawrence Garrett, David Schizer, Michael Schler, Jodi Schwartz, Sara B. Zablotney and Libin Zhang. This Report reflects solely the views of the Tax Section and not those of its individual members or any other party.

[2] Unless otherwise stated, all "Section" references are to the Internal Revenue Code of 1986, as amended, (the "Code"), "Treas. Reg. §" references are to the Treasury regulations thereunder, and "Prop. Treas. Reg. §" references are to proposed Treasury regulations promulgated under the Code.

[3] One Big Beautiful Bill Act, Pub. L. No. 119-21, 139 Stat. 72 (2025).

[4] *See* Section 4968 (2025).

[5] One Big Beautiful Bill Act § 70415(c), 139 Stat. at 224

[6] New York State Bar Association Tax Report No. 1424, *Report on Proposed Section 4968 Regulations* (October 1, 2029).

[7] New York State Bar Association Tax Report No. 1396, *Report on Provisions of the New Tax Law Affecting Tax-Exempt Organizations* (June 7, 2018).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

I. SUMMARY OF RECOMMENDATIONS

A. Definition of Applicable Education Institution

1. We recommend that Treasury and the IRS issue regulations clarifying the definition of eligible educational institution for purposes of Section 4968. Schools that are controlled by an educational institution or are under common control with the educational institution should be aggregated as a single eligible educational institution for purposes of determining the number of tuition-paying students as well for purposes of computing an eligible educational institution's student adjusted endowment. Students and assets should be counted consistently for purposes of calculating the institution's student adjusted endowment. Under this approach, the students of a particular school within a university would only be taken into account in determining the number of tuition-paying students and the student adjusted endowment if the assets of that school were also counted. An appropriate standard for determining control and common control is to apply the definition of control already used in Treasury regulations section 53.4968-3(b) with some suggested modifications to focus more closely on control over a school's governing body.

B. Definition of Student

1. We recommend that Treasury and the IRS clarify what enrolled and attending a course for "academic credit" from the institution means. Treasury should provide that "academic credit" means credit that is included in a transcript or other record maintained by an educational institution and awarded in credit hours or another recognized academic unit. Additionally, certain credit-bearing non-degree certificate programs (e.g., executive programs) as well as credit eligible classes taken by students not pursuing a formal degree should qualify.

2. We recommend that Treasury and the IRS clarify what "being charged tuition at a rate that is commensurate with the tuition rate charged to students enrolled for a degree" means. Treasury and the IRS should consider adopting one or more safe harbors pursuant to which a student will be treated as charged tuition at a rate that is commensurate with the tuition rate charged to students enrolled for a degree, such as a per-credit safe harbor or a flat-rate tuition conversion safe harbor. For tuition charges that do not otherwise satisfy one of the safe harbors, a general facts and circumstances test should apply.

3. We recommend that, for purposes of determining whether a student is a "tuition-paying student," scholarships from any related organization, the assets of which are required to be taken into account by the educational institution in calculating the student adjusted endowment, be considered paid by the educational institution in determining whether the student is tuition-paying.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

C. Royalties

1. We recommend that Treasury and the IRS provide a direct tracing rule for determining when federal funds are considered "used" in the research, development, or creation of IP (as defined below). Under this rule, royalties generated by IP would be included in gross investment income only where federal funds were directly granted or paid to the educational institution, or a faculty member or student in that capacity, for the purpose of conducting research or similar activities and such research and activities result in the development or creation of IP. We also recommend that educational institutions generally be permitted to use any reasonable method, consistently applied, to identify federally-subsidized IP. Consistent with this framework, for IP of a type subject to a requirement that there be a "Bayh-Dole" (defined below) filing or other filing in a federal registry or under a federal agency grant tracking system that identifies IP of that type as being federally funded, an educational institution should be entitled to rely on the existence or absence of any such filing to identify applicable, federally-funded IP and should be required to treat as federally funded any applicable IP so identified.

2. We recommend that Treasury and the IRS issue guidance treating, for purposes of determining a school's student-adjusted endowment, all IP resulting from the work of students or faculty members in their capacities as such with the applicable educational institution as assets used directly in carrying out the institution's exempt purposes under Treas. Reg. § 53.4968-1(b)(5) regardless of whether royalties from the IP are federally-subsidized.

3. We recommend that Treasury and the IRS issue guidance clarifying whether capital gain from the sale or other disposition of IP that produces federally-subsidized royalty income is taken into account in calculating net investment income.

4. We recommend that Treasury and the IRS develop rules that would permit the deduction of all costs incurred in developing federally funded IP against any royalty income produced by such IP. We recommend an approach under which educational institutions would be permitted to elect to capitalize research and development expenses for a federally funded project and amortize those capitalized amounts over a period of time selected by the institution and beginning when income is first recognized. This approach should be undertaken on a project-by-project basis, so that costs incurred for a project would be deductible only against income from that project. For costs incurred prior to the enactment of OBBBA, we recommend that institutions be permitted to elect to capitalize their historic costs, which would be subject to amortization under these rules.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

D. Student Loan Interest and Student Loans

1. We recommend that Treasury and the IRS issue guidance clarifying whether the rules in Section 4968(g) and Treas. Reg. § 53.4968-3(d) apply to interest income from a student loan made by an organization related to an educational institution.

2. We recommend that Treasury and the IRS confirm that, for purposes of determining a school's student-adjusted endowment, student loans held on an educational institution's books are considered assets used directly in carrying out the institution's exempt purposes under Treas. Reg. § 53.4968-1(b)(5), whether or not income from the loans is taken into account in determining net investment income.

3. We recommend that Treasury and the IRS issue guidance allowing a carryforward of expenses incurred in generating student loan interest to offset student loan interest income earned in subsequent years, which is necessary to appropriately tax only the overall net income from student loan interest.

E. Basis Step Up for Existing Properties

1. We recommend that Treasury and the IRS confirm that universities that become subject to the Section 4968 excise tax after the enactment of the OBBBA amendments will be allowed to use the fair market value of an asset on December 31, 2017, as its basis for purposes of calculating the gain on sale of the asset subject to the tax, consistent with universities that became subject to the tax as of its original enactment.

F. Anti-Abuse Rule.

1. We believe that any regulations issued should identify particular abusive transactions or known abusive arrangements designed to reduce or eliminate the value of net investment income or assets subject to the excise tax. In the absence of specific transactions or arrangements, any regulations should define characteristics or attributes that could cause a transaction and substantially similar transactions to be treated as abusive. We otherwise recommend that Treasury and the IRS refrain from issuing a broad, generally-applicable anti-abuse rule or more detailed anti-abuse guidance until ascertaining whether there is any actual abuse by institutions.

II. OVERVIEW OF SECTION 4968 AND BACKGROUND

A. General Background

Section 4968 imposes an annual excise tax on the net investment income of certain educational institutions. This excise tax is intended to be similar to the excise tax under Section

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

4940 which applies to private foundations, but not to public charities.[8] As private colleges and universities are generally treated as public charities rather than private foundations, they are not subject to the private foundation excise tax on net investment income under Section 4940.[9]

Section 4968 was originally added to the Code by section 13701 of public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act (the "TCJA").[10] In response to an increase in the endowment balances at many private colleges and universities coupled with a rise in college tuition fees in excess of inflation, Congress initially imposed a "modest excise tax" on investment income derived from endowments of certain educational institutions.[11] The legislative history justified the tax by explaining that, in certain cases, the endowments of private colleges or universities had grown so large that the endowments were not commensurate with the scope of the institution's activities in educating students, particularly where a significant portion of the student population did not receive scholarships.[12] Prior to the enactment of the TCJA, Congress held a hearing to address tax-exempt college and university endowments. The hearing was framed by Representative Peter Roskam, the Chairman of the Subcommittee on Oversight of the House Ways and Means Committee, as necessary to address the rising costs of higher education. Sheila Bair, President of Washington College, testified to the importance of scholarships, and commended the Subcommittee for looking at college endowments as a means to provide further financial aid to students. Chairman Roskam also noted that it would be interesting to look at ways to incentivize donors to contribute to scholarships, noting that it would not be unprecedented to use the tax code in such a way.[13]

As originally enacted, Section 4968 imposed an annual excise tax of 1.4 percent on the net investment income of an "applicable educational institution," as defined in Section 4968(b). The

[8] *See* STAFF OF S. COMM. ON BUDGET, 115TH CONG., EXPLANATION OF BILL TO THE TAX CUTS AND JOBS ACT, 268 (Nov. 30, 2017), https://www.budget.senate.gov/imo/media/doc/SFC%20Explanation%20of%20the%20Bill.pdf (the "Senate Report").

[9] *Id.* An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on is considered a per se public charity. Section 509(a)(1) and Section 170(b)(1)(A)(ii). Although public charities are not subject to the excise tax on net investment income, they are subject to tax on any unrelated business taxable income ("UBTI"). Section 512.

[10] Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13701, 131 Stat. 2054, 2167 (2017).

[11] Senate Report, 268 ("In recent years, the endowment balances at many private colleges and universities have increased dramatically. At the same time, college tuition has risen at rates in excess of the rate of inflation. Where the endowment of a private college or university has grown so large that it is not commensurate with the scope of the institution's activities in educating students, and where the significant portion of the student population does not receive scholarships, the Committee believes it is appropriate to impose a modest excise tax on the investment income derived from the endowment.").

[12] *Id.*

[13] Hearing on Tax-Exempt College and University Endowments: Hearing Before the Subcommittee on Oversight of the H. Comm. on Ways & Means, 114th Cong. (Sept. 13, 2016), Serial No. 114-OS14.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

TCJA defined an "applicable educational institution" by reference to Section 25A(f)(2) to include all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions[14] (i) that have at least 500 tuition-paying students during the preceding taxable year, [15] (ii) more than 50 percent of the tuition-paying students of which are located in the United States, (iii) that are private schools and not state or community colleges or universities, [16] and (iv) that have a least $500,000 in assets per student, "other than those assets which are used directly in carrying out the institution's exempt purpose."[17]

In general, the assets and net investment income of related organizations are attributed to the educational institution.[18] For these purposes, a related organization is any organization that controls, is controlled by, or is under common control with the private college or university, or that is a supported organization described in Section 509(f)(3) or a supporting organization described in Section 509(a)(3) with respect to the applicable educational institution.[19] There are two exceptions. First, no amount shall be taken into account with respect to more than one educational institution.[20] Second, unless the related organization is "controlled by" the educational institution or is described in Section 509(a)(3) (relating to supporting organizations) with respect to such institution for the taxable year, assets and net investment income which are "not intended or available for the use or benefit" of the educational institution will not be taken into account.[21]

The Conference Report for the TCJA states that Congress intended that Treasury promulgate regulations to carry out the intended purpose of Section 4968, including regulations that describe: (a) assets that are used directly in carrying out an educational institution's exempt purposes; (b) the computation of net investment income; and (c) assets that are intended or available for the use or benefit of an educational institution.[22]

---

[14] Section 25A(f)(2) defines "eligible educational institution" as an institution described in the Higher Education Act of 1965 (20 U.S.C. 1088) ("HEA") and eligible to participate in certain U.S. federal student financial aid programs.

[15] We understand that the tuition-paying requirement is intended to exempt Berea College (a college in Kentucky that does not charge tuition but has a large endowment) from the tax. *See* New York State Bar Association Tax Report No. 1424, *Report on Proposed Section 4968 Regulations,* (Oct. 1, 2019) at 5, FN 10.

[16] For this purpose, the number of students of an institution (and the number of students at a particular location) is based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis). Section 4968(b)(2) (2017).

[17] Section 4968(b) (2017).

[18] Section 4968(d)(1) (2017).

[19] Section 4968(d)(2) (2017).

[20] Section 4968(d)(1)(A) (2017).

[21] Section 4968(d)(1)(B) (2017).

[22] H.R. REP. NO. 115-466, at 555 (2017) (the **"**Conference Report**"**).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

On June 8, 2018, Treasury and the IRS issued Notice 2018-55[23] to provide interim guidance regarding the calculation of the excise tax. On July 3, 2018, Treasury and the IRS issued proposed regulations under Section 4968 (the "Proposed Regulations").[24] The Proposed Regulations generally incorporated the interim guidance provided in Notice 2018-55, defined several terms, and requested comments on certain aspects of the application of the excise tax.[25]

On October 15, 2020, prior to the enactment of OBBBA, Treasury and the IRS issued final regulations under Section 4968 (the "Final Regulations").[26]

B. Summary of the Final Regulations

The Final Regulations provide additional guidance on the excise tax and define several terms necessary for educational institutions to determine whether the excise tax applies to them, including the term "applicable educational institution," and several terms related to the number of students that should be counted for purposes of the 500 "tuition-paying" student test.[27]

"Tuition-paying" is defined by the Final Regulations as the payment of any tuition or fees, but does not include payment for room and board or other personal living expenses, or payments for supplies or equipment required of enrolled students during a specific course.[28] Students required to pay a comprehensive or bundled fee that combines charges for tuition with charges for personal expenses (e.g., room and board) are considered tuition-paying students.[29] The determination of whether a student is tuition-paying is made after taking into account any scholarships and grants provided directly by the educational institution or the federal, or any state or local, government, and after application of any work study program operated by the institution.[30] However, scholarships and grants provided by non-governmental third-parties, including related organizations and supporting organizations, are considered tuition payments on behalf of the student.[31] Thus, a student receiving a full-tuition scholarship from an educational institution is not a tuition-paying student, whereas if the scholarship came from a related organization the student would be a tuition-paying student.

---

[23] 2018-26 I.R.B. 773.

[24] REG 106877-18, 84 Fed. Reg. 31795 (July 3, 2019) (the "Preamble to the Proposed Regulations").

[25] Prop. Treas. Reg. §§ 53.4968-1(b), (c).

[26] TD 9917, 85 Fed. Reg. 65526 (October 15, 2020) (the "Preamble to the Final Regulations").

[27] Treas. Reg. § 53.4968-1(b).

[28] Treas. Reg. § 53.4968-1(b)(3)(i).

[29] Treas. Reg. § 53.4968-1(b)(3)(ii).

[30] Treas. Reg. § 53.4968-1(b)(3)(iii).

[31] *Id.*

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

The Final Regulations further clarified what assets count for the $500,000 of assets per student test (including by providing certain rules governing assets of related organizations) and how to value such assets.[32] For affected institutions, the Final Regulations provided guidelines on how to determine which assets are used in furthering the institution's tax-exempt purposes,[33] and how to calculate net investment income[34] (including rules relating to the net investment income of related organizations[35] and tax basis).[36]

The Final Regulations generally provided that if a related organization controls an educational institution, is under common control with an educational institution (but is not described in Section 509(a)(3) with respect to the organization for the taxable year), or is a supported organization, then its assets are not taken into account for purposes of the per-student endowment test unless the assets are "intended or available for the use or benefit of the educational institution", meaning, they are specifically earmarked or restricted for the benefit of, or otherwise fairly attributable to, the institution, such as being affirmatively designated or appropriated or available to be drawn at will.[37] However, if a related organization is controlled by the educational institution or is a supporting organization described in Section 509(a)(3) with respect to the institution during the taxable year, all of its assets and net investment income will be taken into account, regardless of whether they are earmarked or restricted for the benefit of, or otherwise are fairly attributable to, the educational institution and even if they are specifically earmarked or restricted for another entity or for unrelated purposes (subject to special rules applicable to Type III supporting organizations).[38] For these purposes, an educational institution is generally deemed to control another organization if (i) the organization is a corporation exempt from tax under section 501(a) and the educational institution owns (by vote or value) more than 50 percent of the voting and non-voting stock or membership interests in the corporation, or (ii) the organization is a nonstock organization and the educational institution can (A) appoint or elect (and remove and replace) more than 50 percent of the members of the educational institution's governing body, (B) require the organization to make (or prevent it from making) an expenditure, or (C) require the

---

[32] Treas. Reg. § 53.4968-1(b)(5); Treas. Reg. Sec. 53.4968-3(d); *see also* Preamble to the Final Regulations, pp. 65529-65532.

[33] Treas. Reg. § 53.4968-1(b)(5)(i)-(ii).

[34] Treas Reg. § 53.4968-2.

[35] Treas. Reg. § 53.4968-3(d).

[36] Treas. Reg. § 53.4968-2(d)(2)-(3).

[37] Treas. Reg. § 53.4968-3(d)(2)(B).

[38] Preamble to the Final Regulations, p. 65541. The Final Regulations also excluded certain entities from being treated as related organizations, including (i) taxable corporations (ii), partnerships, S corporations, and other pass-through entities whose income flows through to the educational institution, (iii) a decedent's estate, and (iv) certain trusts. Treas. Reg. § 53.4968-3(a)(2).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

organization to perform (or prevent it from performing) any act that significantly affects its operations.[39]

Additionally, the Final Regulations generally excluded from the calculation of net investment income (i) certain interest on student loans, (ii) rental income on housing provided by the institution or a related organization to students of the institution and from housing for faculty and staff if the housing is provided contingent on their roles as faculty or staff of the institution, and (iii) royalty income derived from patents, copyrights, and other intellectual property and intangible property ("IP") to the extent those assets resulted from the work of students or faculty in their capacities as such with the institution.[40] The rationale for these exclusions was that it would be consistent with the overall purpose of Section 4968 to exclude investment income derived from assets like these used directly in carrying out an educational institution's exempt purpose.[41]

Lastly, for purposes of determining net investment income, the Final Regulations established rules generally allowing educational institutions, for purposes of calculating gain on disposition, to step up their basis in assets[42] and partnership interests[43] held as of December 31,

---

[39] Treas. Reg. § 53.4968-3(b)(2). Additional rules apply to trusts that are controlled by educational institutions.

[40] Treas. Reg. § 53.4968-2(b)(2).

[41] Preamble to the Final Regulations, p. 65532-65533. The preamble to the Proposed Regulations noted that, in contrast to the express exclusion of assets used directly in carrying out an institution's exempt purpose in determining whether an institution was an "applicable educational institution," the statue did not expressly limit "net investment income" to net income derived from assets that are not used directly in carrying out an educational institution's exempt purpose. The preamble asked for comments on whether certain types of income, such as student loan interest and rents from student and faculty housing, should be excluded from gross investment income because taxing those types of income would not further congressional intent. *See* Preamble to the Proposed Regulations p. 31800. In response to comments, the Final Regulations generally excluded from gross investment income student loan interest and rent from student and staff housing, as well as, royalties from IP to the extent the IP resulted from the work of students or faculty in their capacities as such with the applicable educational institution (but not royalties from trademarks on the institution's logo or name or royalty from intellectual property donated or sold to the institution). Treas. Reg. § 53.4968-2(b)(2); *see also* Preamble to the Final Regulations p. 65532-65535.

[42] More specifically, for purposes of calculating capital gain net income from the disposition of property other than a partnership interest, an applicable educational institution's basis in an asset for generally is the greater of (a) the fair market value of the property as of December 31, 2017, plus or minus all subsequent basis adjustments or (b) the basis as determined under part II of subchapter O. Treas. Reg. § 53.4968-2(d)(2)(i).

[43] For purposes of determining an applicable educational institution's share of gain upon the disposition of a partnership asset or a partnership interest, the institution's basis in such asset or interest is generally determined under the rules of Subchapter K, but its distributive share of gain from the sale of a partnership asset, or its gain on the sale of a partnership interest is reduced (i) in the case of a disposition of a partnership asset, by the least of the institution's share of applicable capital gain from the partnership, one-third of the institution's unadjusted step-up for the partnership, or the intuition's adjusted step-up for such partnership and (ii) in the case of a disposition of all or a portion of a partnership interest, by an amount that bears the same relation to the institution's adjusted step-up for the partnership as the fair market value of the transferred portion of the partnership interest bears to the fair market value of the institution's entire interest in the partnership before the disposition. Treas. Reg. § 53.4968-2(d)(3)(ii).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

2017 and continuously thereafter, to the fair market value of such property as of December 31, 2017, the effective date of Section 4968. This rule is similar to the rule in Section 4940(c)(4)(B) which allowed private foundations a basis step-up as of the effective date of the private foundation excise tax under Section 4940.[44] The rationale for the step-up was to avoid taxing private foundations on appreciation in value that occurred prior to the enactment of the tax.[45] Section 4968(c) requires net investment income to be determined under rules similar to Section 4940(c).

C. Changes Enacted by OBBBA

Section 4968 was amended by OBBBA such that applicable educational institutions are now subject to a sliding scale excise tax rate (the "applicable percentage") depending upon the size of their "student adjusted endowments". For institutions with a student adjusted endowment of at least $500,000 and not in excess of $750,000, the applicable percentage is 1.4 percent.[46] For institutions with a student adjusted endowment in excess of $750,000 and not in excess of $2,000,000, the applicable percentage is 4%.[47] For institutions with a student adjusted endowment in excess of $2,000,000, the applicable percentage is 8%.[48] An institution's student adjusted endowment is equal to the aggregate fair market value of its assets (determined as of the end of the preceding taxable year), other than those assets which are used directly in carrying out its exempt purpose, divided by, the number of students of the institution.[49]

OBBBA also redefined what constitutes an "applicable educational institution" by increasing the number of tuition-paying students an eligible educational institution needed to have in order to be subject to the tax from at least 500 to at least 3,000 tuition-paying students during the preceding taxable year.[50]

OBBBA included a provision overriding the regulatory exemption from net investment income for student loan interest and federally-subsidized royalties, and thus for taxable years beginning after December 31, 2025, the net investment income of an applicable educational

---

The unadjusted basis step-up is equal to the excess of the fair market value of the interest over its adjusted basis, in each case as of December 31, 2017. Treas. Reg. § 53.4968-2(d)(3)(iii)(B). The adjusted basis step-up is equal to the unadjusted basis step-up reduced by any capital gain net income reductions. Treas. Reg. § 53.4968-2(d)(3)(iii)(C).

[44] Section 4940(c)(4)(B).

[45] Rev. Rul. 76-424, 1976-2 C.B. 367, 368.

[46] Section 4968(b)(1).

[47] Section 4968(b)(2).

[48] Section 4968(b)(3).

[49] Section 4968(d). According to the legislative history, assets used directly in carrying out an institution's exempt purpose include classroom buildings and physical facilities used for educational activities and office equipment or other administrative assets used by employees of the institution in carrying out exempt activities, among other assets. Conference Report, 419.

[50] Section 4968(c)(1).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

institution will be calculated taking into account any interest from a student loan made by the institution (or a related organization) and any federally-subsidized royalty income (as described in more detail below).[51]

Finally, OBBBA added an anti-abuse provision directing the Secretary of the Treasury to prescribe regulations to prevent avoidance of the tax. It is specifically aimed at preventing the restructuring of endowment funds, and the reduction of value of net investment income or assets subject to the tax.[52]

III. RECOMMENDATIONS

A. Definition of Applicable Education Institution

Section 4968(b)(1) defines "applicable educational institution," in part, as an eligible educational institution defined in Section 25A(f)(2).[53] Treas. Reg. § 53.4968-1(b) provides that an applicable educational institution must be an "eligible educational institution" described in Section 25A(f)(2) and Treasury regulations section 1.25A-2(b).[54]

Treasury regulations section 1.25A-2(b) in turn defines "eligible educational institution" by reference to qualification under the Higher Education Act of 1965 (20 U.S.C. 1088) as in effect on August 5, 1997 ("HEA").[55] Specifically, Treasury regulations section 1.25A-2(b) provides that an eligible educational institution means, in general, a college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the HEA (generally all accredited public, nonprofit, and proprietary postsecondary institutions)[56] that (i) is participating in a federal financial aid program under title IV of the HEA or (ii) is certified by the Department of Education as eligible to participate in such program but does not.[57]

Accordingly, by cross referencing Section 25A(f)(2) and Treasury regulations section 1.25A-2(b), the Final Regulations effectively provide that an accredited "college" or "university" meeting certain requirements is treated as an eligible educational institution. The U.S. Department of Education maintains a database containing information on accrediting agencies and the

---

[51] Section 4968(f)(2).

[52] Section 4968(h).

[53] Section 4968(b)(1).

[54] Treas. Reg. § 53-4968-1(b)(1).

[55] Treas. Reg. § 1.25A-2(b).

[56] Treas. Reg. § 1.25A-2(b)(i).

[57] Treas. Reg. § 1.25A-2(b)(ii).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

institutions, programs, internships and residencies they accredit.[58] The accreditation process is a voluntary public recognition practice that is entirely unrelated to the purpose of Section 4968. Under this process, it appears that a university with multiple schools may be classified as either one educational institution or multiple institutions. In other words, the university may be considered as a whole or each school may be considered a separate institution. We do not believe how a university may be accredited should, in and of itself, be determinative of whether the university or each individual school should be an eligible educational institution for purposes of Section 4968. The purpose of accreditation is to ensure that post-secondary schools meet acceptable levels of quality[59] and only students at accredited institutions are able to participate in federal financial aid programs.[60] Rules for accreditation of institutions and treatment as one or multiple institutions are subject to change unrelated to any tax policy.[61] For these reasons, we believe that the scope of what constitutes an eligible educational institution for excise tax purposes should not be based solely on a school's accreditation status, which is established independently of federal tax law.

Accordingly, we recommend that Treasury and the IRS issue regulations clarifying the definition of eligible educational institution for purposes of Section 4968. We believe that those regulations should address questions concerning the treatment of larger institutions, which may house multiple schools within the same university. In that situation, we believe that schools that are controlled by an educational institution, or that are under common control with the educational institution, should be aggregated as a single eligible educational institution for purposes of determining the number of tuition-paying students as well for purposes of computing an institution's student adjusted endowment. We believe it is appropriate that students and assets are counted consistently for purposes of calculating the institution's student adjusted endowment. Under this approach, the assets of a particular school within a university would only be taken into account in determining the number of tuition-paying students and the student adjusted endowment if the students of that school were also counted in determining the number of students (and tuition-paying students) attending the university.

There are many universities that are comprised of multiple schools (e.g., an undergraduate school, a law school, a medical school, and a business school). The Final Regulations do not address whether individual schools within a single university should be tested separately (and each

[58] The U.S. Department of Education maintains a database of accredited postsecondary institutions and programs. *See* Database of Accredited Postsecondary Institutions and Programs, https://ope.ed.gov/dapip/#/home (last visited Apr. 30, 2026).

[59] *Id.*

[60] *See* U.S. Dep't of Educ., *Overview of Accreditation in the United States*, https://www.ed.gov/laws-and-policy/higher-education-laws-and-policy/college-accreditation/overview-of-accreditation-united-states, (last visited Apr. 30, 2026).

[61] *See* U.S. Dep't of Educ., *U.S. Department of Education Announces Negotiated Rulemaking to Reform and Strengthen America's Higher Education Accreditation System* (Jan. 26, 2026), https://www.ed.gov/about/news/press-release/us-department-of-education-announces-negotiated-rulemaking-reform-and-strengthen-americas-higher-education-accreditation-system (last visited Apr. 30, 2026).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

treated as its own educational institution) or aggregated for purposes of the 3,000 tuition-paying student and student adjusted endowment tests. The Final Regulations also do not address whether it matters whether individual schools within a single university are separately incorporated and have their own tax-exempt status.

For example, consider a university, incorporated as a single entity, under which there are multiple schools (e.g., an undergraduate college, a law school and a medical school none of which are separately incorporated or have their own tax-exempt status) with each school having fewer than 3,000 tuition-paying students, but well in excess of 3,000 tuition-paying students when the students at all schools within the university (i.e., the undergrad, law and medical school students) are aggregated. Assume the university is registered under the HEA as the accredited institution, and each of the schools are listed as separate accredited programs. Alternatively, assume each school is separately identified as an accredited institution.

Similarly, consider a university under which there are multiple schools each of which is separately incorporated and has its own tax-exempt status, including an undergraduate college with 5,000 tuition-paying students and multiple other separately incorporated schools (e.g., a separately incorporated and tax-exempt law school and a separately incorporated and tax-exempt medical school) with fewer than 3,000 tuition-paying students each. In addition, assume that the board of trustees of the undergraduate university has the authority to appoint all of the trustees of each of the separate schools. Finally, assume that each separate school is registered as a separate accredited institution under the HEA.

The application of the Final Regulations to these various situations is unclear. The Final Regulations may be read such that, in the first example, the university as a whole (which is a single incorporated tax-exempt entity) is treated as a single applicable educational institution. Some may also read the Final Regulations such that, in the first example, if each "school" were a separately accredited institution, then each school would be evaluated separately (even though all the schools are part of a single incorporated and tax-exempt university) and neither the over-arching university nor any of the underlying schools would be treated as an applicable educational institution.

The Final Regulations could also be read such that, in the second example, only the undergraduate college with 5,000 tuition-paying students is within the definition of an applicable educational institution and that the other separately incorporated and tax-exempt schools of the university are independent institutions that are tested separately and are not aggregated and treated as single applicable educational institution (and none of the students of those separate schools are taken into account for purposes of calculating the student adjusted endowment).

The result is that certain institutions with large endowments but many smaller schools under the same university, each of which is treated as a separate eligible educational institution (and none having more than 3,000 tuition-paying students), could be unintentionally excluded from the application of Section 4968. It is also possible that treating separately incorporated and tax-exempt schools within an over-arching university as separate institutions could unintentionally inflate the student adjusted endowment because students of separately incorporated but related schools are not counted as students of the tested institution, yet the assets and income of the

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

separate schools are potentially taken into account in calculating the per-student endowment under the related organization rules (e.g., in the second example, if the tested institution is the undergraduate school, the tuition-paying students at the law and medical schools are not counted as students of the tested school, but because the law and medical schools are related to the undergraduate school, it is possible that their assets may be taken into account for purposes of the per-student endowment test).[62]

We believe that Congress intended for Section 4968 to apply to the university as a whole in both situations. Accordingly, we recommend that guidance provide rules for aggregating schools within a single university, including where those schools are separately incorporated tax-exempt entities, in a manner consistent with the rules for aggregating assets held by related organizations.

In this context, we believe that the appropriate standard for aggregating schools is "control" by an educational institution of another school or schools under "common control" (where two or more schools are controlled by the same persons). This would be similar to the standard that applies in determining which assets are included in calculating an educational institution's student adjusted endowment, with certain modifications.[63]

Under this approach, control and common control would generally follow standards similar to those set forth in the Final Regulations with respect to control over governing bodies and membership interests. For example, one school (School A) would be treated as controlling another school (School B) if (i) School A holds more than 50% of the voting power of membership interests in School B, or (ii) School A otherwise has the right to (A) appoint or elect (and remove and replace) more than 50% of the members of School B's governing body, or (B) subject to the discussion below, require School B to make (or prevent it from making) an expenditure, or require School B to perform (or prevent it from performing) any act that significantly affects its operations.[64]

School A and School B would be considered commonly controlled where (i) the same person or persons hold more than 50% of the voting power of membership interests in both schools or (ii) more than 50% of the members of School A's governing body are directly or indirectly controlled by persons that comprise more than 50% of the members of School B's governing body (and vice versa).[65]

Our recommendation would ensure that similarly situated universities and schools are treated consistently for purposes of Section 4868, regardless of differences in their organizational

---

[62] Section 4968(g).

[63] *See* Treas. Reg. § 53.4968-3(b).

[64] *See* Treas. Reg. § 53.4968-3(b)(2).

[65] Treas. Reg. § 53.4968-3(b)(3). Similar rules would also apply where schools are not organized in a corporate form, such as an LLC or perhaps a trust. In that situation, the test should be whether another institution is, in substance, able to appoint those persons who exercise authority over the school or whether the same persons possess the power to appoint for both the entities, regardless of form.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

structure or accreditation status under the HEA. In addition, this approach would promote consistency between the determination of an educational institution's student count and the determination of its student adjusted endowment.

We also believe that Treasury and the IRS should consider modifying the existing broad control tests in the Final Regulations to the extent those tests treat an organization as controlling another organization based on the ability to cause or prevent the other organization from making an expenditure or taking an action that significantly affects operations. In determining control over an operating entity, such as a separately organized school, control may be more appropriately limited to the power to appoint or elect, and remove and replace, more than 50% of the members of the entity's governing body, such as its directors or trustees or to the holding of more than 50% of the voting power of membership interests of the entity.[66] The existing indicia of control based on the ability to require or prevent expenditures or certain actions appear less applicable where one institution does not control the composition of the other entity's governing board and the board members owe independent fiduciary duties to their organization.

B. Definition of Student

Who is treated as a "student" is an important element in determining the application of Section 4968. In particular, the tax rate that applies to the net investment income of an applicable educational institution is determined by reference to the size of the institution's student adjusted endowment.[67] An institution's student adjusted endowment is, for any taxable year, the aggregate fair market value of the assets of the institution (determined as of the end of the preceding taxable year), other than those assets used directly in carrying out the institution's exempt purpose, divided by the number of students of the institution.[68]

The term "student" is not defined in the statute. The Final Regulations define the term "student" to mean "a person who is enrolled and attending a course for 'academic credit' from the institution and who is being charged tuition at a rate that is 'commensurate with the tuition rate charged to students enrolled for a degree'."[69] The Final Regulations do not further define "academic credit".

The number of students at an educational institution is based on the daily average number of full-time students (with part-time students taken into account on a full-time student equivalent basis).[70] The Final Regulations allow each educational institution to establish the standards it will

[66] The focus of the test should be on the ability to appoint those persons exercising decision making authority, even if fewer than a majority.

[67] Section 4968(d).

[68] Section 4968(d).

[69] Treas. Reg. § 53.4968-1(b)(2).

[70] Section 4968(e).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

use to determine the number of its part-time, full-time and full-time equivalent students; provided the standards may not be lower than the minimum applicable standards established by the HEA.[71]

i. Academic Credit

We recommend that Treasury and the IRS clarify what enrolled and attending a course for "academic credit" from the institution means.

Several points should be addressed: First, Treasury should provide that "academic credit" means credit that is included in a transcript or other record maintained by an educational institution and awarded in credit hours or another recognized academic unit.

Second, we recommend that Treasury and the IRS confirm that credit-bearing non-degree certificate programs (*e.g.*, executive programs) as well as credit eligible classes taken by students not pursuing a formal degree qualify. In these cases, the students should be subject to discernable standards, including customary academic rigor and grades (which could include a pass/fail standard).

Third, we note that many graduate and post-graduate students are "enrolled" but do not "attend" classes in a conventional sense. We recommend that Treasury and the IRS confirm that "attending a course for academic credit" includes dissertations and thesis research registrations, clinical rotations and practica that award credit, and independent study with credit.

The commonality among the individuals participating in any one of these programs (i.e., full-time, part-time, degree pursuing, non-degree pursuing, graduate, post-graduate, executive and certification programs) is that they are all using the institution's resources, including its infrastructure, financial resources, and the time and attention of the institution's faculty for their individual instruction, all in the pursuit of activities which furthers the institution's tax-exempt purposes. That is certainly the situation for graduate students as they are often researchers or teachers as well as individuals taking courses for credit—even if that credit may be applied years later towards a degree. The case is more difficult for executive programs. We believe the distinguishing feature of those programs from mere continuing education programs should be a measure of rigor typical of courses for degrees. In that case, the person attending the class is subject

[71] Treas. Reg. § 53.4968-1(b)(2). Under the HEA, a full-time student for an academic year is expected to complete at least (i) 24 semester or trimester hours or 36 quarter credit hours in a course of study that measures its program length in credit hours; or (ii) 900 clock hours in a course of study that measures its program length in clock hours. 20 USC 1088. A "credit hour" is an amount of student work defined by an institution, as approved by the institution's accrediting agency or State approval agency. The credit hour must "reasonably approximate" one hour of classroom instruction and a minimum of two hours of out-of-class student work. 34 CFR 600.2 (definition of "credit hour"). A "clock hour" is a period of time consisting of a 50 to 60 minute class, lecture, recitation, faculty-supervised laboratory, shop-training, or internship. It also covers 50 to 60 minutes of "distance education," which includes a synchronous or asynchronous class, lecture, or recitation where there is opportunity for direct interaction between the instructor and students; or an asynchronous learning activity involving academic engagement in which the student interacts with technology that can monitor and document the amount of time that the student participates in the activity. 34 CFR 600.2 (definition of "clock hour").

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

to a similar standard of coursework generally. Therefore, we believe it is appropriate that individuals participating in these programs be considered students for purposes of Section 4968.

ii. Tuition Commensurate with the Rate Charged to Students Enrolled for a Degree

We recommend that Treasury and the IRS clarify what "being charged tuition at a rate that is commensurate with the tuition rate charged to students enrolled for a degree" means. In the preamble to the Final Regulations, Treasury and the IRS explained that the "commensurate" requirement is intended to ensure that a part-time or non-degree student is attending the institution on an "equivalent basis" to full-time degree students, presumably to prevent inflating the student counts (and thus reducing the student adjusted endowment) with individuals taking for-credit courses at nominal non-degree pricing.[72] Colleges and universities typically price degree program tuition based on a flat rate fee per semester for full-time students and based on a per credit rate for part-time students. Treasury and the IRS should consider adopting one or more safe harbors pursuant to which a student will be treated as charged tuition at a rate that is commensurate with the tuition rate charged to students enrolled for a degree. For example, Treasury and the IRS could adopt a per credit safe harbor where tuition is commensurate if the student is charged tuition on a per-credit basis at a rate no less than (or within a stated percentage range of) the per-credit rate charged to degree students at the same academic level (undergrad/grad/professional) and school/college. Treasury and the IRS could also adopt a flat-rate tuition conversion safe harbor pursuant to which if degree students pay flat-rate tuition, allows a specified method to convert to a per-credit equivalent (e.g., divide flat tuition by average "full-time" credit hours under institutional standards) for commensurability testing. For tuition charges that do not otherwise satisfy one of the safe harbors, a general facts and circumstances test should apply.

iii. Scholarships from Related Organizations

As described above, a student is considered a "tuition-paying" student if tuition or a fee is required for enrollment or attendance after applying any scholarships offered directly by the institution, any work study program operated directly by the institution, and any grants and scholarships provided by the federal, state, or local government.[73] The Final Regulations count scholarships provided by related organizations as tuition by the student even if the assets of the related organization are taken into account for purposes of the student adjusted endowment.[74] In our view, this has the effect of artificially inflating the number of tuition-paying students because in such circumstances the related organization effectively is aggregated with the educational institution and, consistent with such treatment, scholarships provided by the related organization should be treated as funded by the educational institution. If a related organization's assets are

[72] Preamble to the Final Regulations p. 65528.

[73] Treas. Reg. § 53.4968-1(b)(3)(iii). Payments for supplies or equipment required of enrolled students during a specific course and payments for room and board and other personal living expenses are not considered "tuition or fees" for this purpose.

[74] *Id.*

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

counted in calculating whether the institution's student adjusted endowment exceeds the relevant thresholds, then any scholarships granted to students at the tested institution funded from those assets should be taken into account in determining whether the student is tuition-paying. Accordingly, we recommend that, for purposes of determining whether a student is a "tuition-paying student," scholarships from any related organization the assets of which are required to be taken into account by the educational institution in calculating the student adjusted endowment, be considered paid by the educational institution. Thus, if a student receives a 50% tuition paid scholarship from the educational institution and a 50% tuition paid scholarship from such a related organization (e.g., a supporting organization), the student would not be considered a tuition-paying student. We believe that this is fair and consistent with the policy of Section 4968.[75]

C. Royalties

One of the more significant changes made by OBBBA was the legislative reversal of the provision in the Final Regulations excluding from gross investment income federally-subsidized royalty income.[76] This change presents substantial interpretive issues, which should be addressed in guidance.

Section 4968(f)(1) and Treasury regulations section 53.4968-2(a)(1) provide that the "net investment income" of an applicable educational institution is determined under rules similar to the rules of Section 4940(c).[77] Net investment income equals the amount by which "gross investment income" and "capital gain net income" exceed the allowable deductions.[78] "Gross investment income" of an institution is generally defined as the gross amount of interest, dividends, rents, payments with respect to securities loans, and royalties (but not including such amounts that are included in UBTI) of the institution.[79]

Notwithstanding the statute, the Final Regulations excepted certain types of income from the definition of gross investment income, including royalties derived from patents, copyrights, and other intellectual property and intangible property ("IP") to the extent those assets resulted from the work of students or faculty members in their capacities as such with the applicable educational institution.[80] Educational institutions produce IP as part of the pursuit of knowledge by faculty and students and the production of IP is integral to the tax-exempt purposes of colleges

[75] *See* Senate Report, p. 268, explaining that in certain cases, the endowments of private colleges or universities had grown so large that it was not commensurate with the scope of the institution's activities in educating students, particularly where a significant portion of the student population does not receive scholarships.

[76] *See* Treas. Reg. § 53.4968-2(a)(2)(iii); Section 4968(f)(2).

[77] Section 4988(f)(1); Treas. Reg. § 53.4968-2(a)(1); Section 4940(c).

[78] Section 4940(c)(1).

[79] Section 4940(c)(2).

[80] Treas. Reg. § 53.4968-2(b)(2).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

and universities.[81] For this reason, Treasury and the IRS excluded these royalties from gross investment income.

OBBBA enacted section 4968(f)(2)(B), which overrides the regulatory exception from net investment income for "federally-subsidized royalty income" and provides that federally subsidized royalty income will be included in gross investment income and the term "federally-subsidized royalty income" means *any* "otherwise-regulatory-exempt royalty income" if *any* federal funds were used in the research, development, or creation of the patent, copyright, or other intellectual or intangible property from which such royalty income is derived. [82]

The term "otherwise-regulatory-exempt royalty income" means royalty income which would otherwise not be taken into account as gross investment income by reason of being derived from IP which resulted from the work of students or faculty members in their capacities as such with the applicable educational institution.[83]

The term "federal funds" includes *any* grant made by, and *any* payment made under any contract with, any federal agency to the applicable educational institution, any related organization or any student or faculty member in their capacities as such with the applicable educational institution.[84]

In light of OBBBA's enactment of Section 4968(f)(2)(B), we recommend that Treasury and the IRS issue guidance on the treatment of IP which resulted from the work of students or faculty members in their capacities as such with the applicable educational institution and royalty income derived from such IP in calculating the excise tax. That guidance should address the following issues:

i. Rules for Determining When IP is Considered "Federally Funded"

OBBBA's override of the Final Regulation's exclusion of certain royalties from gross investment income is limited to "federally-subsidized" royalty income, not all royalty income.[85] This suggests that Congress intended to limit the scope of royalty income potentially subject to the excise tax to a discrete pool of income.

The legislation does not offer any guidance for determining how that limited set of royalties should be determined. One interpretation would be to tax royalties from all IP where any federal funds directly or indirectly were involved in the research, development, or creation of the IP. This would likely result in taxing all royalties from IP created at the educational institution. We do not

[81] Preamble to the Final Regulations p. 65535.

[82] Section 4968(f)(2)(B).

[83] Section 4968(f)(2)(B)(ii)(II).

[84] Section 4968(f)(2)(B)(ii)(III).

[85] Section 4968(f)(2)(B).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

believe that this is what Congress intended. For example, consider a building constructed 20 years ago in part with federal funds which were not earmarked or otherwise granted for a specific research project (or set of research projects). It would not seem that all activities conducted within that building should be considered federally funded. In that situation, the connection between the federal funding and the research project leading to IP seems very remote.

Interpreting the statue to tax royalties from IP indirectly financed with federal funds would also seem to lead to an insurmountable tracing problem. For example, if some university computers were acquired in part with federal funds as compared with computers specifically purchased for a research project that received federal funding, the educational institution would be required to trace both which computers were purchased with federal funds and whether the research participants used those computers for the project leading to the IP. Similarly, if a student involved in developing the IP received government scholarships for tuition generally, would the IP produced by that student's research be federally-subsidized? We do not believe such an expansive view was intended.

For these reasons, we recommend that Treasury and the IRS provide a direct tracing rule for determining when federal funds are considered "used" in the research, development, or creation of IP. Under this rule, royalties generated by IP would be included in gross investment income only where federal funds were directly granted or paid to the educational institution, or a faculty member or student in that capacity, for the purpose of conducting research or similar activities and such research and activities result in the development or creation of IP. This rule would apply both where the faculty member or student received federal funds for the project and also where the educational institution received federal funds and allocated them to the specific project. For example, if a university professor, acting in that capacity, receives a federal grant to study a particular medical intervention, any IP arising from that research should be treated as federally-subsidized. Likewise, if a university receives a federal grant to purchase specialty research equipment intended to be used for one or more research projects giving rise to IP, any IP developed using that equipment should also be considered federally-subsidized.

The rule would not apply where federal funds were provided for more general endeavors, rather than a specific research project or similar IP generating activity. For example, royalties from IP would not be included in gross investment income solely because the IP was created in a building or laboratory that may have received federal funding not earmarked or otherwise granted for a specific research project (or set of research projects).

We recommend that Treasury and the IRS issue guidance generally allowing educational institutions to determine whether IP is federally subsidized by tracing the direct use of federal funds under any reasonable method that is consistently applied. Under this approach, a university would be required to treat IP as federally-subsidized if the IP, or any publication describing the research that produced the IP, credits a federal grant as a source of funding.

For example, federal patent registries and federal agency grant tracking programs may provide a reasonable basis for determining when IP should be treated as federally-subsidized. In this regard, Treasury and the IRS may find it helpful to look to the Patent and Trademark Act

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

Amendments of 1980, commonly called "Bayh-Dole", and the regulations promulgated thereunder, as an example of a federal funds tracing regime used by the government in a similar context.

Bayh-Dole established a uniform federal patent policy that allows certain contractors, including colleges and universities, to retain ownership rights in patentable inventions developed with federal funding, subject to applicable disclosure, registration and reporting requirements.[86]

We understand that Bayh-Dole largely relies on a direct tracing approach.[87] We also understand that IP researched, developed, or created with federal funds is generally subject to one or more mandatory federal agency disclosure requirements.[88] Educational institutions have strong incentives to accurately identify and report IP created with federal funds in accordance with Bayh-Dole and federal agency guidelines, both to preserve their rights to share in any royalties generated by the IP and because successful federally funded IP creation may support future federal funding opportunities.

Given these reporting obligations and incentives, an educational institution's reliance on public reports, federal patent registries, and agency grant tracking systems to identify federally-subsidized IP should be treated as a reasonable method. Consistent with this framework, for IP of a type subject to a requirement that there be a "Bayh-Dole" (defined below) filing or other filing in a federal registry or under a federal agency grant tracking system that identifies IP of that type as being federally funded, an educational institution should be entitled to rely on the existence or absence of any such filing to identify applicable, federally-funded IP. Similarly, an educational institution should be required to treat as federally funded any applicable IP so identified.

---

[86] Patent and Trademark Act Amendments of 1980, Pub. L. No. 96-517, § 6(a), 94 Stat. 3015, 3018–28 (1980) (codified as amended at 35 U.S.C. §§ 200–212).

[87] More specifically, Bayh-Dole applies to "subject inventions", which are inventions "conceived or first actually reduced to practice" in the performance of work under a "funding agreement". A "funding agreement" is generally a contract or other agreement entered into between a federal agency and any contractor for the performance of experimental, developmental, or research work funded in whole or in part by the federal government. Bayh-Dole's implementing regulations clarify that an invention made outside of the research activities of a government-funded project are not considered "subject inventions" because they aren't conceived or first actually reduced to practice in performance of the project. The regulations provide as an example, that "where an instrument purchased with government funds is later used, without interference with or cost to the government funded project, in making an invention all expenses of which involve only non-government funds," that invention will not be a "subject invention". 37 C.F.R. Section 401.1(a)(2) (2026).

[88] For example, the National Institutes of Health ("NIH") requires specific acknowledgement of NIH grant support and the level of NIH funding received when describing any project or program funded with NIH funds. *See* National Institutes of Health, *Communicating and Acknowledging Federal Funding*, Grants & Funding, https://grants.nih.gov/policy-and-compliance/policy-topics/federal-funding#requirements-for-acknowledging-nih-supported-research (last visited May 19, 2026). Organizations receiving grants from the NIH are subject to active monitoring obligations and detailed reporting requirements regarding the use of funds. *See* Nat'l Insts. of Health, *Post-Award Monitoring and Reporting*, https://grants.nih.gov/grants-process/post-award-monitoring-and-reporting (last visited May 21, 2026).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

We recognize that there may be other types of federally-subsidized IP, such as copyrights, that produce royalty income but may not be captured by the Bayh-Dole framework or other agency grant tracking systems. In many cases, the publication or other release of the proprietary or copyrighted material will credit or acknowledge federal funding, together with any other sources of support. In those circumstances, the university should be required to treat any IP as federally-subsidized. For other types of IP or other circumstances not captured by existing tracking systems or funding acknowledgements, we recommend that educational institutions be permitted to use any reasonable method, consistently applied, to identify these other types of federally-subsidized IP.

We recommend that a similar direct-funding approach apply to administrative fees, facilities and administrative cost recoveries, and other charges that universities commonly impose in connection with grants made to support a specific project. For example, where a grant is awarded to a researcher for a particular project and a portion of the grant is retained by, or transferred to, the university to cover administrative or overhead costs, the university should not be required to trace the subsequent use of those amounts. Nor should the subsequent use of those amounts cause unrelated projects to be treated as federally funded. In our view, those fees or charges are too attenuated from any such other projects to support treating those projects, or any IP resulting from them, as federally funded.

We believe Congress intended to include in gross investment income only royalties derived from IP that was directly subsidized with federal funds. Accordingly, the more natural reading of the statue is that federally-subsidized royalty income should be limited to royalties from IP created pursuant to direct federal funding.

We therefore recommend that royalties be treated as federally funded only where federal funds are directly granted or paid to an educational institution, or a faculty member or student in that capacity, for the purpose of conducting research or similar activities that result in the development or creation of IP. We further recommend that educational institutions be permitted to use any reasonable method, consistently applied, to identify federally-subsidized IP, including reliance on the Bayh-Dole framework and other federal reporting registries.

ii. Assets Used Directly in Carrying Out Exempt Purpose

As described above, an educational institution will only be in the scope of the Section 4968 excise tax if the student adjusted endowment with respect to the institution is at least $500,000 (*i.e.*, the aggregate fair market value of the institution's assets at the end of the preceding taxable year, "*other than those assets which are used directly in carrying out the institution's exempt purpose,*" is at least $500,000 per student) (*emphasis added*).[89]

The Final Regulations provide that an asset is used directly in carrying out an educational institution's exempt purpose only if, based on all facts and circumstances, the asset is actually used

[89] Section 4968(d).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

in carrying out its exempt purpose.[90] The Final Regulations include as an example of an asset that is used directly in carrying out an institution's exempt purpose, IP "to the extent income from the IP is excluded from net investment income under Treas. Reg. § 53.4968-2(b)(2)(iii)".[91] As noted above, OBBBA overrode the regulatory exemption for federally-subsidized royalty income. This creates uncertainty as to whether IP that produces federally-subsidized royalty income will be considered an asset used directly in carrying out the institution's exempt purpose for purposes of student adjusted endowment test.

We recommend that Treasury and the IRS issue guidance treating, for purposes of determining an educational institution's student adjusted endowment, all IP resulting from the work of students or faculty members in their capacities as such with the applicable educational institution as assets used directly in carrying out the institution's exempt purposes under Treas. Reg. § 53.4968-1(b)(5) regardless of whether royalties from the IP are federally-subsidized.[92] As noted in the preambles to the Proposed Regulations and the Final Regulations, applicable educational institutions produce IP as part of the pursuit of knowledge by faculty and students and these activities are integral to an educational institution's exempt purposes.[93] There is no policy reason to treat the source of funding for the creation of the IP as a dividing line for characterizing IP as used (or not used) directly in carrying out the institution's exempt purposes. Accordingly, IP that resulted from the work of student or faculty members in their capacities as such with the applicable educational institution and any other IP used directly in carrying out an applicable educational institution's exempt purposes, regardless of the source of funding, should be treated as an asset used directly in carrying out the institution's exempt purpose for purposes of calculating the institution's student adjusted endowment under Section 4968(b)(1)(D).

iii. Gain from the Sale of IP

Treas. Reg. § 53.4968-2(d)(1)(ii) provides that to the extent property is used by an educational institution for its exempt purposes, capital gain from the sale of such property is disregarded in calculating net investment income.[94] The Final Regulations state that an example of an asset used directly in carrying out an institution's exempt purpose includes IP to the extent income from the IP is excluded from net investment income by Treas. Reg. § 53.4968-2(b)(2)(iii).[95]

---

[90] Treas. Reg. § 53.4968-1(b)(5)(i)

[91] Treas. Reg. § 53.4968-1(b)(5).

[92] Treas. Reg. § 53.4968-1(b)(5).

[93] Preamble to Proposed Regulations p. 31800; Preamble to Final Regulations p. 65535. *See also,* preamble to Proposed Regulations ("Section 4968 does not expressly provide that the tax on net investment income is limited to net investment income derived from assets that are not used directly in carrying out an applicable educational institution's exempt purpose. This lack of limitation is in contrast to the specific language in section 4968(b)(1)(D) that excludes assets used directly in carrying out an institution's exempt purpose in determining whether the education al institution is an applicable educational institution.") Preamble to Proposed Regulations p. 31800.

[94] Treas. Reg. § 53.4968-2(d)(1)(ii).

[95] Treas. Reg. § 53.4968-1(b)(5)(ii)(F).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

OBBBA's override of the regulatory exemption for federally-subsidized royalty income creates uncertainty as to whether capital gain on the sale or other disposition of IP that produces federally-funded royalty income is excluded from net investment income. Because of that uncertainty, we recommend Treasury and the IRS issue guidance clarifying the treatment of such gain. We also recognize that there are arguments supporting both inclusion and exclusion of such gain from net investment income.

As discussed above, educational institutions produce IP as part of the pursuit of knowledge by faculty and students and these activities are integral to an educational institution's exempt purposes.[96] OBBBA included federally-funded royalties in the calculation of net investment income, but did not expressly include capital gain on the sale or other disposition of IP that produces federally-funded royalties.[97] Based on the statutory text, there is a reasonable argument that Congress was aware that the Final Regulations excluded both royalties and capital gain from net investment income, but chose to override only the exclusion for royalties. Under that reading, capital gain on the sale or other disposition of IP that produces federally-subsidized royalty income should remain excluded from the calculation of net investment income.

However, in many respects, a sale or other disposition of IP may be viewed as an acceleration of the royalty stream that the IP would otherwise produce. On that basis, there is a reasonable tax policy argument that gain on the sale or other disposition of IP that produces federally-funded royalty income should be taken into account in calculating net investment income. Additional support for this position is that the existing exclusion for such gain was adopted by Treasury in the Final Regulations and is not provided for in the statute.[98] Rather, Section 4968(f)(1) cross-references Section 4940(c), which imposes an excise tax on all capital gains (other than capital gain that is UBTI), even where the gain is derived from assets used in furtherance of a private foundation's exempt purposes. In light of that statutory framework, the OBBBA's apparent policy of overriding the Final Regulations and broadening the tax base, and the potential for abuse by converting royalties to capital gains,[99] there is a sound tax policy basis for treating capital gain from the sale or other disposition of IP that produces federally-subsidized royalty income as includible in net investment income.

---

[96] Preamble to the Final Regulations p. 65535.

[97] *See* Section 4968(f).

[98] Moreover, the fact that Treas. Reg. § 53.4968-1(b)(5)(ii)(F) excludes from assets used directly in carrying out an institution's exempt purposes only IP *to the extent that income from those assets are excluded from net investment income* may be read to support the proposition that the elimination of the exclusion of federally-funded royalty income from net investment income had the corollary effect of eliminating any exclusion of gain on sale or other disposition of the underlying IP.

[99] Cf. *Hort v. Commissioner*, 313 U.S. 28 (1941). One possible alternative would be to tax gain that is dependent upon the use of the IP while not taxing a sale for a fixed sum.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

Accordingly, we recommend that Treasury and the IRS issue guidance clarifying whether capital gain from the sale or other disposition of IP that produces federally-subsidized royalty income is taken into account in calculating net investment income.

iv. Expenses Incurred to Derive Royalties

We recommend that Treasury develop rules that would permit all costs incurred in developing federally funded IP to be deducted against any royalty income produced by such IP. These rules will need to address the mismatch arising from the typical pattern in which research and development expenses are most often incurred in years before the intangible property produces income. While there are a number of possible approaches, we believe Treasury and the IRS should consider adopting rules under which educational institutions would be permitted to elect to capitalize research and development expenses for a federally funded project and amortize those capitalized amounts over a period of time selected by the institution and beginning when income is first recognized. We believe that the approach should be on a project-by-project basis, so that costs incurred for a project would be deductible only against income from that project. For costs incurred prior to enactment of OBBBA, we believe that institutions should be permitted to elect to capitalize their historic costs, which would be subject to amortization under these rules. If Treasury and the IRS determine that gain from the sale of IP that produces federally-subsidized royalties should be excluded from net investment income (which is discussed above under Part III.C.iii), then they should consider whether proper matching of expenses incurred and income produced therefrom requires rules to limit or apportion expenses incurred in creating the IP. These rules should be designed so that a university is not able to deduct all expenses incurred to produce the IP upfront against royalties, and then after all expenses have been taken into account, sell the IP for a gain that is excluded from net investment income.

We recognize that these are not the only choices that might be made to permit deductions offsetting income. For example, rules could allow research expenses as a current deduction offsetting investment income from all federally funded research or from other sources. Alternatively, rules could permit carryforwards of research and development expenses similar to the rules for net operating losses to the extent the deduction is limited to offset income either on a project-by-project basis or income from federally funded research. [100] Another approach would allow only expenses incurred in a year in which there was income to be deducted against the income in that year. As explained below, we believe that our recommendation is the approach most consistent with the existing provisions in the statute and regulations and one that provides for a clear reflection of income.

Our recommendation is based on a number of considerations. First, the position allowing for the deduction of expenses, including prior year costs, is consistent with the Final Regulations. The Final Regulations state that amounts allowable as a deduction from gross investment income in computing net investment income include all the ordinary and necessary expenses paid or

[100] Section 172.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

incurred for the production or collection of investment income and generally include certain overhead costs, such as salaries of employees, professional fees and interest.[101]

Second, under this rule, we believe it would be unfair and inconsistent with clear reflection of income principles to limit the deductions in a year to those expenses incurred in that year. Rather, there should be an ability to offset costs incurred in a prior year. Royalty income produced by educational institutions (including from federally funded research) is different than royalty income earned by private foundations. For educational institutions, royalty income at issue is the result of direct development activities often incurred over many years; that is not the case for private foundations which do not engage in research and development activities through their own employees.

Third, a failure to allow an offset for such costs would be inconsistent with general rules relating to deductions for research and development expenses. In particular, Section 174A, as added by OBBBA, permits a taxpayer to elect to capitalize otherwise deductible research and development expenses and to elect to recover them over a period selected by the taxpayer, but not less than 60 months.[102]

Finally, our recommendation is consistent with existing rules governing treatment of income from activities that are both used for the production of investment income and are a part of the tax-exempt mission. Treas. Reg. § 53.4968-2(c)(2)(iv) provides that in determining the amount of deductions for expenses paid or incurred in any year for the production of gross investment income earned as an incident to a charitable function can be no greater than the income earned from the function that is included in gross investment income for the year.[103] The regulations include an example of rental income incidentally realized from historic buildings open to the public and provide that deductions are limited to the amount of rental income includible as gross investment income for the year.[104] The regulation and example are drawn from the private foundation excise tax rules contained in Treas. Reg. § 53.4940-1(e)(2)(iv).[105]

Based on the foregoing, we believe Treasury and the IRS should issue guidance which sets forth specific rules permitting the deduction of research expenses limited to the income derived from the federally funded research. Research and development at an educational institution are considered activities that are part of the institution's mission. The product of such efforts—

---

[101] Treas. Reg. § 53.4968-2(c).

[102] Section 174A(c)(1)(B).

[103] Treas. Reg. § 53.4968-2(c)(2)(iv).

[104] *Id.*

[105] Treas. Reg. § 53.4940-1(e)(2)(iv).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

intellectual property which may be exploited to produce royalties—is not the primary intent.[106] It would therefore seem that the general rule limiting expenses to the income should be applicable.

The most practical approach would be to apply the rule on a project-by-project basis. This approach requires the university to trace expenses and income directly derived from a project, a task the institution is likely already undertaking. This approach is also consistent with our recommendation that federally funded research projects are determined on a specific identification method.

To address the timing mismatch—expenses in years prior to the receipt of income—Treasury should permit educational institutions to apply rules similar to those in Section 174A. Under these rules, institutions would be permitted to capitalize expenses and recover them over a period designated by the institution.[107] Also, consistent with the basis adjustment rules, we believe that institutions should be able to make an election to capitalize expenses incurred prior to the change in the statute making royalties taxable.[108] This approach would also result in tax being paid in years in which the IP produces royalties in excess of the amortization. This result is also consistent with clear reflection of income; the IP may be expected to produce income over a period of years and the expenses of producing that income should be recovered over that period rather than all up front.[109]

Another approach would be to allow all expenses of federally funded research to offset income from all federally funded royalties. We question whether that is what Congress intended. By singling out income from federally funded royalties, it is a reasonable inference that Congress intended that the institution pay tax on its net income from each of those projects. Under the broader approach, expenses from projects with small amounts of federal funding would potentially offset income from those royalties.

D. Student Loan Interest and Student Loans

Similar to royalties and consistent with the overall purpose of Section 4968, final Treasury regulations section 53.4968-2(b)(2) excepted from the definition of gross investment income, interest income from a student loan that was made by an applicable educational institution or a related organization to a student of the applicable educational institution in connection with the student's attendance at the institution.[110]

---

[106] Preamble to the Final Regulations p. 65535.

[107] *See* Section 174A(c).

[108] Treas. Reg. § 53.4968-2(d)(2)(i).

[109] As mentioned earlier, if Treasury and the IRS determine that gain from the sale of IP that produces federally-subsidized royalties should be excluded from net investment income (which is discussed above under Part III.C.iii), then they should also consider whether to adopt rules to limit or apportion expenses incurred in creating the IP.

[110] Treas. Reg. § 53.4968-2(b)(2).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

OBBBA enacted section 4968(f)(2)(A), which overrides the regulatory exception for student loan interest and provides that net investment income will take into account any interest income from a student loan made by an applicable educational institution (or any related organization) as gross investment income.[111] This change presents a number of interpretive issues, which should be addressed in Treasury guidance.

i. Treatment of Student Loan Interest Derived by Related Organizations

Under the statute, as amended by OBBBA, any interest from a student loan made by a related organization is included as gross investment income.[112] It is unclear how that change is intended to interact with Section 4968(g) and Treas. Reg. § 53.4968-3(d), which provide that the net investment income of a *related organization* that is not intended or available for the use or benefit of the educational institution is not included in the net investment income of the applicable educational institution unless the organization is controlled by the institution or is described in Section 509(a)(3) with respect to the institution.[113]

Read literally, OBBBA would treat student loan interest earned by related organizations differently from all other types of income earned by related organizations. It is not clear that Congress intended this result. Congress was aware of the rule in Section 4968(g), and the apparent purpose of the statutory change was to override the regulatory exemption for student loan interest. Accordingly, we do not believe the amendment was intended to reach income that was otherwise excluded under the statute itself.

We recommend that Treasury and the IRS issue guidance confirming that the rules in Section 4968(g) and Treas. Reg. § 53.4968-3(d) apply to interest income from student loans made by related organizations. Under this approach, student loan interest earned by a related organization would be subject to the rules governing the related organization's income generally. This treatment would be consistent with the treatment of all other types of income earned by related organizations.

We acknowledge that the literal language of the statute could support an argument that all student loan interest earned by related organizations should be included in gross investment income. However, we are not aware of any tax policy rationale for treating student loan interest less favorably than other types of income. If Treasury and the IRS believe that the statute was intended to override Section 4968(g) and Treas. Reg. § 53.4968-3(d), we recommend that they make that interpretation clear in future guidance.[114]

---

[111] Section 4968(f)(2)(A).

[112] *Id.*

[113] *See* Section 4968(g) and Treas. Reg. § 53.4968-3(d).

[114] That guidance should also specify the entity which should pay the tax on the student loan interest. The related party that may earn the income need not be an educational institution subject to Section 4968 and therefore it would seem unclear that such related party could be required to pay the tax. Perhaps a better approach would be to attribute the student loan interest earned by the related party to the educational institution whose students received the funding.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

ii. Assets Used Directly in Carrying Out Exempt Purpose

As noted in the preambles to the Proposed Regulations and the Final Regulations, student loans are provided by educational institutions to their students to further their exempt missions of educating students.[115] There is no policy reason to treat student loans, for purposes of determining the student adjusted endowment of an educational institution, as anything other than an asset used directly in carrying out an educational institution's exempt purposes. Given the changes to the treatment of student loan interest under OBBBA, we recommend that Treasury and the IRS confirm that student loans held on an educational institution's books are considered assets used directly in carrying out the institution's exempt purposes under Treas. Reg. § 53.4968-1(b)(5), whether or not income from the loans is taken into account in determining net investment income.

iii. Expenses Incurred to Derive Student Loan Interest

The Final Regulations state that amounts allowable as a deduction from gross investment income in computing net investment income include all the ordinary and necessary expenses paid or incurred for the production or collection of investment income and generally include certain overhead costs, such as salaries of employees, professional fees and interest.[116] Treas. Reg. § 53.4968-2(c)(2)(iv) provides that in determining the amount of deductions for expenses paid or incurred in any year for the production of gross investment income earned as an incident to a charitable function can be no greater than the income earned from the function that is included in gross investment income for the year.[117]

Commentators to the Final Regulations have observed that loans made by colleges and universities to students are not offered with the intent of earning investment income, rather they are made to assist students in need of financial assistance to complete their educations.[118] As such, it is quite possible that the ordinary and necessary expenses incurred by an educational institution for the production or collection of student loan interest in any year will exceed the amount of student loan interest derived by the institution for the year. Moreover, there may be timing mismatches such that an educational institution could have net student loan interest income in one year and net losses incurred for the production of student loan interest in another year. Limiting deductions to the amount of student loan income includible in gross investment income for the year without any ability to carryforward those losses to offset future student loan interest income could unfairly tax educational institutions. Accordingly, we recommend that Treasury and the IRS issue guidance allowing a carryforward of expenses incurred in generating student loan interest to offset student loan interest income earned in subsequent years. We believe a carryforward rule is necessary to appropriately tax only the overall net income from student loan interest. We recognize that our approach to expenses paid or incurred for the production and collection of student loan

[115] Preamble to the Proposed Regulations p. 31800; Preamble to the Final Regulations p. 65533.

[116] Treas. Reg. § 53.4968-2(c).

[117] Treas. Reg. § 53.4968-2(c)(2)(iv).

[118] Preamble to the Final Regulations p. 65533.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

interest differs from our approach to expenses incurred for the production and collection of federally-subsidized royalty income. This is because the expenses incurred to research, create and develop IP that produces royalty income will largely, if not entirely, precede the income generated from the IP. Moreover, in the context of student loan interest, there can be a loss in one year and net income in another, depending upon interest rates, defaults, and other factors. Therefore, in our view a different rule is needed to appropriately address expenses incurred for the production and collection of student loan interest.

E. Basis Step Up for Existing Properties

The Final Regulations contain rules for calculating the net investment income of an applicable educational institution subject to the tax under Section 4968.[119] The Final Regulations generally permit an institution to use the fair market value of an asset on December 31, 2017, as its basis for purposes of calculating the gain on sale of the asset subject to the tax.[120] The Final Regulations also contain special rules for determining the amount of gain from the sale of partnership interests and an applicable educational institution's distributive share of gain from a partnership's sale of an asset that use fair market value as of December 31, 2017 as a reference point. [121] The purpose of these rules was to avoid taxing educational institutions on appreciation in value that accrued prior to the enactment of Section 4968.[122]

For applicable educational institutions that are already subject to tax under Section 4968, OBBBA's introduction of a graduated tax system may increase the rate of tax to which they are subject.[123] For these organizations, appreciation accruing after December 31, 2017, may be subject to tax at a rate higher than it would have been had the institution sold the property prior to the effective date of OBBBA. We considered whether these organizations should be entitled to an additional step-up so that any such appreciation is taxed at the original 1.4% rate and only appreciation accruing after December 31, 2025, is potentially taxable at the graduated rates. However, we do not believe such a rule would be consistent with general tax policy. For example, when Congress has increased the general capital gains rate under Section 1(h), Congress has not provided a basis step-up protecting taxpayers from increased tax rates on any built-in gain.[124]

---

[119] Treas. Reg. § 53.4968-2.

[120] Treas. Reg. § 53.4968-2(d)(2).

[121] Treas. Reg. § 53.4968-2(d)(2)(iii) and Treas. Reg. § 53.4968-2(d)(3).

[122] *See* Preamble to the Final Regulations p. 65532.

[123] Section 4968(b).

[124] Section 1(h). For example, the top tax rate for long-term capital gains was raised to 20 percent as part of the American Taxpayer Relief Act of 2012, but no basis step-up was given to affected taxpayers. *See* American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 102(b), 126 Stat. 2313, 2318–19 (2013) (codified as amended at I.R.C. § 1(h)(1)).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

We also note that educational institutions not initially subject to Section 4968 may become subject to the excise tax in years subsequent to its enactment, and in some cases, many years subsequent to its enactment. These institutions will be eligible for the December 31, 2017, basis step-up rules contained in the Final Regulations, but not a basis step-up to the year immediately preceding the year they become subject to the tax. We believe that is the correct result and guidance should confirm that position. We note that in the past, the IRS has taken a different approach in an analogous context, although it is not clear that the IRS would reach the same conclusion today. More specifically, the IRS has previously issued guidance under Section 4940 allowing an initial basis step-up as of the end of the year prior to conversion of a public charity that converted to a private foundation many years after the enactment of Section 4940. In Private Letter Ruling 9852023, a public charity planned to engage in certain transactions following which it would be classified as a private foundation. The organization requested guidance regarding the basis of stock to be sold after the transaction when the organization was a private foundation. The IRS noted that if the assets were sold while the organization was a public charity, the gain would not be subject to the excise tax. The IRS ruled that the adjusted basis of the stock at issue would be its fair market value at the time the organization ceased being a public charity. The IRS's position was based on the special transitional rule and evidence of an objective in the rules that the gains on the sales of certain assets that were earned but not realized before the organization became a private foundation should not be subject to the excise tax. Educational institutions that become "applicable educational institutions" after the date of enactment of Section 4968 are similar to public charities that convert to private foundations. However, we recognize that the IRS recently rejected the approach set forth in the ruling and issued a memorandum (PMTA-2022-1) stating that it believes Private Letter Ruling 9852023 is incorrect.[125]

F. Anti-Abuse Rule

Section 4968(h) authorizes the Secretary of the Treasury to issue guidance as may be necessary to prevent avoidance of tax under Section 4968, including through the "restructuring of endowment funds or other arrangements designed to reduce or eliminate the value of net investment income or assets subject to the tax" imposed by Section 4968.[126] There is no statutory guidance as to what transactions, arrangements, or approaches would actually fall within the scope of this rule.

We believe that any regulations issued should identify particular abusive transactions or known abusive arrangements designed to reduce or eliminate the value of net investment income or assets subject to the excise tax. In the absence of specific transactions or arrangements, any regulations should define characteristics or attributes that could cause a transaction or substantially similar transactions to be treated as abusive. Otherwise, absent evidence of actual abuse by educational institutions, we recommend that Treasury and the IRS take a measured approach and generally wait to see how transactions develop in practice before adopting a broad, generally-applicable anti-abuse rule or issuing more detailed anti-abuse guidance. While we acknowledge

[125] I.R.S. Program Manager Tech. Advice 2022-01, at 3 n.2 (Nov. 18, 2021).

[126] 4968(h).

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.

the potential for abuse associated with Section 4968, we believe that concern is mitigated by the continuing applicability of general federal income tax principles governing tax avoidance transactions, such as the economic substance doctrine, the step-transaction doctrine, and the substance over form doctrine, and Treasury and the IRS should consider confirming the applicability of those rules to this excise tax.[127]

[127] For example, assume a school charges a nominal tuition which is offset entirely by scholarships for all students. Assume also the school imposes excessive, above market, mandatory room and board charges to make up for lost revenue. General tax law principles of substance over form should apply to find this approach abusive.

Opinions expressed are those of the Tax Section and do not represent those of the New York State Bar Association unless and until they have been adopted by its House of Delegates or Executive Committee.