New DOL Regulations Affecting Tax-Qualified Retirement Plans

The Department of Labor has two new regulations regarding fee disclosure and fee transparency that will dramatically affect almost all employers that sponsor retirement plans ("Plan Sponsors") subject to ERISA.

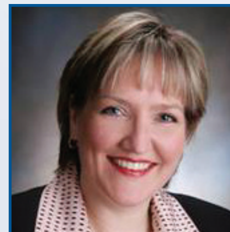
The first regulation (effective July 1, 2012) is intended to ensure that Plan Sponsors know and understand all of the fees being charged by those entities that provide recordkeeping and investment management services ("Service Providers") to the plan. The second regulation (with an initial compliance date of August 30, 2012) is intended to ensure that the participants in plans which permit participant-direction of plan investments are provided with similar information including all of the costs and expenses charged against their plan accounts.

To comply with these new requirements, the Plan Sponsor, as well as any other plan fiduciary with authority to contract with a Service Provider (which may include the plan's Administrative Committee, the Plan Sponsor's officers, and any individuals serving as plan trustees), should have a process to review the data received from the Service Providers to determine if the expenses are "fair and reasonable". The required analysis may require comparing the fees being paid with benchmarks of fees paid by similar plans for similar services. If it is determined that the expenses are not reasonable, the Plan Sponsor must take all prudent steps to negotiate a lower fee, seek rebates of excessive fees, or even replace the Service Provider to comply with the new rules.

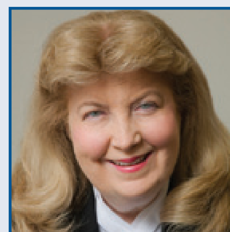
In general, a Service Provider's failure to comply with these new requirements will automatically result in a "prohibited transaction" between the plan and the Service Provider. A "prohibited transaction" must be disclosed on the plan's Form 5500, and, for "large" plans (those with 100 or more participants), must be reported in the plan's audited financial statements. As indicated above, the Plan Sponsor is charged with the responsibility of analyzing the disclosed information to determine if the fees being charged are "fair and reasonable". The failure to do so could result in the Plan Sponsor being treated as "breaching its fiduciary duty" to the plan's participants.

This fiduciary duty to properly analyze the information supplied by the Service Providers is critically important, especially in light of a recent class action case styled Tussey v. ABB, Inc. In that case, the court ruled that the Plan Sponsor pay $35.2 million to the plan's participants for failing to prudently monitor the recordkeeping and revenue-sharing payments made to Fidelity, as the plan's recordkeeper and provider of investment alternatives under the plan.

Your UHY team can consult with you to ensure compliance with the requirements of the new regulations.



Heather Raschke is a Principal at UHY LLP's Farmington Hills, MI office. She can be reached at 248.204.9330 or hraschke@uhy-us.com.



Barbara Hale is a Tax Principal with UHY Advisors TX, LLC and is a licensed CPA. Barbara chairs UHY's Compensation and Benefits Tax Service Team. She can be reached at 713.561.6557 or bhale@uhy-us.com.

Not-For-Profit Industry Insight

With the increasing complexity of laws and regulations, it's important for associations, foundations, charities, hospitals, schools and other tax-exempt entities to seek out professionals with extensive experience in not-for-profit compliance issues.

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Not-For-Profit Insider

Insights & Observations for Not-For-Profit Organizations Volume 7 :: Issue 2

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The Non-Profits, the Internet and the UBTI

Part 1 of 2

Tax-exempt organizations are increasingly utilizing the Internet to help generate revenues that can be used to fund their tax-exempt operations. Unfortunately, there is not much in the way of citable authority or even formal IRS guidance as to the federal income tax consequences of generating these types of revenue through the use of the Internet. This article is divided into 2 parts. This ***first part*** *focuses on how the IRS treats for income tax purposes advertising revenues verses sponsorship payments received by tax-exempt organizations. The* ***second part*** *of this article, which will appear in the next edition of the UHY Not-For-Profit Insider, will consider how the present distinction between these two types or revenues holds up in the present Internet environment.*

Continued on Page 2...

The Non-Profits, the Internet and the UBTI *Continued from Page 1...*

When is a tax-exempt organization ("EO") subject to federal income tax?

While EOs are ordinarily not subject to federal income tax on their revenues, the Internal Revenue Code nevertheless subjects an EO's "unrelated business taxable income" (UBTI) to income tax. UBTI is defined in IRC Section 512(a)(1) as:

> ". . . . gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, ... "

Based on the above definition, UBTI exists only if (1) there is a trade or business, (2) that is regularly carried on by the EO, and (3) the trade or business is "unrelated" to the EO's tax-exempt purposes. IRC Section 513 provides rules for determining when a trade or business is "unrelated" for UBTI purposes.

Advertising revenues vs. sponsorship revenues

Analysis of this issue, especially within the context of an EO's use of the Internet, should probably start with an IRS training publication entitled "2000 CPE EO Text". Although the 2000 CPE EO Text specifically states that it cannot be cited as IRS authority, it is still helpful in seeing how the IRS views the special issues raised by the Internet.

One of the most significant issues addressed in the 2000 CPE EO Text is the need to distinguish between an EO's advertising revenues and sponsorship payments received by an EO.

This distinction is significant from a federal income tax standpoint, as follows:

- On the one hand, whenever an EO sells advertisements to appear in its written publications, the resulting **advertising revenues** are considered UBTI, unless the EO can establish that the advertisement "relates" to its tax-exempt purpose (for a good analysis of when advertising can be "related" to an EOs exempt purposes, see U.S. v. American College of Physicians, 475 U.S. 834 (1986)).

- On the other hand, payments made by companies to EOs to help them meet their funding needs in consideration of the EO's publicly acknowledging the payor of such payments in its written publications (**"sponsorship payments"**), are generally not UBTI.

A problem can arise, however, whenever what is thought to be sponsorship payments begins to take on the character of advertising revenues. This *blurring of the line between the two types of payments* can easily occur whenever an **EO operates its own website.** This *blurring of the line* typically arises whenever an EO *acknowledges* its "sponsors" by displaying their names, logos, banners, and products on the EO's website, and/or by creating links on the EO's web site to the sponsor's own website.

So what exactly is advertising (and thus UBTI) according to the IRS?

According to Treasury Regulation Section 1.513-4(c)(2)(v), "**advertising means** any message . . . . . which is broadcast or otherwise transmitted . . . . .which promotes or markets any trade or business, or any service, facility or product . . . . that contains qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase . . . ." (emphasis added)

So what exactly is a sponsorship payment (and thus not UBTI) according to the IRS?

The Internal Revenue Code contains a provision that sets forth a "safe harbor" (referred to as a "*qualified sponsorship payment*") which, if its requirements are met, ensures that certain **sponsorship payments** will not be treated as UBTI[1] . See IRC Section 513(i) and Treasury Regulation Section 1.513-4. In general, Section 513(i) defines "*qualified sponsorship payments*" as payments from a sponsor of the EO:

- With respect to which there is no arrangement or expectation by the payor (i.e., the sponsor) that it will receive a "*substantial return benefit*" other than the use or acknowledgement of the name or logo (or product lines) of the payor's trade or business in connection with the activities of the EO;
- That are not paid for any use or acknowledgement that includes advertising the payor's products or services (including messages containing qualitative or comparative language, price information or other indications of savings or value, an endorsement, or an inducement to purchase, sell or use such products or services); and
- The amount of which is not in any way contingent upon the level of attendance at one or more of the EO's events, broadcast ratings of an EO event, or other factors indicating the degree of public exposure of the EO's events.

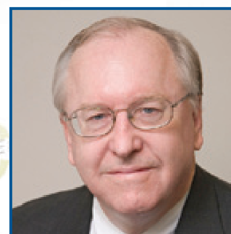
According to Treasury Regulation Section 1.513-4(c)(2)(iv), the following uses or acknowledgements are expressly not considered to provide a "*substantial return benefit*" to a sponsor:

- Logos and slogans that do not contain qualitative or comparative descriptions of the payor's products, services, facilities or company;
- A listing of the payor's locations, telephone numbers, or Internet address;
- Value-neutral descriptions, including displays or visual depictions, of the payor's product-line or services; and
- A listing the payor's brand or trade names and product or service listings.

CAVEAT: IRC Section 513(i)(2)(B)(ii)(I) sets forth a **very important exception** as to what constitutes a "*qualified sponsorship payment*" which has uncertain application in the context of an EOs Internet activities (which will be considered more fully in Part 2 of this article scheduled to appear in the next edition of the *UHY Not-For-Profit Newsletter*).

Specifically, the Section provides that a "*qualified sponsorship payment*" does not include a sponsorship payment which entitles the payor to the use or acknowledgment of the name or logo (or product lines) of the payor's trade or business in "exempt organization *periodicals*". For this purpose, a "*periodical*" is any regularly scheduled material published (whether in print or electronically) by the EO that is not related to a specific event conducted by the EO.

[1] It should be noted that even if a **sponsorship payment** does not satisfy the "safe harbor" requirements of a "*qualified sponsorship payment*", it might still avoid being characterized as UBTI. Per Treasury Regulation Section 1.513-4(d)(1)(i), the tax treatment of any payment that, for whatever reason, cannot meet the requirements of a "*qualified sponsorship payment*", will nevertheless be determined under the general rules governing UBTI which are found in IRC Sections 511-512 and the Regulations and case law interpreting same. **For purposes of this article**, however, only sponsorship payments that meet the definitional requirements of a "*qualified sponsorship payment*" are discussed.



Don Hughes is a Tax Manager at the Houston office of UHY Tax Advisors TX, LLC. Don can be reached at 713.407.3190 or dhughes@uhy-us.com.

OMB Proposed Changes to Single Audits

The Office of Management and Budget (OMB) has proposed significant changes to Circular A-133. Circular A-133 is the guide created by the OMB to be used in auditing federal assistance and grant programs and recipients of federal funds under these programs. The changes proposed could affect nearly every organization that receives federal funds and is currently subject to a single audit.

One significant proposed change would increase the exemption threshold for entities required to have a single audit or program-specific audit from $500,000 to $1,000,000 in annual federal expenditures. In addition, it would modify the requirements for those entities above the audit threshold, differentiating based on the total federal awards expended. The proposal includes a different approach for audits between $1,000,000 and $3,000,000, and audits for entities above $3,000,000.

What could this proposal mean for entities expending federal awards?

- Entities with less than $1,000,000 in federal award expenditures would generally be exempt from federal single audit requirements for that year
- Entities with expenditures between $1,000,000 and $3,000,000 would be required to obtain a limited scope audit which focuses on allowable and unallowable costs and one other area, at the discretion of the granting agency
- Entities with more than $3,000,000 in federal award expenditures would still be required to obtain an annual full scope audit. However, the audit program will be strengthened to include a focus on improper payments, fraud, waste and abuse

Another part of this proposal is an effort to reduce the burden of sub-recipient audit follow up work. Sub-recipients are entities who receive federal funds from another entity. This other entity, or pass-through entity, receives the federal funding directly from the federal agency and passes it along to the sub-recipient. To reduce the burden of sub-recipient follow up work, it is proposed that the federal agencies issuing the award perform the follow-up work with the sub-recipient itself, instead of relying on the pass-through entity. Once the audit has been performed, the responsibility to ensure the sub-recipients compliance with the audit findings would be the responsibility of the pass-through entity, thus not completely eliminating the responsibility of the pass-through entity to monitor the sub-recipients expenditures of federal awards.

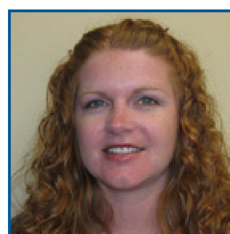
Why are these changes being recommended?

- Higher risk and higher dollar awards and award recipients would be audited and would allow federal agencies to focus their oversight on these areas
- Single audits would target high risk areas by cutting down the required testing therefore making the audits more cost effective and efficient
- Once audits are completed, the federal government would have a more direct follow up with auditees which would reduce the burden of follow up on pass-through entities

The OMB will analyze the feedback they receive to the advance notice over the next few months. It is anticipated that the proposed regulatory changes may be released for comment before the end of the calendar year.

If the changes proposed by the OMB are made official for the single audit requirements, it could mean a reduction in the cost of compliance with federal regulations. These changes would have a dramatic effect on future single audits and auditees.

Cynthia Szczur is a Manager in UHY LLP's Farmington Hills office. She can be reached at 248.204.9313 or cszczur@uhy-us.com.



Shannon Taulbee is a Staff Accountant in UHY LLP's Farmington Hills, MI office. She can be reached at 248.204.9307 or staulbee@uhy-us.com.