

any period ending on or before August 15, 2006.

(b) *Applicability of the regulations.* As of July 6, 2010, except as provided in paragraph (c) of this section, §§ 53.4965-1 through 53.4965-8 of this chapter will apply to taxable years ending after July 6, 2007. A tax-exempt entity may rely on the provisions of §§ 53.4965-1 through 53.4965-8 for taxable years ending on or before July 6, 2007.

(c) *Effective/applicability date with respect to certain knowing transactions—(1) Entity-level tax.* The 100 percent tax under section 4965(b)(1)(B) and § 53.4965-7(a)(1)(i)(B) does not apply to prohibited tax shelter transactions entered into by a tax-exempt entity on or before May 17, 2006.

(2) *Manager-level tax.* The IRS will not assert that an entity manager who approved or caused a tax-exempt entity to become a party to a prohibited tax shelter transaction is liable for the entity manager tax under section 4965(b)(2) and § 53.4965-7(b)(1) with respect to the transaction if the tax-exempt entity entered into such transaction prior to May 17, 2006.

[T.D. 9492, 75 FR 38702, July 6, 2010]

§ 53.4968-1 Excise tax based on investment income of certain private colleges and universities.

(a) *Excise tax on the investment income of certain private colleges and universities.* For taxable years beginning after December 31, 2017, section 4968 of the Internal Revenue Code (Code) imposes a tax equal to 1.4 percent of the net investment income (as defined in section 4968(c) and § 53.4968-2) of an applicable educational institution (as defined in section 4968(b)(1) and paragraph (b)(1) of this section).

(b) *Definitions.* The definitions in this paragraph (b) apply for purposes of section 4968 and §§ 53.4968-1 through 53.4968-4.

(1) *Applicable educational institution.* The term *applicable educational institution* means any eligible educational institution (as defined in section 25A(f)(2) of the Code and § 1.25A-2(b) of this chapter)—

(i) That had at least 500 tuition-paying students during the preceding taxable year;

(ii) More than 50 percent of whose tuition-paying students are located in the United States;

(iii) That is not described in the first sentence of section 511(a)(2)(B) of the Code (relating to state colleges and universities); and

(iv) The aggregate fair market value of the assets of which at the end of such preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose) is at least \$500,000 per student.

(2) *Student.* The term *student* means 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. The number of students of an educational institution (including for purposes of determining the number of students at a particular location) 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). The standards for determining part-time students, full-time students, full-time equivalents, and daily average are determined by each educational institution. However, the standards may not be lower than the minimum applicable standards established by the Department of Education under the Higher Education Act of 1965 (20 U.S.C. 1088), as amended.

(3) *Tuition-paying—(i) In general.* The term *tuition-paying* means the payment of any tuition or fees required for the enrollment or attendance of a student for a course of instruction at an educational institution. Tuition and fees do not include payment for supplies or equipment required during a specific course once a student is enrolled in and attending the course, or payment for room and board or other personal living expenses.

(ii) *Treatment of a comprehensive or bundled fee.* If a student is required to pay a fee (such as a comprehensive fee or a bundled fee) to an educational institution that combines charges for tuition with charges for personal expenses such as room and board, the student is a tuition-paying student.

(iii) *Scholarships, grants, and work study programs.* Whether a student is tuition-paying is determined after taking into account any scholarships and grants provided directly by the educational institution or by the Federal government or any state or local government, and after application of any work study programs operated directly by the institution. Scholarships and grants provided by non-governmental third parties, even if administered by the institution, are considered payments of tuition on behalf of the student. Accordingly, a student will be considered a tuition-paying student if payment of tuition or a fee is required for the enrollment or attendance of the student for courses of instruction after the application of 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 government or any state or local government.

(4) *Located in the United States.* A student is *located in the United States* if the student resided in the United States for at least a portion of the time the student attended the educational institution during the institution's preceding taxable year. Whether a student resided in the United States in any given year can be determined using any reasonable method, as long as that method is consistently applied.

(5) *Assets used directly in carrying out an institution's exempt purpose—*(i) *In general.* Except as provided in paragraph (b)(5)(iv) of this section, an asset is *used directly in carrying out an educational institution's exempt purpose* only if the asset is actually used directly by the institution in carrying out its exempt purpose. Whether an asset is used directly by the institution to carry out its exempt purpose is determined based on all the facts and circumstances. If property is used for an exempt purpose and for other purposes, and the exempt use represents 95 percent or more of the total use, the property is considered to be used exclusively for an exempt purpose. If the exempt use of such property represents less than 95 percent of the total use, the institution must make a reasonable allocation be-

tween such exempt and nonexempt uses.

(ii) *Illustrations.* Examples of assets that are used directly in carrying out an institution's exempt purpose include, but are not limited to, the following—

(A) Administrative assets, such as office equipment and supplies used by the institution directly in the administration of its exempt activities;

(B) Real estate or the portion of any building used by the institution directly in its exempt activities;

(C) Physical property such as paintings or other works of art owned by the institution that are on public display (or held for public display), fixtures and equipment in classrooms, research facilities and related equipment that under the facts and circumstances serve a useful purpose in the conduct of the institution's exempt activities;

(D) The reasonable cash balance, determined using any reasonable method, necessary to cover current operating and administrative expenses and other normal and current disbursements directly connected with the educational institution's exempt activities. For this purpose, a reasonable method would include calculating an amount equal to three months of operating expenses allocable to program services, calculated by dividing annual functional expenses allocable to program services by four. A larger amount may be a reasonable cash balance for this purpose if, under the facts and circumstances, a larger amount is established to be necessary to cover administrative expenses and other normal disbursements directly connected with the institution's exempt activity.

(E) Any property the educational institution leases to other persons at no cost (or at a nominal rent) to the lessee in furtherance of the institution's exempt purposes; and

(F) Patents, copyrights, and other intellectual property and intangible property to the extent that income from those assets is excluded from net investment income by § 53.4968-2(b)(2)(iii).

(iii) *Assets not used directly.* The following assets are examples of assets not used directly in carrying out an institution's exempt purpose—

(A) Assets that are held for the production of income or for investment (for example, stocks, bonds, interest-bearing notes, endowment funds, or leased real estate not described in paragraph (b)(5)(ii)(E) of this section), even if the income from such assets is used to carry out such exempt purpose; and

(B) Property (such as offices and equipment) used for the purpose of managing the institution's endowment funds.

(iv) *Assets of related organizations.* An asset of a related organization that is treated as an asset of an educational institution by section 4968(d) and § 53.4968-3(c) and that is used directly in carrying out an educational institution's exempt purpose, or that is used directly in carrying out the exempt purpose of a related organization that is described in section 501(c)(3), is considered used directly by the educational institution in carrying out its exempt purpose.

(v) *Valuation of assets not used directly in carrying out an institution's exempt purpose—(A) In general.* The values of assets not used directly in carrying out an educational institution's exempt purpose are determined under the rules of section 4942(e) and § 53.4942(a)-2(c)(4), as modified by paragraph (b)(5)(v)(B) of this section.

(B) *Modifications.* In applying the rules of § 53.4942(a)-2(c)(4), an educational institution must—

(1) Substitute “educational institution” for “private foundation” or “foundation” every place they appear; and

(2) Make such adjustments as are reasonable and necessary to obtain the fair market value of any and all assets as of the last day of the preceding taxable year, rather than as of any other times permitted or required by § 53.4942(a)-2(c)(4).

[T.D. 9917, 85 FR 65557, Oct. 15, 2020]

§ 53.4968-2 Net investment income.

(a) *Net investment income—(1) In general.* For taxable years beginning after December 31, 2017, section 4968(a) of the Internal Revenue Code (Code) imposes a 1.4 percent excise tax on the net investment income (as defined in section 4968(c) and this section) of an applica-

ble educational institution and on certain amounts of net investment income of certain related organizations, as described in section 4968(d) and § 53.4968-3. For purposes of this section, net investment income is determined under rules similar to the rules of section 4940(c) of the Code. Thus, net investment income generally is the amount by which the sum of the gross investment income (as defined in paragraph (b) of this section) and the capital gain net income (as defined in paragraph (d) of this section) exceeds the deductions allowed by paragraph (c) of this section. Except to the extent inconsistent with the provisions of this section, net investment income is determined under the principles of subtitle A of the Code.

(2) *Tax-exempt income.* For purposes of this section, net investment income is determined by applying section 103 of the Code (relating to State and local bonds) and section 265 of the Code (relating to expenses and interest relating to tax-exempt income).

(b) *Gross investment income—(1) In general.* For purposes of this section and except as provided in paragraph (b)(2) of this section, the term *gross investment income* means the gross amounts of income from interest, dividends, rents, payments with respect to securities loans (as defined in section 512(a)(5) of the Code), and royalties, but not including any such income to the extent included in computing the tax imposed by section 511 of the Code. Such term also includes income from sources similar to those in the preceding sentence. In general, gross investment income includes the items of investment income described in § 1.512(b)-1(a) of this chapter.

(2) *Exceptions.* The following items of income are excluded from the definition of gross investment income:

(i) Interest income from a student loan that was made by the 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;

(ii) Rental income from the provision of housing by the applicable educational institution or a related organization to students of the applicable