



December 3, 2018

Internal Revenue Service
CC:PA-LPD:PR (Notice 2018-67), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2018-67

Dear Madam/Sir:

The National Council of Nonprofits welcomes this opportunity to respond formally to the Request for Comments from the Treasury Department and Internal Revenue Service published in Notice 2018-67 on August 21. The National Council of Nonprofits (Council of Nonprofits) works with and through our unique network – the nation’s largest network of charitable nonprofits – to identify emerging trends, share proven practices, and promote solutions that benefit charitable nonprofits and the hundreds of million people they serve in local communities throughout the country. In formulating the comments presented herein, we rely on extensive communications within this network and feedback from multiple organizations representing subsector groups across the nonprofit sector. In addition to the points raised below, we incorporate by reference two sets of comments the Council of Nonprofits previously submitted to Treasury and IRS officials prior to the August 21 publication of Notice 2018-67, namely our [preliminary letter](#), dated April 24, 2018, and our [updated letter](#) dated June 21, 2018, comprising comments and concerns from dozens of subsector organizations.

Introductory Comments

New Internal Revenue Code Section 512(a)(6) directs that nonprofits “with more than 1 unrelated trade or business” must compute their new UBIT liability “separately with respect to each such trade or business.” The new statute, however, fails to define what constitutes an “unrelated trade or business.” Regulations based on prior law provided that, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses could aggregate all revenues and expenses from all such activities and compute UBIT liability on the aggregate income. This natural, logical approach permitted an organization to use a loss from one unrelated trade or business to offset income from another. It promoted sustainability and innovation. The approach also eased compliance costs of having to hire accountants and attorneys to advise where to best draw artificial distinctions on such things as whether rentals of a nonprofit’s main room for a community theater’s use, its garden for a wedding, and its parking lot for a for-profit driver’s education school’s use for practicing safe parking amounts to one line of business (short-term rental of property) or three (nonprofit use, private weddings, and for-profit’s use). Significantly, because income and losses were treated in the aggregate, distinctions between separate businesses were made, if at all, not for tax payment or reporting purposes, but instead largely for internal management and, perhaps, branding purposes.

The tax change, which imposes unique liabilities on nonprofit organizations that are not assessed against for-profit businesses, went into effect on January 1, 2018, and has been subject to three separate quarterly estimated payments. The Council of Nonprofits does not envy the task Congress imposed on Treasury and the IRS to divine its will that was not explained in the legislative process nor in legislative language. As Notice 2018-67 refreshingly acknowledges, “There is no general statutory or regulatory definition defining what constitutes a ‘trade or business’ for purposes of the

Internal Revenue Code.” This new tax is vague and ambiguous, making it unenforceable as a matter of law. Moreover, it is patently unfair, especially since no similar tax burden is imposed on for-profit businesses that instead received significant tax cuts through the Tax Cuts and Jobs Act. This provision that was included in the tax law to partially defray the costs of those business tax cuts is not justifiable and must be repealed.

We recognize that repeal is not the province of Treasury and the IRS and that clarity, efficiency, and the reduction of administration burdens is the best that can be achieved through formal rulemaking and public comments. With this acknowledgement, we offer the following comments to specific sections of Notice 2018-67.

Section 6. Interim and Transition Rules for Partnership Investments

.04: Transition Rule

We start this analysis out of sequence because Notice 2018-67 highlights an issue of law and administrative prerogative that must be addressed at the outset. The Notice implicitly recognizes the injustice of mechanically applying the undefined dictates of Congress by proposing special treatment for one category of revenues and losses: those derived from various partnership interests. The Notice suggests that even when entities are made up of multiple business interests, the IRS will treat revenue from a partnership as a single "trade or business" under Section 512(a)(6) if one of two tests is satisfied: the *de minimis* test (ownership interest of no more than 2%) or the control test (no more than 20% ownership interest and no control over the operations of the business). The *de minimis* test is not in the statute.

The Notice goes farther to accommodate actual business practices. In Section 6.04, the Notice states, “A previously acquired partnership interest may be difficult to modify to meet the *de minimis* test ... or control test ... under the interim rule and the exempt organization may have to incur significant transition costs.” It goes on to create a transition rule, providing “[r]evenue from other forms of partnership interests that fail to meet these tests can still be treated as a single ‘trade or business’ during the one-year transition period that runs from August 21, 2018 to August 21, 2019.”

By creating a *de minimis* test and a one-year transition rule, Treasury and the IRS are utilizing their inherent power to prevent severe hardship as the nonprofit community shifts from the reasonable rules of the past to the vagaries of the new statutory language. That exercise of authority to minimize unnecessary pain and cost of administrative compliance is appreciated. And it is also instructive for the entirety of this rulemaking. By exercising this authority, which the Council of Nonprofits fully recognizes is within their purview, Treasury and the IRS are effectively saying: the impact of Section 512(a)(6) is exceedingly complicated, Congress did not provide sufficient guidance for straightforward and unconvoluted interpretations, so the government will provide a simple rule for one year to enable organizations to get their houses in order.

We believe that this inherent authority should be used more broadly with respect to application of the new statutory language to all revenues and costs, not just those relating to partnership interests. This new unrelated business income tax on nonprofits took effect on January 1, 2018. Nonprofits had only a few days over the holidays to learn of and try to understand these new tax liabilities, adapt their accounting systems and procedures to secure full compliance, and budget for the unanticipated costs. For many organizations, the application of the new liabilities landed in the middle of their fiscal years, thus requiring different cost allocation and tax treatment within the same accounting period, adding to the burden and costs of compliance. Many have been responsible for

making three quarterly estimated payments to the IRS based on their best guess of what their new tax liabilities might be.

It is axiomatic that the government should not impose retroactive bookkeeping changes and tax liabilities on law-abiding organizations. Normally, and for very good reason, laws affecting organizational finances are applied prospectively, and only after providing taxpayers with sufficient time to make necessary systems changes. A *de minimis* standard and transition rule that relieves nonprofits of unanticipated tax liabilities should be adopted.

Recommendation: Treasury and the IRS should utilize their inherent administrative authority to delay implementation of Section 512(a)(6) until one year after final regulations under this rulemaking are promulgated. This delay is essential to provide both the necessary official guidance for compliance and a reasonable transition period for nonprofits to develop the necessary record-keeping systems. Further, to avoid injustice, that delay should be made retroactive to January 1, 2018 and late filing penalties must be abated, recognizing that it is manifestly unfair to impose late-filing penalties on organizations when there has been no guidance from Treasury/IRS about how to calculate tax liability based on vague and ambiguous statutory language.

Section 3. Separate Trade or Business

.03 Possible Method for Identifying Separate Trades or Businesses

Notice 2018-67 proposes in Section 3.03 that nonprofits seek to identify what constitutes a “separate” “trade or business” by using the nearly 2,000 six-digit classification codes in the North American Industry Classification System (NAICS). The Notice states that the regulated community may rely on the six-digit NAICS system as a reasonable, good faith interpretation of the law until proposed regulations are published. While this admittedly is a creative attempt to establish a partial solution to the untenable position in which Congress put Treasury, the IRS, and the nonprofit community, further refinement is needed.

The Notice gives as an example the NAICS code for income derived from advertising, explaining “all of an exempt organization’s advertising activities and related services (NAICS code 541800) might be considered one unrelated trade or business activity, regardless of the source of the advertising income.” The [National Council of Nonprofits](#) and many other organizations had highlighted the question whether income from multiple sources of ad revenue (print publications, e-newsletters, websites) would equate to a “separate” trade or business.

But the NAICS code may not provide the clarity required for many other sources of revenue and expenses. For example, the NAICS has multiple codes relating to rentals. Trying to apply the six-digit classification system would impose undue burdens and compliance costs. To illustrate the conundrum with just one of endless examples, rental income from use of a banquet hall (NAICS code 531120) would be treated as different from rental income from use of a vacant lot (NAICS code 531190) in which a renter holds an outdoor banquet. Consequently, rental income and expenses may need to be divided or grouped in other ways, meaning it’s possible that expenses for some types of rentals may not be used to offset income from other types, perhaps even when the same equipment – e.g., tables and chairs, linens, serving trays – is used for each type of rental. These two examples share the same first-four code, demonstrating that the intent of the law would be preserved without undue pressure on nonprofits feeling forced to guess between nearly identical six-digit codes – and then being second-guessed years later in an audit.

Recommendation: As initially proposed in Notice 2018-67, the NAICS safe harbor would inject further uncertainty, complexity, and expense into an already burdensome tax regime. We propose that the safe harbor be revised to allow nonprofits to utilize the four-digit NAICS codes in order to more appropriately align trades and businesses, and to avoid the unnecessary costs and burdens of segregating clearly related activities.

Section 3. Separate Trade or Business **.04 Allocation of Directly Connected Deductions**

Notice 2018-67 raises the issue of proper allocation of various expenses “directly connected with the carrying on of such trade or business” under the new law that forces the arbitrary and artificial disaggregation of trades or businesses. The Notice requests comments “regarding possible rules or defined standards for the allocation of indirect expenses between separate unrelated trades or businesses for purposes of calculating UBTI.” It specifically seeks input on “what allocation methods should be considered ‘reasonable’” when determining how costs should be divvied up between mission-related and unrelated activities, and between separate unrelated activities.

The request for comments is welcomed because it invites shining the light on the current disfunction and uncoordinated interpretations of cost allocations by various federal departments and agencies. Nonprofits are fully aware that costs must be properly allocated under different organizational programs and functions. Indeed, nonprofits providing services on behalf of governments under grants already must follow established cost principles for cost allocations. In 2014, the Office of Management and Budget formally promulgated [Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards](#) (Uniform Guidance) 2 C.F.R. 200 (12/26/2014). The Uniform Guidance defines indirect costs as

“those costs incurred for a common or joint purpose benefitting more than one cost objective, and not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. To facilitate equitable distribution of indirect expenses to the cost objectives...[expenses] must be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.” (2 CFR 200.56).

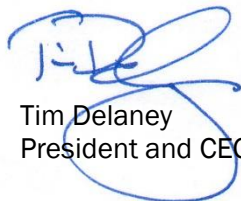
This definition is consistent with FASB ASU 2016-14 (Accounting Standards Update) that recently went into effect and requires that allocations are made on a rational, reasonable, and objective basis across functional expense categories and that the specific details of the costs allocated and the methodology used to do so is disclosed in the footnotes. Both the Uniform Guidance and ASU 2016-14 recognize that because of the diversity of nonprofits it is not possible to specify which costs to allocate in all situations. These rules do, however, require that similar costs in like situations are treated consistently across programs and services.

Since both the Uniform Guidance and ASU 2016-14 consider any regular unrelated business activity as a separate functional expense category and because cost principles anticipate that all functional cost centers are allocated their respective portion of shared costs, there is no need for additional rules to be established in the rulemaking on Section 512(a)(6). In fact, doing so is counterproductive. In short, the cost allocation rules in the Uniform Guidance, in the Uniform Guidance and ASU 2016-14 are perhaps the most current and practical rules for determining “directly connected” costs and should be adopted in the rulemaking on Section 512(a)(6).

Recommendation: As its name suggests, the Uniform Guidance was intended to establish a single set of rules applicable to nonprofits with government grants. FASB ASU 2016-14 broadens the applicability of consistent principles to all charitable nonprofits with regard to cost allocations. Notice 2018-67 seeks to superimpose unnecessary complexity and potentially contradictory allocation requirements onto an already established reasonable accounting practices, some of which are so new that they have not yet even been audited. Treasury and the IRS should adopt the cost allocation principles in the Uniform Guidance and ASU 2016-14 to ensure consistency and simplicity, rather than imposing an alternative scheme that will only add costs, conflicts, and unnecessary complexity for years to come.

The National Council of Nonprofits offers these comments with the intent of promoting both fairness and tax compliance within the charitable nonprofit community.

Respectfully submitted,



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President and CEO



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