NATIONAL COUNCIL OF
NONPROFITS
National voice. State focus. Local impact.

February 20, 2019

Internal Revenue Service
CC:PA-LPD:PR (Notice 2018-99)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Notice 2018-99

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 2018-99 on December 10, 2018. 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 December 10 publication of Notice 2018-99, namely our preliminary letter, dated April 24, 2018, and our updated letter dated June 21, 2018, comprising comments and concerns from dozens of nonprofit organizations.

We stress at the outset that the vast majority of charitable organizations are small entities with few or no employees. Ninety-two percent of America's nonprofits have budgets under $1 million; 88 percent have budgets less than $500,000. These comments address the following seven issues of concern to charitable nonprofits operating in communities throughout the United States.

1. Treasury and the IRS Must Exercise Inherent Administrative Authority to Prevent Manifest Injustice by Delaying Implementation Until Rulemaking Is Complete
2. Guidance Limited to Parking Does Not Go Far Enough
3. Inappropriate Application of Taxes to Compensation Reduction Agreements
4. Taxing Government-Mandated Commuter Benefit Payments as "Fringe" Benefits is Patently Unfair
5. Clarifying Status of Volunteers
6. Clarifying Parsonage Parking
7. Conflicts with Other Legal Authority; Additional Unintended Consequences from Treasury/IRS Action

Introductory Comments – Taxing Tax Exempts

Notice 2018-99 seeks to clarify a provision of the Tax Cuts and Jobs Act, codified as Internal Revenue Code Section 512(a)(7), that imposes a 21-percent unrelated business *income* tax on the *expenses* that *tax-exempt* nonprofits incur for providing to their employees transportation fringe benefits, such as parking and transit passes. Charitable organizations, houses of worship, foundations, and other nonprofits became liable for the tax on January 1, 2018. For eleven and a

half months after passage of the 2017 tax law, Treasury and the IRS provided no guidance on how to calculate this new tax, putting nonprofits in the untenable position of having to guess about how to comply with the unknown, putting them unfairly at risk of filing inaccurate reports, making insufficient or inaccurate payments, and suffering other adverse consequences. The Notice issued on December 10 provides complex instructions for determining some tax liabilities, including a four-step calculus that will vary for each organization, and can change from month to month. It completely ignores, however, the imposition of the new taxes on transit benefits, benefits that are mandated for some employers in various cities. Further, the related Notice 2018-100, also issued on December 10, 2018, relieves some organizations of penalties that are the result of the IRS's own delay, but that moratorium has already expired. Repeal of Section 512(a)(7) is the only reasonable response.

Stripped of the technicalities and citations, Notice 2018-99 provides the following instructions.

- **Calculating Expenses**: The income tax is levied on employer *expenses* and not on the value of the benefit to employees, which is a relief; but taxable expenses include such disparate items as salary and benefits of parking lot attendants; repaving costs; snow, ice, leaf and trash removal; interest; rent or lease payments, and property taxes. Many of these expenses are not easily separated from overall nonprofit operational costs and will require complex analyses solely to determine whether the employer has sufficient unrelated business taxable income.
- **Reserved Parking**: Designated and reserved employee parking signs will automatically trigger taxable income on employers pursuant to the Notice, unless the signs are taken down by March 31, 2019.
- **Public Parking, or Not; It's Complicated**: Truly public parking is scot free, which is only reasonable; but the Notice mandates a four-step calculus for determining whether the parking is truly public and for allocating expenses. The calculations, combined with the identification of includable expenses, will likely cost more in accounting fees than many nonprofits will ultimately have to pay in taxes in the first year or two.
- **$1,000 Threshold**: The $1,000 income exemption existing in prior tax law still applies, and not every nonprofit with parking facilities will be required to file with the IRS, but, again, the cost of calculating the expenses and determining whether taxes are owed will cost more than the exemption.

This new federal income tax on nonprofits' expenses imposes significant costs and record-keeping burdens on nonprofits, making it harder for these organizations to address their charitable missions and more difficult to recruit and retain employees. Treasury and the IRS have a duty to take additional actions to minimize the adverse consequences of this demonstrably flawed public policy.

1. Treasury and the IRS Must Exercise Inherent Administrative Authority to Prevent Manifest Injustice by Delaying Implementation Until Rulemaking Is Complete

Shortly after the Tax Cuts and Jobs Act was signed into law, accountants, attorneys, nonprofits, foundations, and lawmakers began calling on Treasury and the IRS to exercise their inherent administrative authority to delay implementation of new taxes on tax-exempt organizations until regulations could be formally promulgated. In every instance, experts and those adversely affected by the new taxes have demonstrated that Treasury and the IRS have wide discretion in interpreting the law to prevent unjust and unconscionable outcomes. Indeed, in recent months Treasury and the IRS have shown flexibility that demonstrates the inherent authority.

Notice 2018-67, published in August 2018, seeks to clarify when nonprofits should treat various business interests as a “separate” “trade or business.” That Notice implicitly recognized 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 found in the statute.

Notice 2018-67 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. By exercising this authority, 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. See the comments submitted by the National Council of Nonprofits on December 3, 2018.

The foregoing is not the only example under the 2017 tax law. In Notice 2018-100, a companion Notice to the current rulemaking, Treasury and the IRS took action, “in the interest of sound tax administration,” to waive late penalties and costs for certain nonprofits that failed to make quarterly estimated income tax payments prior to December 17, 2018. As with the *de minimis* standard and the one-year transition rule proposed in the Section 512(a)(6) rulemaking, the waiver of penalties is not expressly permitted in the statute. Yet, Treasury and the IRS rightly took administrative action to prevent a clearly unfair outcome.

A one-year delay until after final regulations are promulgated is especially warranted here, given that prominent leaders of both parties in Congress have indicated the intent of Congress to repeal this mistake in the law. Last December, the House passed a bill that, among other things, would have repealed the nonprofit transportation tax (see Section 505). Bills in the current 116th Congress, HR 1223 by House Majority Whip Clyburn (D-SC) and HR 513 by Representative Conaway (R-TX), also target Section 512(a)(7) for repeal. The demonstrated bipartisan support at the leadership level for repealing the income tax on tax-exempt entities for the expenses they incur obviously signals that Congress intends to fix this error. Without granting the needed delay, Treasury and the IRS will face significant and ongoing challenges dealing with demands from nonprofits and their Members of Congress for refunds from those who did pay before the formal repeal.

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. We believe that “sound tax administration” demands that the entirety of new Section 512(a)(7) be suspended until one year after Treasury and the IRS promulgate final regulations.

RECOMMENDATION: Treasury and the IRS should utilize their inherent administrative authority to delay implementation of Section 512(a)(7) 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.

2. Guidance Limited to Parking Does Not Go Far Enough

Internal Revenue Code Section 512(a)(7) imposes new and novel tax liabilities on nonprofits for making certain benefits available to their employees, most notably transit passes, parking, and gym memberships. Notice 2018-99 attempts to provide clarity for calculating parking expenses and tax liability, and states definitively that due to poor legislative drafting the 2017 tax law fails to extend the new tax to most gym memberships. On the extremely important and costly issue of transit passes, the Notice is virtually silent and provides neither clarity nor relief. This failure is a major shortcoming of this rulemaking and must be corrected.

RECOMMENDATION: Treasury and the IRS should suspend the current rulemaking on Notice 2018-99 unless and until additional clarity is provided to nonprofits that provide transit benefits to their employees, either directly or indirectly through compensation reduction agreements. The issues discussed below relating to non-parking transportation benefits should be included in any such rulemaking.

3. Inappropriate Application of Taxes to Compensation Reduction Agreements

On March 22, 2018, at a tax law conference in Washington, D.C., there were audible gasps of incredulity in the room full of professional nonprofit tax advisors when an IRS official stated that the IRS would interpret Section 512(a)(7) as imposing unrelated business income taxes not only on employer subsidies for transportation fringe benefits, but also on the amounts that employees voluntarily asked to be deducted from their paychecks and placed into pre-tax qualified plans to pay for employees' expenses for commuting to work. Until that conference, journalists and tax professionals struggling to make sense of the new law never even dreamed that the statutory language might apply to voluntary employee compensation reductions for the convenience of employees to pay transportation costs through qualified plans long authorized by Congress.

Notice 2018-99 appears to adopt the interpretation that shocked the regulated community. This is most unfortunate and, we believe, unsupportable in law or congressional intent. We agree with the position articulated by the American Society of Association Executives in its comments last year:

> Because employees pay for transportation themselves through a payroll deduction in a pre-tax manner, tax-exempt employers have not previously viewed pre-tax compensation reduction agreements as a fringe benefit. The fact that providing a pre-tax compensation reduction agreement now has negative tax consequences for tax-exempt employers was unexpected, and will have many organizations scrambling to recalculate their tax liability for transportation and parking benefits utilized by their employees this tax year.

This is no mere theoretical inquiry; real nonprofits addressing real challenges in their communities will be adversely affected by the proposed, overly expansive reading of Section 512(a)(7). Consider this example provided in comments from the **Maine Association of Nonprofits**:

> One of our members indicated that they went through a lot of effort to create a pre-tax Qualified Transportation Account (QTA) last summer, primarily to allow their three staff who commute from far away and park at their building to pay for the parking using pre-tax dollars. They saw the ability of the employee being able to pay the $95/month with pre-tax as taking some of the sting out of no longer enjoying free parking. To set up the QTA, [the nonprofit employer] had to pay a one-time fee of $300 to have the paperwork for it drawn up which they were hoping to recover over 2 or 3 years from the FICA savings. Now, instead of recouping the cost, as a result of this surprise tax, they have already accumulated a tax liability of $239.40 through April. They terminated the QTA after 4/30 and are going back to charging parking post-tax to avoid this, a loss of a benefit to our employees.

We recognize that some in Washington, DC who have high salaries may scoff at the dollar amounts in the preceding example. But in rural America where people often drive long distances to work at small nonprofits trying to survive with little revenue in local communities, the dollar amounts are real factors for nonprofit boards working hard to ensure sustainability to continue deliver services needed by people in their communities. Unlike for-profit employers, nonprofits cannot simply raise prices to cover these unexpected and unreasonable costs.

As proven by the observation in Maine, imposing a tax penalty on expenses incurred by tax-exempt organizations is likely to cause nonprofit employers to cease providing qualified plans that offer such support. This will reduce incentives for employees to work for nonprofits and negatively affect the ability of charitable nonprofits and foundations to hire and retain talented workers. This unjustified and overly expansive interpretation of new subsection 512(a)(7) would amount to a penalty on the nonprofit employer for allowing employees to reduce their own salaries through a qualified plan. Imposing an income tax on an expense is a novel, alien, and even punitive concept to charitable organizations. Moreover, imposing a tax on an employer based on employee's own voluntary decision to reduce her/his own salary is equally inscrutable. That this tax should result in devaluing workers by making employment less attractive in the nonprofit sector (approximately 10 percent of the US workforce) is ironic given that nonprofits struggle to keep their workplaces competitive with for-profit employers.

The argument has been made that Treasury and the IRS must treat employer-provided and pre-tax withholdings for transportation benefits as equally taxable in order to ensure that taxes are generated as anticipated by Congress. The argument is that unless both approaches are covered by the tax, employers will simply convert the transit benefits they currently provide into agreements with their employees to pay the same amount through compensation reduction agreements and no taxes will be owed. Regardless of whether this rationale is applicable in the for-profit world, it does not follow for nonprofit employers. Likely in most cases, nonprofit employers will be forced to abolish both means of reducing employee transportation costs because the 21 percent tax makes them cost prohibitive. In that expected outcome, the U.S. Treasury will reap no new tax revenue, the result that Treasury and the IRS reportedly are trying to avoid by imposing its draconian interpretation.

Generally, when interpreting a statute, one must "'start, of course, with the statutory text,' and proceed from the understanding that '[u]nless otherwise defined, statutory terms are generally interpreted in accordance with their ordinary meaning.'" *Sebelius v. Cloer*, 133 S.Ct. 1886 (2013). Yet the surprise statement by the IRS at the March 22 tax conference, incorporated in Notice 2018-

99, strongly indicates that someone at the IRS may be reading the provisions far more broadly than the plain statutory language – which will not only violate all norms of statutory interpretation, but also have the ironic, and outrageous effect of giving for-profit corporations and wealthy individuals significant tax cuts while heaping new tax liabilities and tax increases on large numbers of charities and other nonprofit organizations serving the public good.

RECOMMENDATION: We believe application of the unrelated business income tax on employee compensation reduction agreements is a tortured interpretation of congressional intent and adverse to the best interests of employees and nonprofit employers. We urge Treasury and the IRS to clearly state that nonprofit employers shall not be taxed on the portions of their employees' pay that is voluntarily withheld and applied to transportation benefits.

4. Taxing Government-Mandated Commuter Benefit Payments as "Fringe" Benefits Is Patently Unfair

By its very title, Notice 2018-99 addresses "Parking Expenses for Qualified Transportation ***Fringes*** Under § 274(a)(4) and § 512(a)(7) of the Internal Revenue Code." The emphasis here on "fringes" is intentional because the guidance fails to recognize that parking and transportation are not voluntary expenses for many nonprofit and other employers in several cities; they are mandated by local law.

At least five communities have enacted ordinances mandating that certain employers – for-profit and nonprofit alike – provide commuter benefits to some or all of their employees. Currently, the communities with mandatory commuter benefits laws are Berkeley and Richmond, CA; New York City, NY; San Francisco Bay Area, CA; and Washington, DC. The ordinances in Berkeley and Richmond, CA require employers with 10 or more employees to offer pre-tax commuter benefits as a payroll deduction, provide a subsidized benefit, or a combination of the two. The New York City ordinance requires all employers in the five boroughs with 20 or more full-time employees to offer pre-tax transit benefits. Employers in the nine-county San Francisco Bay Area with 50 or more employees must offer a Commuter Benefit option, which includes a pre-tax program, a subsidy of up to $75 per month (based on the value of the local bus pass), provide a company shuttle program, or an alternative program approved by the relevant regulating agency. The Washington, DC program is similar to the San Francisco mandate, but applies to employers with 20 or more employees.

Imposing an unrelated business income tax on government-mandated transportation expenses is not only unfair, but also inexplicable. Fringe benefits of the types targeted in subsection 512(a)(7) are by definition voluntary. The adjective "fringe" means that they are not a core component of pay. Historically, they are added on top of pay packages to entice and retain qualified workers. Fringe benefits are optional.

In extreme contrast, mandated benefits and protections are not optional, and are not added into an employee's paycheck. An employer must provide a safe workplace, grant family and medical leave in some circumstances, pay for worker compensation and unemployment insurance, among many costs, all in order to remain compliant with federal, state, and local laws. While it is true that certain mandated benefits are included on a person's paycheck, such as Social Security and Medicare (FICA), these are unique items that are taxed not with an income tax, but with a dedicated tax. The fact that the new unrelated business income tax liability is an income tax to the general treasury distinguishes it from FICA.

RECOMMENDATIONS: Mandated commuter benefits cannot and should not be treated as voluntary "fringe" benefits subject to the 21-percent tax under Section 512(a)(7). We ask Treasury

and the IRS to clearly and definitively state that employers providing transportation or commuter benefits identified in Section 512(a)(7) under compulsion of law are thereby exempt from the tax.

5. Clarifying the Status of Volunteers

Notice 2018-99 fails to address a significant group of individuals whose support is often essential for charitable organizations to advance their missions: volunteers. This oversight may arise from the fact that Treasury and the IRS wrote first from the perspective of for-profit businesses, and then added minimal language to extend the for-profit rule to nonprofits. The oversight is both disconcerting and instructive to both regulators and legislators regarding the clear distinctions between these markedly different sectors of the U.S. economy.

In June 2018, the National Council of Nonprofits, anticipating the lack of focus on the unique aspects of the nonprofit community, asked the following: "Because of the new emphasis on parking as an employee benefit, are there circumstances in which providing volunteers free parking, combined with other modes of appreciation such as discounted meals or admission without charge, that could convert the volunteer into an employee for tax and labor law purposes?"

The need for clarity is very real. Charitable nonprofits rely on volunteers working in many different capacities to advance the organizations' missions. The Corporation for National and Community Service reports that in 2017 nearly 77.4 million people volunteered 6.9 billion hours. The 1.3 million charitable organizations in the United States are guided by millions of volunteer board members. Nonprofits provide many other volunteer opportunities through regularly scheduled volunteer hours, unpaid internships, and more. It is incumbent for Treasury and the IRS to state clearly that volunteers are not "employees" and shall be considered members of the "general public," as those terms are discussed in the Notice.

RECOMMENDATION: Treasury and the IRS should revise the description of "general public" provided in Step 2 (pages 9 and 10 of the Notice) to explicitly list "volunteers" as persons who shall not be deemed "employees" and who shall be considered members of the "general public" when calculating parking lot usage.

6. Clarifying Parsonage Parking

The Notice, at pages 3 and 7, states that the term "qualified parking" does "not include any parking on or near property used by the employee for residential purposes." This statement, while helpful in many instances, does not offer clarity when the employer provides housing for employees. The National Council of Nonprofits raised the following questions in its June 21, 2018 letter to Treasury and the IRS that we are concerned have not been adequately addressed in the above-quoted text:

> A midwestern state association of nonprofits reports this question from a house of worship: Will the garage attached to the home provided to the pastor home (manse [or parsonage]) be treated as a qualified parking benefit for purposes of 512(a)(7)? Does the analysis change if the manse is next to the church or many miles away?

The lack of clarity is troubling. As already discussed, nonprofits are well advised to take down their "Reserved for Pastor" signs in their parking lots to void triggering unrelated business taxable income. While it would be intensely unreasonable for Treasury and the IRS to extend the tax to a faith leader's home, other statements, interpretations, and actions in this rulemaking render this a legitimate concern that must be addressed.

RECOMMENDATION: We ask that any subsequent guidance clearly state that parking at an employee's residence should never trigger unrelated business income tax liability for the nonprofit employer, regardless whether the residence is provided by the employer.

7. Conflicts with Other Legal Authority; Additional Unintended Consequences from Treasury/IRS Action

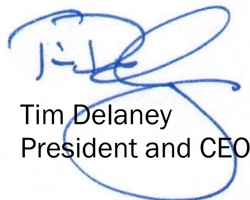
Finally, we are mindful that Treasury and the IRS cannot address all of the many unintended consequences and unanswered questions posed by the strange imposition of an unrelated business *income* tax on *expenses* associated with employee transportation matters. For instance, the White House Office of Management and Budget will be called on to resolve whether the cost of the new tax purportedly on employee benefits expenses is reimbursable to nonprofits operating pursuant to grants funded in whole or in part with federal funds, thus including all the pass-through grants of states and localities. Normally, nonprofits providing services on behalf of governments receive reimbursement for expenses, including the costs of employee benefits expenses as well as sales, property, and many other taxes paid. Regardless of whether these expenses are treated as direct or indirect costs under a grant governed by the OMB Uniform Guidance, the end result will be that the federal government will be reimbursing nonprofits for paying taxes to the federal government. This means that costs imposed on nonprofits through Notice 2018-99 and its final version will likely increase the costs to the federal government as it reimburses nonprofits for their transportation unrelated business income taxes.

A related question arises for nonprofit employers that provide transportation benefits pursuant to collective bargaining agreements. In comments submitted last year, the League of American Orchestras urged Treasury and the IRS to recognize: "It is exceedingly difficult and, in most cases, impossible to turn on a dime to absorb new expenses, and many orchestras' compensation arrangements with their musicians are fixed in multi-year collective bargaining agreements, adding complexity to any consideration of adjustments to employee benefits." In our June 21, 2018 letter to Treasury and the IRS, we asked if the government "is considering delaying implementation of this tax liability for the duration of existing collective bargaining agreements, as is frequently done in federal and state regulations when significant costs are imposed?" If Treasury and the IRS fail to take collective bargaining agreements into consideration in this rulemaking process, the government will likely impose even greater costs on nonprofit employers, potentially leading to labor discord and severe interruption of services.

Conclusion

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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