NATIONAL COUNCIL OF NONPROFITS
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April 24, 2018

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

David Kautter
Acting Commissioner
Internal Revenue Service
111 Constitution Avenue, NW
Washington, DC 20224

Re: Urgent Request to Delay Implementation of the New UBIT Provisions in Public Law No. 115-97

Dear Secretary Mnuchin and Commissioner Kautter:

The charitable nonprofit community has very grave concerns about the implementation of new subsections 512(a)(6) and (7) of the Internal Revenue Code and believes that the Department of Treasury and the Internal Revenue Service have a duty to the regulated community to provide immediate relief and substantive guidance on these provisions. In advance of a meeting scheduled this week with representatives of your offices and tax-exempt nonprofit organizations ("nonprofits") spurred by confusion and concerns about new subsection 512(a)(7) (unrelated business income tax on certain employee fringe benefits), we share these initial observations about that provision, as well as new subsection 512(a)(6) (unrelated business income tax computed separately for each undefined separate "trade or business"). We will submit more detailed, formal comments to the Treasury Department and the IRS following the meeting.

At this time, we anticipate that the National Council of Nonprofits, which advocates for public charities with and through our network – the largest network of Section 501(c)(3) organizations in the country – will be seeking the following relief:

- For legal, policy, and practical reasons, and consistent with established precedent, Treasury and the IRS should immediately delay implementing those two new UBIT subsections until one year after Final Rules are promulgated, to provide both the necessary official guidance for compliance and a reasonable transition period for nonprofits to develop the necessary record-keeping systems;
- To avoid injustice, that delay should be made retroactive to January 1, 2018; and
- Treasury and the IRS should engage the regulated community in identifying not only how the wording of the new provisions are causing great confusion and operational compliance challenges among nonprofits and their professional tax advisors, but also possible solutions.

Overview

On December 22, 2017, President Trump signed into law Public Law No. 115-97 that includes two new provisions regarding unrelated business income tax ("UBIT"):

- Section 512(a)(6) directs nonprofits "with more than 1 unrelated trade or business" to somehow compute their unrelated business income (and related losses) earned "separately with respect to each such trade or business," but does not provide any definition about what constitutes a "separate" trade or business, creating uncertainty about how to document, compute, report, and pay such a tax; and
- Section 512(a)(7) inexplicably uses the structure of unrelated ***business income*** tax liability to impose a tax on ***expenses for employee fringe benefits***.

Although Congress directed in subsection 512(a)(7) that the "*Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph*," we are unaware of any announced rulemaking or other guidance to implement either subsection.

On February 22, 2018, the IRS updated Publication 15-B, "Employer's Guide to Fringe Benefits," providing instructions for determining which payments for employee benefits are deductible and which are taxable under Section 13304 of the Public Law No. 115-97, the section relating to for-profit employers. This publication does not mention tax-exempt organizations or UBIT. Nor does it provide any guidance for our nation's more than 1.8 million nonprofits on how to comply with either of these two new subsections.

On March 22, 2018, at a tax law conference in Washington, D.C., there were audible gasps in the room by professional nonprofit tax advisors when an IRS official told those in attendance that the IRS would interpret the new subsection 512(a)(7) as imposing UBIT on not only employer subsidies for transportation fringe benefits, but also payments employers make using funds that employees voluntary 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, professionals had been interpreting the statutory language as applying to employer subsidies, but not to voluntary employee salary reductions for the convenience of employees to pay transportation costs through such qualified plans.

On March 27, 2018, the IRS published 2017 Instructions for Form 990-T, Exempt Organization Business Income Tax Return. Although the document references P.L. 115-97 and the new "flat 21% corporate tax rate … effective for tax years beginning after December 31, 2017," it provides no guidance for nonprofits on how to comply with either of the two new UBIT subsections of Internal Revenue Code Section 512.

The absence of any official guidance puts nonprofits in the untenable position of having to speculate 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. This problem of lack of guidance is compounded by the fact that for many nonprofits the due date for first UBIT Form 990-T quarterly estimated tax payments was April 15 or will be May 15.

Since information about these two new tax provisions only recently has started filtering into the nonprofit community, the National Council of Nonprofits has heard from charitable nonprofits across the country raising significant questions that **the government has not addressed**, such as:

With respect to the new requirement in Code Section 512 (a)(6) to report unrelated business income/losses from "separate trade or businesses":

- When a charitable nonprofit school earns revenue by allowing its campus to be used in the summer for an unrelated use by a basketball camp, an arts program, and a learn-to-swim program, is all the income to the school that summer from one "trade or business" or are the basketball camp, arts program, and swimming program each separate "trades or businesses"?
- When a charitable nonprofit has advertising income from more than one source, is each source of advertising a "separate trade or business"? For example, a charitable nonprofit may publish a digital newsletter that has advertising in it and may also publish a print magazine with advertising in it. Is advertising income (and losses) from the newsletter to be documented and reported separately from advertising in the magazine?

- When a charitable nonprofit runs a social enterprise that sells various goods, do all sales emanate from the same "trade or business," or are sales of clothing a separate "trade or business" distinct from sales of used computer parts?" What about sales for coffee from the small coffee maker on the front counter?
- When an educational nonprofit enrolls attendees in an unrelated learning program for professional development in computer sciences, is the income from registration fees for that program a "separate trade or business" from the registration fees for similarly unrelated certificate program in human resources management? What about for a certificate program in computer science?
- When a nonprofit that has debt-financed property rents out its function room for a private event in July and then rents out the same space to a different private entity at several other times during the year, is each instance of renting out space to a different entity a "separate trade or business"?

Until these and similar questions are answered through guidance from the Treasury and the IRS, nonprofits and tax preparers have no way of knowing for sure what is meant by "trade or business," or "computed separately," or how to allocate incomes/losses. Without relief, they may have to completely rework their books – long after the year began and expenses were incurred – in an after-the-fact attempt to compute and report the income/losses appropriately. It would be patently unfair to penalize taxpayers with late-filing fees for inaccurate filings or innocent underpayment caused by lack of guidance from the government. (We also note that the current IRS Form 990-T does not provide any way of reporting incomes/losses for multiple trades or businesses separately, or any other guidance, so some filers may wonder if they are supposed to continue consolidating all incomes/losses onto one Form 990-T or submit multiple 990-T forms to the IRS, one for each presumed "separate trade or business.")

The National Council of Nonprofits joins the comments of the American Institute of Certified Public Accountants (AICPA Comments), submitted April 17, 2018, highlighting the challenges imposed by new Section 512(a)(6), the need for delay in the effective date, and the legal authority of Treasury and the IRS to establish such a delay.

<u>With respect to the new requirement in Code Section 512 (a)(7) to pay UBIT on expenditures for employees' "transportation fringe benefits</u>":

- When a nonprofit employer makes payments into a pre-tax qualified plan at the request of individual employees so that the employees can direct their own money to defray the expenses of mass-transit passes or parking expenses, are those payments subject to the tax?
- When an employer is required by state or local law to make pre-tax qualified plans available so that employees can take mass-transit, are those mandatory payments subject to tax?
- What types of transportation fringe benefits are covered by the new code section? For instance, when an employer reimburses employees for transportation expenses to attend an out-of-town conference, are those amounts paid to the employee subject to the tax? Or are "commuting expenses" defined more narrowly as transportation to the employee's primary place of work? What if an employee is a remote worker and is "commuting" to the nonprofit's primary place of business for an all-staff meeting and the nonprofit employer pays for the remote worker's occasional transportation costs?
- When an employer owns a building and sets aside parking spaces for its employees so that those employees do not have to pay to park their vehicles at their workplace, does the employer have to pay a tax on the monetary value of those parking spaces? If so, how will they be valued?

- Similarly, if the employer leases a building and parking spaces for its employees are included in the lease, does the employer have to pay a tax on the monetary value of those parking spaces that are provided for its employees? And if so, how will the cost of the parking spaces be valued?

To avoid manifest injustice, taxpayer confusion, ineffective assistance of tax practitioners (who also are at a loss over how to interpret these new provisions), and risky speculation and filings of potentially unnecessary forms by hundreds of thousands of nonprofits, Treasury and the IRS need to delay implementation of these provisions until at least one year after Final Rules have been promulgated.

Overarching Problems and Challenges

A. Compliance Can't Happen Without Clear Guidance

Although both new subsections ostensibly create tax liability for some nonprofits, the plain language of those provisions suggests to any neutral reader that the number of organizations affected will be small. Yet the surprise statement at the March 22 tax conference strongly indicates the IRS may be reading the provisions far more broadly than the plain statutory language – which would have the curious, ironic, and outrageous effect of giving for-profit corporations and wealthy individuals significant tax cuts while heaping new tax liabilities and tax increases on charities and other nonprofit organizations serving the public good.

B. Compliance Can't Happen Without Sufficient Time to Transition

In addition to providing nonprofits with clear guidance about the actual reach of these new provisions, the government must provide nonprofits sufficient time to change their systems for accounting of expenses. An overly-broad interpretation of new subsection 512(a)(6) regarding "separate trade or business" will require organizations to create multiple new line items in the financial books. These changes, if truly effective on January 1, 2018, would force retroactive review of all income and losses, and perhaps reclassification of them, as well as restructuring of the accounting systems of organizations with unrelated business income/losses, imposing new costs to pay for unanticipated expenditures for staff time or outsourced accounting expertise.

Likewise, the potential documentation of expenditures required by an 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. Such an interpretation would be a novel, alien, and even bizarre concept to charitable organizations that are already struggling to keep their workplaces competitive with for-profit employers and cannot raise "prices" to afford the same fringe benefits that for-profits offer their employees.

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 with sufficient time to make necessary systems changes. For instance, in this strikingly similar case, a federal court issued a nationwide injunction blocking implementation of new record keeping and reporting requirements. See *AFL-CIO v. Chao*, 297 F. Supp. 2d 155 (2003). There, the U.S. Department of Labor promulgated new recordkeeping requirements that changed the way labor unions would be required to disclose financial transactions. The AFL-CIO demonstrated, among other things, that unions did not previously record the key data required under the new regulations, that the unions would have to make major changes to their accounting systems in order to record and report the newly sought data, and that the changes must be made immediately because of a very short implementation period. In the *Chao* case, the regulations were finalized on November 30, 2003, and effective on January 1, 2004. The judge found that the federal agency failed to provide adequate time to prepare after formal guidance was provided, observing, "The Department of Labor has allowed the unions covered by the statute less than two months to make the extensive and sophisticated accounting, computer, and employee training changes that are necessary in order to bring them into compliance with the Rule." He ordered a one-year postponement of the disclosure rule. Here, by comparison, nonprofits had less than 10 days (and over the holidays, no less) to comply with statutory changes, and they still, as of April 24, 2018, have no meaningful guidance from Treasury or the IRS.

C. Unfair Imposition of Unanticipated Costs and Burdens on Nonprofits

The two new UBIT subsections will impose new and unanticipated costs and burdens on the nonprofit sector, including:

1. Additional costs to develop accounting systems to collect, document, calculate, report, and pay quarterly estimates;
2. Additional costs to retroactively review and potentially reclassify income and losses;
3. Additional costs to prepare Form 990 and 990-T (particularly for those who previously had no Form 990-T filing requirement); and
4. Additional costs to pay unanticipated penalties for failure to remit sufficient estimated unrelated business income tax and/or inaccurate returns– not through any fault of the individual nonprofit, but instead due to lack of clarity by Treasury and the IRS.

D. Anticipated New Liability for Many Small Charitable Organizations

Eve Borenstein of BAM Law Office LLC has analyzed IRS Statistics of Information (SOI) numbers and predicts that the number of nonprofits filing Form 990-T will "explode" because of the two new UBIT provisions. Borenstein estimates that fewer than 35,000 tax-exempt nonprofits filed Form 990-T returns for 2013, the latest year for which IRS data are available. Of those, only 16,416 entities filing unrelated business income tax returns were 501(c)(3) organizations. Given that the vast majority of nonprofits are charitable and philanthropic organizations, it stands to reason that application of the new provisions will exponentially increase the number of 990-T filers. Thus, the need for relief and guidance is urgent.

Additional Comments on New Code Section 512(a)(7)

A. Application to Employee-Elected Compensation Reduction Agreement

We agree with the position articulated by the American Society of Association Executives in its Comments dated March 28, 2018, that:

> *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*.

Overall, imposing a tax penalty on 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.

B. Taxing Government-Mandated Commuter Benefit Payments Is Patently Unfair: Application to Organizations in Cities with Mandatory Commuter Benefit Ordinances

If the language in Publication 15-B and the statement made at the March 22 tax conference hold, then nonprofit employers in several communities will now be taxed for costs over which they have little control because those costs are mandated by local governments.

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 a UBI 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 a pay package 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 UBIT liability is an income tax to the general treasury distinguishes it from FICA.

In short, mandated commuter benefits cannot and should not be treated as voluntary "fringe" benefits subject to UBIT under subsection 512(a)(7). We ask Treasury and the IRS to clearly and definitively rule that employers providing transportation or commuter benefits named in subsection 512(a)(7) under compulsion of law are thereby exempt from the tax under that subsection.

Conclusion

Public Law No. 115-97 includes subsections 512(a)(6) and (7) that appear to tax tax-exempt organizations in strange and inexplicable ways. Many tax-exempt organizations are just now learning about the changes in the tax law that went into effect at the first of the year. Absent explicit guidance from Treasury and the IRS on these two subsections, tax-exempt filers will continue to be confused and either miss filing deadlines or file inaccurate returns through no fault of their own. We urge Treasury to provide the nonprofit community with more time and more guidance to fully understand our compliance obligations, and anticipate that we will have more specific recommendations following the meeting.

Thank you for your consideration of the issues we raise. We will be happy to answer any questions you may have.

Sincerely,

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