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

June 21, 2018

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

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

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

Dear Secretary Mnuchin and Commissioner Kautter:

On behalf of the networks of the National Council of Nonprofits – the nation's largest network of charitable nonprofits – we write to express significant concerns about challenges that tax-exempt organizations are experiencing in attempting to comply with new Internal Revenue Code Sections 512(a)(6) and 512(a)(7), enacted as part of the Tax Cuts and Jobs Act (Public Law No. 115-97). The National Council of Nonprofits submitted preliminary comments to the Department of Treasury and the Internal Revenue Service, dated April 24, 2018, that provided details about the many legal, practical, and accounting problems and questions that the two new sections of the tax code present to frontline nonprofits. In the weeks since that statement was delivered to your offices, hundreds and perhaps thousands of charitable organizations, houses of worship, and foundations have raised additional questions and submitted substantive statements about the very pressing need for guidance before they can comply with the new requirements. These organizations are all requesting transition relief because of the substantial ambiguity surrounding these significant changes.

The National Council of Nonprofits has been monitoring the engagement and commentary of many other national networks and membership organizations – large and small, representing most subsectors of the nonprofit community across all regions of the United States. Throughout these comments we reference their perspectives, concerns, and questions to ensure that Treasury and the IRS have a complete picture of the complexity and challenges created by these new code sections.

The new tax law imposes on charitable nonprofits, houses of worship, foundations, and other nonprofits significant new tax liabilities on (1) each "**trade or business**" and (2) **qualified transportation benefits** for employees, such as transit passes and parking. Quarterly tax payments are already past due for many nonprofits, but no one – not accountants, lawyers, or nonprofits – can say with certainty what is and is not covered by the new tax because Treasury and the IRS have not provided necessary guidance.

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 Treasury and the IRS have a duty to the regulated community to provide immediate relief and substantive guidance on these provisions. The National Council of Nonprofits and many other nonprofit organizations seek 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 late filing penalties must be abated, recognizing that it is manifestly unjust to impose late-filing penalties on organizations when there has been no guidance from Treasury/IRS about how to calculate the tax liability; 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.

To avoid manifest injustice, taxpayer confusion, ineffective assistance of tax practitioners, and risky speculation and filings of potentially inaccurate and/or 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.

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 it 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 concerned about the lack 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 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, employing approximately 10 percent of America's workforce on how to comply with new Section 512(a)(7).

On March 22, 2018, at a tax law conference in Washington, D.C., there were audible gasps of incredulity 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 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, tax professionals struggling to make sense of the new law, and journalists, 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 qualified plans long authorized by Congress.

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.

Confusion and Its Consequences

The new unrelated business income taxes (UBIT) 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 were required to make quarterly estimated payments to the IRS by mid-April 2018 based on their best guess of what their new tax liabilities might be since no guidance has been issued nor is expected to be forthcoming anytime soon.

Organizations as sophisticated as nonprofit hospitals have expressed concern that the law as drafted is inscrutable and stressed that guidance is needed immediately. The **American Hospital Association** wrote Treasury and the IRS on May 1, 2018, acknowledging, "Computation of liability for unrelated business income tax requires precision, and different potential interpretations of this provision could produce very different results." The organization stated further, "Without regulations, it is impossible for tax-exempt organizations to be confident of the amount of any tax liability under the new law." Likewise, the **National Association of College and University Business Officers** (NACUBO), representing chief administrative and financial officers at nearly 2,000 institutions of higher education, finds that "this new tax is particularly complex and questions abound as to what would ultimately be classified as an amount 'paid or incurred' by the institution," referring to the new tax on transportation benefits.

State associations of nonprofits, the organizations that work most closely with frontline nonprofits in local communities, report that there is scant awareness among frontline nonprofits about the new UBIT liabilities, and even less is understood. This fact is not surprising, given that the IRS has not published anything to put nonprofits on notice of any change in the law. The **Michigan Nonprofit Association**, in a letter dated April 24, reported fielding "many questions from nonprofits that do not understand their obligations under the new law." The **Center for Non-Profits** in New Jersey wrote in the comments it submitted last month that most charitable nonprofits "do not understand how a fringe benefit can be taxed and/or are confused about which part of the benefit (the employer contribution, the service fee, or the employee contribution) is actually subject to tax." Continuing, the Center wrote, "There is also no clarity with respect to how to determine what constitutes a 'separate trade or business' pursuant to the new law."

The confusion is rampant – among not only charitable nonprofits, but also tax professionals who are divided in their interpretations of the scope and specifics of new provisions. Nonprofits are understandably nervous about complying with the new vague and ambiguous UBIT subsections without any certainty that their professionals are giving them accurate information. In comments filed in April, the **American Institute of Certified Public Accountants** (AICPA) stated emphatically, "The lack of guidance affects tax practitioners, who are currently unable to accurately and consistently advise taxpayers on reasonable recordkeeping and the calculation of estimated tax payments for 2018." This observation was confirmed in a May 4 letter to Treasury and the IRS by the **North Carolina Center *for* Nonprofits**, which has been hearing about this challenge from its nonprofit members for months:

> **Nonprofits are receiving conflicting advice from tax professionals about the applicability of these changes to their organizations.** We have heard from several organizations that they

> have received different guidance when they talked with more than one CPA and/or attorney about these new provisions in the Internal Revenue Code. For example, there appears to be varying opinions among tax professionals about how UBIT applies to the portion of nonprofits' leases that cover employee parking expenses. Some nonprofits have been advised that they may be better situated renegotiating their leases to change the terms related to payment for parking expenses. (Emphasis in original.)

The **CT Community Nonprofit Alliance** reported to Treasury and the IRS back in April, "we are finding that professional advisors are not in agreement as to how to apply the new taxes, creating great confusion and consternation among law-abiding community nonprofits." Likewise, New Jersey's **Center for Non-Profits** informed the government, "Tax professionals are similarly divided in their interpretations of the scope and specifics of new provisions, and non-profits are scrambling to comply." In New York City, the **Nonprofit Coordinating Committee** shared, "In New York, there is an active conversation amongst nonprofit tax experts (lawyers, accountants, and nonprofit leaders) as to whether and which portion of the benefit is taxed," stating bluntly, "Confusion reigns as various opinions circulate."

The absence of any official guidance puts nonprofits in the untenable position of having to speculate about how to comply with the unknown. This problem of lack of guidance is compounded by the fact that for many nonprofits the due date for their first UBIT Form 990-T quarterly estimated tax payments has passed. In the words of the **Maine Association of Nonprofits**, in comments filed on May 10, "Absent urgently needed IRS guidance, charitable nonprofits will not be able to file accurate reports, are likely to make insufficient or inaccurate payments, and may suffer other adverse tax consequences that can and will be avoided once Treasury and the IRS provide the nonprofit sector the necessary clarity."

We agree with the views of our colleagues at the **Council on Foundations**, who wrote, "Few recent provisions of the tax code have created such confusion and concern among exempt organizations and practitioners as the provisions contained in subsections 512(a)(6) and (7)." Their statement continues, "The risk of unintentional missed deadlines, inaccurate filings and potential penalties is great, and the clear solution is a delay in the implementation of these sections until official guidance can be promulgated."

The National Council of Nonprofits has heard from a significant number of charitable nonprofits across the country that have been urging delay in implementation because the government has not yet answered the substantial – or even basic -- questions. **CalNonprofits** wrote Treasury and the IRS on April 20 stating: "Nonprofits need more time and more guidance to fully understand our compliance obligations." **Washington Nonprofits** is asking the government "to postpone the effective date of the new unrelated business income tax (UBIT) provisions in Internal Revenue Code Section 512 (a)(6) and (a)(7) until a reasonable time after the Service issues guidance clarifying the new tax liability triggered by new those sections." The **North Dakota Association of Nonprofit Organizations** similarly explains that a "delay is required to provide both the necessary official guidance for compliance and a reasonable transition period for nonprofits to develop the necessary record-keeping systems." The **Girl Scouts of the USA** stated the point well in its May 25 letter, "We urge the Treasury to provide the nonprofit community with more time and guidance to fully understand compliance obligations and adhere to the letter of the law."

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. 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 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.

B. Compliance Can't Happen Without Sufficient Time to Transition to Adjust to Unanticipated Costs and Burdens on Nonprofit Missions

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 reverse-engineer their bookkeeping, revise systems, and possibly purchase upgraded software, in order to create multiple new line items in their financial bookkeeping systems. Were Treasury and the IRS to retroactively implement and enforce the two new subsections back to January 1, 2018, they would force hundreds of thousands of nonprofits to suddenly divert substantial time and significant money from their missions in order to restructure their accounting systems to come into compliance. Then organizations would have to retroactively review all of their income and expenses back to January 1, with an eye towards reclassifying them, and all that before reallocating them to calculate the income/losses for each unrelated business or trade to then calculate the new 21 percent tax on the tax-exempt entity. Every one of those steps imposes new costs on each organization to pay for unanticipated expenditures for staff time or outsourced accounting expertise for which organizations have not budgeted, and that, as a result, will directly and adversely affect their ability to provide services in communities and advance their charitable missions.

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." The federal judge 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 June 21, 2018, have no meaningful guidance from Treasury or the IRS.

We agree with the observation of the **Nonprofit Coordinating Committee of New York**, which wrote on May 1 that "compliance cannot happen without clear guidance or sufficient time to transition." Simply stated, fundamental fairness is at stake: "Asking nonprofits to comply with a law for which they were given no notice, nor time to incorporate into an annual budget, is an unfair imposition of unanticipated costs and burdens on nonprofits."

Finally, it must be made clear that an announcement of transition time should include the abatement of penalties for late or inaccurate filings and payments of estimated or final unrelated business income taxes because any such late or inaccurate filings are not due to any fault of the individual nonprofit, but instead due to lack of clarity by Congress, Treasury, and the IRS.

C. Anticipated New Liability for Thousands of Small Charitable Organizations including Churches

Eve Borenstein of **BAM Law Office** LLC has analyzed IRS Statistics of Information data 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. The new law also has a sweeping effect on houses of worship that may never have had a reason to file Form 990-T in the past. Given the significant number of organizations now required to file Form 990-T, it stands to reason that transition relief and guidance are needed not only by the hundreds of thousands of nonprofits in the regulated community but also for the IRS.

In summary, without interpretative guidance from Treasury and the IRS, nonprofits are forced either to overestimate and overpay their tax liabilities (diverting funds from mission) or underestimate and underpay their legal obligations (something antithetical to the law-abiding culture of the charitable nonprofit community). Organizations have many legal, practical, and accounting questions about the two new sections of the tax code that their employees, accountants, and attorneys cannot answer with any degree of certainty.

Comments on New Code Section 512(a)(6)

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 statute does not 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 permitted an organization to use a loss from one unrelated trade or business to offset income from another, thereby reducing total unrelated business taxable income. 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.

Public Law 115-97 attempted to abolish the rule on aggregation and require income and losses to be calculated separately. The extent of the legislative history on the provision (Section 13703 of the Senate bill) is found in the Joint Explanatory Statement of the Committee of Conference, at pages 410-411):

> For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction generally allowed under section 512(b)(12). The organization's unrelated business taxable income for a taxable year is the sum of the amounts (not less than zero) computed for each separate unrelated trade or business, less the specific deduction allowed under section 512(b)(12). A net operating loss deduction is allowed only with respect to a trade or business from which the loss arose.
>
> The result of the provision is that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. The provision generally does not, however, prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year, where appropriate.

Rather than explain how nonprofits are to put the change into effect, the provision raises numerous questions that have, to date, confounded nonprofit and tax-law professionals. Below are a sampling of the many questions and concerns of which the National Council of Nonprofits is aware.

Sampling of Questions on Paying UBIT on Separate Trades or Businesses

Definition of "separate trade or business"

- The **Council on Foundations**, in its letter to Secretary Mnuchin and Acting Commissioner Kautter dated May 16, states: "The key question that remains unanswered with respect to the 512(a)(6) UBIT allocation provision is determining what constitutes a separate trade or business."
- In our preliminary comments submitted to Treasury and the IRS on April 24, the **National Council of Nonprofits** raised the following questions about the practical application of the definitional change, questions that still have not been answered:
  - 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"?
- The comments of the **National Association of Independent Schools** (NAIS) submitted on June 7, raise numerous questions about the use of properties for multiple purposes:
  - "If a school rents out its facilities for summer sports camps and special events such as weddings – providing they also offer ancillary services or the property is debt-

financed – a will each rental income activity be treated as a separate trade or business?

- “If the school rents space to more than one sports camp, will income from each camp have to be treated separately?
- “If a school has two campuses and each location operates a school store that sells items both related and unrelated to their exempt purpose, will the school have to fragment exempt and non-exempt revenue and expenses for each store location and then calculate UBIT separately as well?”

NAIS goes on to warn, “If the IRS defines a trade or business too narrowly, the accounting burden could become significant, particularly if expenses of such facilities and staff are shared between activities deemed to be separate trades and businesses.”

Treatment of Investment Returns

- The **American Institute of Certified Public Accountants** (AICPA), in comments submitted on April 17, 2018, explains the challenge to tax practitioners of determining how investment returns are to be treated: “Absent specific guidance, it is not possible to determine whether a tax-exempt organization that receives, for example, one hundred Schedules K-1, Partner’s Share of Income, Deductions, Credits, etc., is required to track and report each Schedule K-1, or each line of income on each Schedule K-1, as a separate trade or business. A narrow definition of a trade or business for purposes of the computation of UBTI could potentially lead to hundreds or thousands of trades or businesses, which is burdensome to taxpayers, tax practitioners and the IRS to record, report, and audit. Tax-exempt organizations would need, at a minimum, upgraded general ledger software to track each trade or business, to maintain the appropriate records for tax preparation at the end of the tax year.”
- The **American Hospital Association** drills down deeper by asking: “To the extent passive investing is a trade or business, is it a single unrelated trade or business? If not, must the exempt organization look through any investment held in the form of a pass-through entity, such as a partnership or LLC, to the underlying business activity that is generating the unrelated business in order to determine whether it is a separate trade or business from others that may be generating unrelated business income?”
- **Emory University** raised several issues in its May 24 letter to Secretary Mnuchin, including this discussion of the proper treatment of investments: “Emory believes UBTI arising from investment activities should be treated as one activity. As part of Emory's overall investment strategy and management of the investment pool, Emory is invested in approximately 400 investment entities. These investments are governed according to policies created and regularly reviewed by the institution's investment committee of its Board of Trustees. The spending policy (the rules that determine the amount of funds available for withdrawal from the pool and spent by the institution) is typically based on the investment pool's market value.” The University “recommends all investment activities be treated as a single basket in computing UBTI pursuant to section 512(a)(6), which is a logical extension of the governance approach to managing investment pools.”

Treatment of Indirect Costs

- Accountants Deborah Kosnett and Lisa Heller with firm of **Tate & Tryon**, writing in conjunction with the **American Society of Association Executives**, recently pointed out a significant challenge related to cost allocations, observing, “the new law is unclear on whether deductible expenses that are not specifically tied to a specific unrelated trade or business activity should be allocated. Examples include: state and local taxes, tax return preparation fees, and deductible charitable contributions. Will these expenses be allocated, or will they continue to be a general deduction toward taxable unrelated business income?”

Until these and similar questions are answered through final rules from the Treasury and the IRS, nonprofits and tax advisers and 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. That is especially true given that the current IRS Form 990-T does not provide any way of reporting incomes/losses for multiple trades or businesses separately, or offer any guidance, leaving filers to 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."

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

New Internal Revenue Code Section 512(a)(7) creates an awkward structure that seeks to impose unrelated income taxes on nonprofits for certain transportation, parking, and athletic facilities to the extent the expenses for those items are not deductible under Section 274. The Joint Explanatory Statement of the Committee of Conference, at page 254, cryptically describes the impact of new Internal Revenue Code Section 512(a)(7):

> Under the provision, unrelated business taxable income includes any expenses paid or incurred by a tax exempt organization for qualified transportation fringe benefits (as defined in section 132(f)), a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)), provided such amounts are not deductible under section 274.

The brevity of the "explanation" masks numerous policy and substantive challenges that must be addressed before the many questions can be answered.

A. A False Equivalency

The new tax law amended Section 274 to provide that for-profit employers may no longer deduct expenses associated with providing any qualified transportation fringe benefits to an employee. That limitation is extended to tax-exempt organizations through the imposition of a novel application of the law on unrelated business income taxes onto an organization's expenses. Reportedly, the new tax on nonprofit expenses was imposed to ensure "parity" between for-profits and nonprofits in regard to qualified transportation benefits. The **Evangelical Council for Financial Accountability**, in a position statement, calls premise of parity "flawed at its core." In the words of the **Jewish Federations of North America** in its May 11 letter this is a "false equivalency."

The **National Association of College and University Business Officers** (NACUBO), in comments submitted on April 16, emphasizes that the "business models of taxable and tax-exempt organizations are fundamentally different," explaining that while "For-profit businesses seek profits for owners or for shareholders," "Nonprofit entities have no owners or shareholders." Thus, the burden of the unrelated business income taxes imposed on transportation benefits doesn't fall on owners who see lower profits, but on students, in the case of higher educational institutions, and on the patrons, clients, and beneficiaries of services of other charitable organizations. NACUBO speaks for many organizations when it wrote, "This is not parity of treatment, as the burden on tax-exempt organizations diminishes the public good they offer. Straining a tax-exempt organization's ability to deliver its mission is not comparable to impacting the bottom line of a for-profit entity."

There is another important distinction worth noting here: nonprofits never had a deduction for these expenses and never provided transportation benefits to gain a tax deduction. For nonprofits, the benefits truly were about attracting and retaining workers, while reducing traffic and air pollution. *Depending on the answers to some of the questions raised below, however, the benefits* – to nonprofit employees, to the people they serve, and to society as a whole - *will have to be eliminated because of the unexpected costs*.

B. Application to Employee-Elected Compensation Reduction Agreement

As discussed above, the stakeholder community was shocked to learn that the IRS considers voluntary compensation reduction agreements to be taxable under the new UBIT regime. We agree with the position articulated by the **American Society of Association Executives** in its comments dated March 28, 2018:

> 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 an expansive reading of Section 512(a)(7). Consider this example provided in May 10 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, they 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 local people.

Overall, 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 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. We also note that the Treasury's interpretation of imposing a tax on the amount of a worker's salary that he/she deposits in a pre-tax qualified plan does not advance Congress's intent to create "parity" with for-profit employers, but rather deeply disadvantages tax-exempt 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.

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

If the language expressly applicable to for-profit businesses in Publication 15-B is extended to nonprofits and the statement made by an IRS official at the March 22 tax conference holds, then nonprofit employers in several communities will now be taxed for costs over which they have little or even no 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 agree with the conclusion of experts at **RSM**, "This situation clearly was not contemplated by the changes made in this area by Congress and must be addressed as soon as possible." 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.

Sampling of Questions on Paying UBIT on Expenditure for Employees' Transportation Benefits

- In our preliminary comments submitted to Treasury and the IRS on April 24, the **National Council of Nonprofits** raised the following questions that still have not been answered:
  - 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?
- The **College and University Professional Association for Human Resources** (CUPA-HR) observes that "Colleges and universities offer a wide range of transportation benefits to their employees across the country, and often to students and the community." In its May 21 letter, CUPA-HR explains, "In many cases, these arrangements create great value to the public good by offering a much-needed service, reducing traffic and improving local air quality," but recognizes that "The new requirements under IRC Section 512(a)(7) have raised many complex questions and created uncertainty for higher education institutions as to what the IRS considers an amount 'paid or incurred' for a qualified transportation benefit." Importantly, the association stresses, "Making a reliable determination regarding the amount of taxable benefits is simply not possible without further guidance from the IRS."

Technical Challenges

- Several experts and organizations have identified the technical errors in the 2017 tax law and presumably Congress will make amends. Notable are the May 7 article in *Tax Notes* by Davidson and Harding and an analysis by **RSM**, as well as comments submitted by **NACUBO** and the **Jewish Federations of North America**. **Emory University** explained the challenge succinctly and provides a proposed solution: "This provision and new tax is complex due to the fact that IRC Section 274 only disallows the deduction for the "qualified transportation fringe" and does not include expenses associated with parking facilities used in connection with qualified parking nor on-premises athletic facilities. Emory recommends clarification that neither the expenses associated with parking facilities used in connection with qualified parking nor on-premises athletic facilities will give rise to UBTI under IRC Section 512(a)(7)."

Taxing Salary Reduction Agreements

- In addition to the discussion above, we provide the direct question raised by the **Council on Foundations** in its comments submitted on May 16: "With respect to 512(a)(7), the question has been posed whether UBIT applies not only to employer subsidies for the identified fringe benefit, but also to payments employers make for these fringe benefits using voluntary employee pre-tax payroll deductions. The statutory language does not currently answer this question and interpretations vary within the field."
- **NACUBO**, referenced above, wrote in April seeking "clarification that the amount of the compensation reduction that is in fact payment received from employees to pay for transit passes or to park in employer-owned lots is not an expense of the employer that would be disallowed under section 274, and, therefore, that such amounts are not subject to unrelated business income tax (UBIT) under section 512(a)(7)." The association of higher educational institutions provides examples and alternative interpretations that Treasury and the IRS need to assess.

Transportation Benefit or Business Travel

- The **League of American Orchestras** posed this uncertainty in its letter dated June 8: "Orchestras provide transportation and parking benefits to their musicians and staff in varying configurations, and in both urban and rural areas. … For organizations like orchestras, for which the work being completed takes place at multiple rehearsal and performance venues, it is unclear whether transportation compensation provided to musicians and other employees will be considered commuting fringe benefits subject to the new UBIT, or business travel expenses that are exempt from the tax."

Collective Bargaining Agreements

- The **League of American Orchestras** also 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." Is Treasury and the IRS considering delaying implementation of this UBIT liability for the duration of existing collective bargaining agreements, as is frequently done in federal and state regulations when significant costs are imposed?

Alternative Transportation Benefits

- Questions about application of the new tax go beyond traditional rail and bus transit arrangements. The **North Carolina Center *for* Nonprofits** posited this challenge: "Most analysis of the applicability of qualified transportation benefits to payment for transit passes relates to parking or urban mass transit. However, employees of nonprofits in certain parts of North Carolina must commute to work by ferry. The organizations that employ these workers are uncertain whether they are required to pay UBIT on the amount they spend on their employees' ferry passes."

Parking Questions

- The **YMCA of the USA,** on behalf of its 2,700 Ys throughout the United States, raised these questions and concerns in comments submitted on May 22: "an organization in a rural or suburban location that owns or leases a building and parcel of land may not charge its employees for the 'free' parking. But how should that tax-exempt organization calculate UBIT owed for the parking lot or parking spaces assigned to employees? What if the parking lot is open to both employees and members or visitors?"

- The **National Association of Independent Schools**, representing more than 1,600 independent, day, and boarding K-12 schools throughout the United States, gets to the valuation challenge of determining how much of a benefit is provided and how UBIT could be calculated: "When parking is valued for determining whether an employee must include the benefit in gross income (if the benefit has exceeded the exemption threshold), the IRS looks at the fair market value of the parking. However, the language of section 512(a)(7) refers to amounts paid or incurred by the nonprofit. If the cost incurred (or amount paid) for employee parking spots in a nearby garage is $100 per employee and the fair market value of the parking spot is $100, there is little confusion. However, if the organization obtains a discount for reserving multiple spots and only pays $90 per month for each parking spot when the fair market value is $100, what is the amount of UBTI?"
- The **American Hospital Association**, on behalf of its 5,000 member hospitals, asks "If a tax-exempt organization allows its employees to park in parking lots and garages it owns or operates where parking is available free to visitors and members of the public, is the organization deemed to have any additional unrelated business taxable income as a result of offering this free parking?"
- Tax practitioners Benjamin Davidson and Bertrand Harding, writing in A Proposed Guide to the New UBTI Increase for Qualified Parking, *Tax Notes*, May 7, 2018, identify several questions regarding expense allocation of leased parking spaces for which Treasury and the IRS must provide guidance. "An organization that leases a parking lot knows the amount of its rental expense," they write. "However, an organization with a lease that includes both office space and parking space faces legal and factual uncertainty. It is unclear whether such an organization must allocate its rental payments between office and parking, but most organizations we have spoken with are proceeding on the assumption that an allocation is necessary. There is an opportunity for the IRS to provide clarity on this point, including a safe harbor method for allocation." They go on to ask later, "Should an organization allocate its parking expenses based on the number of spaces that are available for employees versus non-employees? What if some spaces are available to employees during business hours, and to students or patients overnight? Allocating expenses by the hour, and accounting for periods when spaces are restricted to specific use (for example, an athletics event) or open to all (for example, during holiday breaks) becomes quite complex."

Church Parking and UBIT

- The **North Carolina Center *for* Nonprofits** flags a significant challenge that has not been widely reported: "Many of these nonprofits may be unaware of this new tax and may have never had to file Form 990-T nor pay UBIT if they do not have income-producing business activities that would otherwise be subject to UBIT. Some houses of worship – particularly those in urban areas – pay for clergy and staff parking but have never previously had to file any version of the Form 990 with the IRS. Without a targeted outreach initiative from the IRS, it is unlikely that these organizations will be aware of the need to File Form 990-T or pay UBIT. As a result, some organizations could become liable for failure to file Form 990-T and pay UBIT on expenses that they should not reasonably have been expected to realize were taxable."
- In a position statement, the **Evangelical Council for Fiscal Accountability** expresses serious concerns about the imposition of the tax on church and other nonprofit parking costs, and insists that "regulations or other guidance" from Treasury and the IRS must provide this level of clarity: "To apply this requirement, nonprofit employers and their accountants must have guidance addressing exceedingly complex questions of allocations of basis, depreciation,

and rent payments among different structures and between employee and non-employee users."

- 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) 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?

Impact on Volunteer Status

- 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?

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 beginning to hear 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.

Specifically, we ask that Treasury and the IRS delay implementing the two new UBIT subsections until one year after Final Rules are promulgated.

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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