June 23, 2020

Internal Revenue Service  
CC:PA-LPD:PR (REG-106864-18)  
Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

RE: Unrelated Business Taxable Income Separately Computed for Each Trade or Business  
IRS REG-106864-18

Dear Madam/Sir:

The National Council of Nonprofits, the largest network of nonprofits in the country, welcomes this opportunity to respond formally to the Notice of Proposed Rulemaking (REG-106864-18) from the Treasury Department and Internal Revenue Service published on April 24, 2020. Our network of more than 25,000 organizations – charitable nonprofits, faith-based groups, and foundations – is committed to promoting positive policy solutions that will enable organizations to advance their missions in their communities. 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 the following materials on this topic that the Council of Nonprofits previously provided to the IRS and Treasury:

1. The December 3, 2018 public comments we submitted in response to Notice 2018-67;  
2. The June 21, 2018, detailed letter we sent expressing our concerns and sharing our comments, as well as summarizing those from dozens of subsector organizations; and  
3. The April 24, 2018, preliminary letter we delivered.

Introductory Comments

Internal Revenue Code Section 512(a)(6), added to the Code through the 2017 tax law, 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 fails to define what constitutes an “unrelated trade or business.” Regulations based on prior law provided that, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses could aggregate all revenues and expenses from all such activities and compute UBIT liability on the aggregate income. This natural and logical approach permitted an organization to use a loss from one unrelated trade or business to offset income from another. It promoted sustainability and innovation. The approach also eased compliance costs of having to hire accountants and attorneys to advise where to best draw artificial distinctions on such things as whether rentals of a nonprofit’s main room for a community theater’s use, its garden for a wedding, and its parking lot for use by a for-profit driver’s education school for practicing safe parking amounts to one line of business (short-term rental of property) or three (community use, private weddings, and for-profit’s use). Significantly, because income and losses were treated in the aggregate, distinctions between separate businesses were made, if at all, not for tax payment or reporting purposes, but instead largely for internal management and, perhaps, branding purposes.
In the current rulemaking, the Council of Nonprofits respects and appreciates the efforts of Treasury and the IRS in seeking to divine the will of Congress that was not explained in the legislative process nor in legislative language. As the Notice of Proposed Rulemaking refreshingly acknowledges, “There is no general statutory or regulatory definition defining what constitutes a ‘trade or business’ for purposes of the Internal Revenue Code.” This new tax is vague and ambiguous, making it unenforceable as a matter of law. Moreover, it is patently unfair, especially since no similar tax burden is imposed on for-profit businesses that instead received significant tax cuts through the Tax Cuts and Jobs Act. This provision that was included in the tax law to partially defray the costs of those business tax cuts is not justifiable and must be repealed.

We recognize that repeal is not the province of Treasury and the IRS and that clarity, efficiency, and the reduction of administration burdens is the best that can be achieved through formal rulemaking and public comments.

**Reliance on NAICS 2-Digit Codes**

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

Nonprofits made clear in prior public comments that the initial proposal from Treasury and the IRS would have required organizations to break down their various unrelated business income into dozens or even hundreds of separate categories, leading to burdensome compliance costs, inconsistency, and arbitrariness. We explained that as proposed in Notice 2018-67, the NAICS safe harbor would inject further uncertainty, complexity, and expense into an already burdensome tax regime.”

With that stated as background, we recognize that the Notice of Proposed Regulations published April 24, 2020 reflects the input from nonprofit organizations. The latest draft rule proposes use of the first two digits of the NAICS code rather than the six digits originally suggested. If this approach is implemented, nonprofits would be required to group their unrelated business income into 20 or so broad buckets, or silos. This would mean, for instance, all types of accommodations and food services would fall into one category instead of several. We believe this is perhaps the least bad option for implementing what we stated at the outset of these comments is a very bad law. While we cannot endorse the proposed rule due to fundamental opposition to the underlying policy, we can express appreciation for the efforts taken by officials at Treasury and the IRS to lessen the administrative burdens and costs that Congress imposed on charitable organizations.

Respectfully submitted,

David L. Thompson  
Vice President of Public Policy