Before the United States House of Representatives
Committee on Ways and Means

Hearing on

The 2017 Tax Law and Who It Left Behind

March 27, 2019

Statement of the National Council of Nonprofits

On behalf of the National Council of Nonprofits, we thank the House Ways and Means Committee for conducting this important hearing into the real-world effects of the 2017 tax law. Through its network of state associations of nonprofits and 25,000-plus member charitable nonprofits, religious groups, and foundations – the nation's largest network of nonprofits – the National Council of Nonprofits serves as a central coordinator and mobilizer to help nonprofits achieve greater collective impact in local communities across the country. Our membership reflects the wide spectrum of nonprofit missions and, like most charitable nonprofits, are primarily smaller organizations. Indeed, 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.

In a November 26 letter to then-incoming Chairman Neal and Senator Grassley, we offered a series of tax policy recommendations that reflect the perspective of the charitable nonprofit community, a major segment of the U.S. economy that employs more than 14 million taxpayers. Those recommendations range from insisting on the preservation of the law that protects nonprofit nonpartisanship (the so-called "Johnson Amendment"), enhancing charitable giving incentives, overseeing and improving tax enforcement, and addressing challenges to nonprofits resulting from tax-law changes enacted in 2017. We encourage Committee Members to review the entire letter, which is attached to this statement. Because time is truly of the essence in one of the significant challenges in the 2017 tax law, we will address only that tax provision in the remainder of this statement.

The Urgent Need to Repeal Section 512(a)(7), the Unrelated Business Income Tax on Nonprofit Transportation Benefits

In less than three weeks, charitable nonprofits, houses of worship, foundations, and other nonprofits will have to send in estimated payments to the IRS to pay taxes on their expenses for providing transportation benefits. For many, additional tax payments will be due a month later. That is, unless this Committee and Congress heed the urgent pleas of nonprofits and repeal this unfair tax in time.

Section 512(a)(7), enacted as part of the 2017 tax act, imposes an unrelated business ***income*** tax on the ***expenses*** of nonprofits that provide employees with transportation benefits, such as transit passes and parking. As interpreted by the Treasury Department and the IRS, tax-exempt organizations must pay this new tax not only on the amount of direct expenditures they make, but also on the amount that their employees ask to have withheld from their paychecks on a pre-tax basis, that is, voluntary salary reduction agreements made pursuant to federal law. This new 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.

Time is of the essence in this request that you repeal Section 512(a)(7) as soon as possible. For nonprofits operating on a calendar year basis, quarterly estimated tax payments are due on April 15 for a tax that is incomprehensible to most, and certainly one for which few have budgeted. To comply with the law and calculate their taxes, nonprofits right now are in the process of determining which and how much of their expenses generate income tax liability. For some, the tax will be crippling. For many others, the cost of hiring accountants and lawyers to determine whether and how much they owe in unrelated business income taxes will be more than their actual tax payments. In urban areas, the application of the tax on train, bus, and ferry passes likely will force many organizations to scale back or eliminate the employee benefit. As a result of this tax, nonprofit employees and the people the organizations serve will suffer the consequences as hundreds of thousands of nonprofits are forced to divert scarce resources away from mission to pay this unjust tax.

We believe that there is no support for retaining Section 512(a)(7) in the 115th Congress. There are, however, misperceptions that need correcting and clarifying here.

Proposed Guidance Insufficient
Some have suggested that guidance from the Treasury Department and IRS significantly resolved the problems that nonprofits have with Section 512(a)(7). It does not.

On December 10, eleven-and-one-half months after enactment of the 2017 tax law, the government issued Notice 2018-99 that provides complex instructions for determining tax liabilities for employer-owned parking lots, including a four-step calculus that will vary for each organization and can change from month to month. The guidance completely ignores, however, the imposition of the new tax on transit benefits; benefits that are mandated for some employers in various cities. Nor does the guidance reduce the tax burden on employers providing paid parking in facilities they do not own.

At a hearing before the Senate Finance Committee on March 14, Treasury Secretary Mnuchin acknowledged that no further relief would be forthcoming in this area when he stated: "We hope we have solved it as best we can."[1] See the Comments of the National Council of Nonprofits for more information on the proposed guidance and its shortcomings. Repeal of the section is the only reasonable response.

Taxing Mandated Transportation Benefits
At least five communities, and now the state of New Jersey, have enacted laws mandating that certain employers provide commuter benefits to some or all of their employees. In every instance, nonprofit employers complying with these lawful mandates would be subject to the 21 percent unrelated business income tax.

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

[1] Treasury Secretary Steven Mnuchin, testifying before the Senate Finance Committee on March 14, 2019, making clear that nonprofits can expect no further clarity from the Treasury and the IRS on calculating the new 21 percent nonprofit transportation tax that many organizations will have to start paying as soon as April 15. Mnuchin was responding to a question from Senator Lankford (R-OK) asking whether nonprofits can expect additional guidance that will alleviate the tax burden on charitable nonprofits, houses of worship, foundations, and nonprofit associations. The exchange appears at 1:37:30 on the recording.

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.

Imposing an Unjust Tax in the Name of "Parity"

Reportedly, the justification offered for applying a new income tax on nonprofit expenses was a desire to impose "parity" between for-profits and nonprofits regarding qualified transportation benefits. To most people, this rationale is flawed at its core. For-profit employers previously paid taxes on profits at a much higher tax rate and could deduct their expenses for providing transportation benefits to their employees. The tax deduction was an inducement for those employers to provide the employee benefit. The 2017 tax law dramatically lowered the taxes that for-profit businesses will now pay, if and when they have profits. As a minor reduction in the cost of the overall tax legislation, the law also repealed the deductibility of the costs of the transportation benefits.

Nonprofit employers, on the other hand, never had a deduction for these expenses and, importantly, never provided transportation benefits to gain a tax deduction. Rather, nonprofits have always provided transportation benefits to attract and retain workers, while helping to reduce traffic and air pollution. Nonprofits received little, if any, gains under the 2017 tax law, and yet are now subject to a new, illogical income tax on transportation benefits in the name of "parity."

Strong Bipartisan Support for Repeal

Section 512(a)(7) is terrible tax policy and there is no support in the House or the Senate for retaining it. Late last year, the House voted to repeal the tax as Section 505 of the year-end tax bill. Three bills in the House this Congress would repeal the transportation tax on nonprofit organizations: HR 1223 sponsored by House Majority Whip Clyburn (D-SC), HR 513 sponsored by Representative Conaway (R-TX), and HR 1545 sponsored by Representatives Walker (R-NC) and Suozzi (D-NY). Similar bipartisan legislation is pending in the Senate as well.

America's Nonprofits Should Not Be Held Hostage to Partisan Fights

As this and other hearings will clearly show, many of the policy decisions incorporated in the 2017 tax law are ripe for open debate. Reasonable people can and do disagree about the substance of the law and rightly point to the trade-offs that were made in crafting a tax reform package that satisfied the dictates of the budget reconciliation instructions. Singular among all of the provisions in the law, however, is the tax on nonprofit transportation benefits. The tax was not the subject of public hearings and no trade-offs were made, at least as applied to the nonprofit community. While some segments of the U.S. economy came out well at the end of the tax reform process, there is no denying that tax-exempt organizations, and particularly charitable nonprofits, houses of worship, and foundations, did not. For this significant sector of the U.S. economy (10 percent of the workforce[2]), there was not any give and take. Only take.

It is manifestly unfair for Congress to treat the tax on nonprofit transportation benefits as merely one more policy issue to be addressed some day in the future. This tax is unique, and, as discussed previously, it's impact will be devastating, starting in less than three weeks for many organizations. We sincerely and earnestly ask that this Committee and this Congress not hold the nonprofit community hostage to unrelated negotiations and partisan posturing.

[2] U.S. Department of Labor, Bureau of Labor Statistics, Research Data on the Nonprofit Sector, 2017 Annual Averages (released March 2019).

In making the case for urgent action – before nonprofits must divert money from mission by April 15 – we close with the words of House Majority Whip James Clyburn, quoted in "Mnuchin suggests further action on parking tax up to Congress," on March 25:

> "I think that we have a tremendous opportunity to have a bipartisan bill to deal with that issue. I think it could move by itself, I really do. But of course, if it doesn't, let's just attach it to whatever will move ...."[3]

We ask that you do the right thing by your community charities, houses of worship, foundations, and associations – and your constituents whom we all serve – by repealing Section 512(a)(7) immediately. For the public good.

Sincerely,

David L. Thompson
Vice President of Public Policy

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[3] *MLex US Tax Watch* (premium), March 25, 2019.

November 26, 2018

The Honorable Charles Grassley
United States Senate
Washington, DC 20510

The Honorable Richard Neal
United States House of Representatives
Washington, DC 20515

Dear Senator Grassley and Representative Neal:

On behalf of the National Council of Nonprofits and our network of more than 25,000 organizational members, we write to congratulate you both for electing to become chairs of the tax-writing committees in Congress and assuming the lead in revising tax policies that work fairly for all Americans. In particular, we express deep appreciation for your public statements in support of working in a bipartisan manner in search of solutions to the many challenges our country faces. We pledge our eagerness to work with you to identify and implement responsible solutions and reforms.

Tax policy does far more than just define the nonprofit sector as tax exempt; whether intentionally or not, it also can promote fairness or its opposite, pick winners and losers, and support or ruin well-managed operations trying their best to improve the lives of others. We believe that the commencement of your chairmanships provides the perfect opportunity to design tax policies that intentionally promote stronger nonprofits and stronger communities. To that end, we offer the following recommendations for your consideration and action. These ideas reflect the perspective of the charitable nonprofit community, a major segment of the U.S. economy that employs more than 14 million taxpayers and interacts in many ways with the Department of Treasury and the Internal Revenue Service. The National Council of Nonprofits works with and through our members – the nation's largest network of 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.

First, Do No Harm

The longstanding Johnson Amendment must be protected. For 64 years, it has successfully shielded charitable nonprofits, houses of worship, and foundations from the rancor of divisive partisanship and schemes by the unscrupulous to profit from tax deductions for disguised political campaign contributions. The Johnson Amendment accomplishes this by limiting tax-exempt status and the ability to receive tax-deductible charitable donations only to organizations that refrain from participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office. The 501(c)(3) nonprofit community – frontline charities, churches, and foundations – stands strongly united in support of the federal law and in opposition to those attempting to politicize the charitable sector in their quest for partisan and financial gains. We ask that you pledge to stand with the broad 501(c)(3) community and state charity regulators by committing to preserving current law and rejecting all efforts to repeal or weaken this vital, and we believe existential, protection. You can learn more at www.GiveVoice.org.

Restoring Balance, Removing Impediments

Nearly 96 percent of America's charitable nonprofits report annual budgets of less than $5 million, and 92 percent bring in less than $1 million per year. Many of these small- and mid-sized charitable organizations already have been struggling financially to advance their missions of improving lives, uplifting faith, and strengthening communities. So, it is quite troubling that the 2017 Tax Cuts and Jobs Act, which significantly reduced taxes for for-profit corporations and wealthier individuals, attempts to defray some of the tax law's lost revenues by imposing new taxes on tax-exempt organizations. We ask that you lead efforts to correct these unjust outcomes that threaten to undermine the sustainability of community-based charitable organizations:

- **Unrelated Business *Income* Taxes on Nonprofit Transportation Benefits *Expenses***: The new tax law, at Section 512(a)(7), imposes a 21 percent unrelated business *income* tax on nonprofits for *expenses* they incur for providing transportation fringe benefits to their employees, such as parking and transit passes. Reportedly, the justification offered for imposing a new income tax on nonprofit expenses was to ensure "parity" between for-profits and nonprofits regarding qualified transportation benefits. To most people, this rationale is flawed at its core. For-profit employers previously paid taxes on profits at a much higher tax rate and could deduct their expenses for providing transportation benefits to their employees. The tax deduction was an inducement for those employers to provide the employee benefit. The 2017 tax law dramatically lowered the taxes that for-profit businesses will now pay, if and when they have profits, and, as a minor reduction in the cost of the overall tax legislation, repealed the deductibility of the costs of the transportation benefits. Nonprofit employers, on the other hand, never had a deduction for these expenses and, importantly, never provided transportation benefits to gain a tax deduction. Rather, nonprofits have always provided transportation benefits to attract and retain workers, while helping to reduce traffic and air pollution. Nonprofits received little, if any, gains under the Tax Cuts and Jobs Act and yet are now subject to a new, illogical income tax on transportation benefits in the name of "parity." We and many in the community consider the "parity" argument a false equivalency, and believe that repeal is appropriate. Please read the National Council of Nonprofits' comments to Treasury and the IRS and blog posting for more information.
- **Unrelated Business Income Taxes on "Separate" "Trade or Business"**: New Section 512(a)(6) of the tax code 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." The law does not define what constitutes a "separate" trade or business, creating uncertainty about how nonprofits are supposed to document, compute, and report unrelated business income and losses. The tax change, which imposes unique liabilities on nonprofit organizations that are not assessed against for-profit businesses, went into effect on January 1, 2018, and has been subject to three separate quarterly estimated payments. Yet, the Treasury Department and IRS have yet to finalize the guidance needed to calculate those payments, and the guidance they have provided – calling on nonprofits to sort through hundreds of possible classification codes in the North American Industry Classification System – would inject further uncertainty, complexity, and expense into an already burdensome tax regime. The new tax is unfair and unjustified; it must be repealed. Please read the National Council of Nonprofits' comments to Treasury and the IRS and blog posting for more information.
- **Paid Leave Tax Credit**: The 2017 tax law included new Section 45S, which provides a generous tax incentive for some employers to pay their employees who take family and medical leave. The incentive comes in the form of an income tax credit, something that nonprofit employers cannot utilize as tax-exempt entities. As a result, the tax law once again provides tax cuts and, with this provision, tax credits to for-profit employers, but extends no benefit to the nonprofit employers, which collectively employ more than 10 percent of the U.S. private workforce. This oversight in the law is easily remedied by permitting nonprofits to apply the credit to the payroll and other taxes they do pay. We urge you to include this common sense and fair solution in any tax legislation you advance in the future.

Every dollar taken from nonprofit entities as a tax is a dollar diverted from missions of serving individuals and communities. That's why two other new taxes merit highlighting here, even though they do not affect most charitable nonprofits. **Taxing compensation** above an arbitrary level undercuts the ability of charitable organizations to hire the most qualified talent to lead the significant work of nonprofits. The new **tax on the endowment returns** of certain institutions of higher education is unsound policy objectionable to all charitable organizations that have the foresight and ability to build reserves that are dedicated to advancing their missions. We ask that the tax committees resist the urge to invade the boardrooms of independent organizations and to refrain from overriding the fiduciary-based decisions of trustees with political judgments that do not take into account the challenges and solutions that these local experts deal with every day.

Strengthening Charitable Giving Incentives

Experts from across the political spectrum agree: the 2017 tax law significantly reduced tax incentives for Americans to give to the important work of charitable organizations across the country. While the law lowered tax rates and, in some cases, simplified future tax filings, there are undeniable adverse consequences. Early data already show declines in charitable giving, findings that likely will be fully documented when data are available in 2019 and beyond. That's why we and nonprofits across America call for immediate tax-law changes to provide stronger tax incentives that help taxpayers give back to good works in their communities. We briefly highlight three potential solutions, all of which are needed:

- **Enable <u>all</u> Americans to Claim Charitable Tax Deductions**: The doubling of the standard deduction means that 21 million fewer taxpayers will receive a tax benefit for giving back to their communities. While individuals give to the charities and missions they believe in, the evidence is clear that people give more because of the tax incentive. The removal of the incentive for 21 million taxpayers threatens to reduce giving by billions of dollars, meaning that giving will decline and community needs will not be met. We believe strongly that <u>all</u> taxpayers – and not just those who itemize – should have equal access to tax incentives to support their communities by donating to the work of charitable nonprofit organizations. Therefore, we urge your support for the creation of a universal or non-itemizer charitable deduction in the tax code.
- **Extend the IRA Charitable Rollover to Retirement Security Plans**: Another solution to the expected decline in charitable giving is a proposal to expand the IRA Charitable Rollover to allow seniors to make tax-free rollovers from their IRA accounts to charities through life-income plans (charitable gift annuities or charitable remainder trusts). In addition to providing resources for charitable works, the approach would promote greater retirement security for seniors to help ensure they do not outlive their resources. We believe that the Legacy IRA Act deserves serious consideration now or in the coming Congress.
- **Modernize the Volunteer Mileage Rate**: Volunteers who drive their vehicles in furtherance of a nonprofit's mission may claim only 14 cents per mile as a charitable itemized deduction, a rate that has been fixed in statute for decades. In contrast, paid employees, whether working for for-profit, nonprofit, or governmental entities, may receive up to 54.5 cents per mile as reimbursement without tax consequences. Even more unfair, volunteers who receive mileage reimbursements from nonprofits must pay income taxes on any amount greater than 14 cents per mile. Congress must update the substandard volunteer mileage rate and shield individuals from tax liability for reimbursement of their reasonable expenses when helping charitable nonprofits serve more people. Learn more about the volunteer mileage rate.

Overseeing Tax Enforcement

Finally, we call your attention to the serious need for your committees to conduct oversight of the Internal Revenue Service. As the primary cop on the nonprofit beat, the IRS needs resources and support of lawmakers in promoting transparency, ethical conduct, and close attention to the laws that protect nonprofits, taxpayers, and the public. Sadly, those resources and support have not been forthcoming in recent years and, we fear, the charitable community has not received the protection from bad actors masquerading as legitimate charitable organizations that it needs to fulfill the many vital missions that serve the public good.

In our view, the most unfortunate outcome of this neglect of the IRS has been that agency's near abdication of its duties to protect the public by screening out unqualified or unscrupulous individuals who seek charitable tax-exempt status. In 2014, the IRS radically streamlined its application and approval process for certain organizations seeking tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. In doing so, it ignored strong opposition and warnings expressed by its own expert Advisory Committee on Tax Exempt and Government Entities, the National Association of State Charity Officials (state regulators of nonprofit organizations), and the National Council of Nonprofits, among others. The IRS made the change for management reasons of reducing a large backlog of applications for tax-exempt status as 501(c)(3) charitable nonprofits. Due to the adoption of the **Form 1023-EZ**, the Taxpayer Advocate has found that virtually every entity that applies using the form receives tax-exempt status – thanks in part to erroneous approvals at rates of 37, 26, and 42 percent during 2015, 2016, and 2017, respectively. And the IRS' primary obligation of preventing ineligible organizations and perhaps bad actors from receiving and exploiting tax-exempt status for personal gain is being shirked with every application processed. IRS Form 1023-EZ should be withdrawn immediately. Learn more about the challenges of and the opposition to IRS Form 1023-EZ.

We end with the offer made at the outset of this letter. The charitable community stands ready to work with you both to promote stronger nonprofits and stronger communities. The recommendations we make here would certainly fulfill those dual goals. We welcome the opportunity to explore these in greater detail and to work on additional solutions that benefit the common good.

Sincerely,

Tim Delaney
President and CEO

David L. Thompson
Vice President of Public Policy