



**INDEPENDENT SECTOR**  
A vital voice for us all

June 6, 2018

Ms. Sunita Lough  
Commissioner, TE/GE  
Internal Revenue Service

Ms. Janine Cook  
IRS Deputy Associate Chief Counsel, TE/GE  
Internal Revenue Service

Ms. Vicki Judson  
Associate Chief Counsel, TE/GE  
Internal Revenue Service

Ms. Elinor Ramey  
Attorney-Advisor, Office of Tax Policy  
U.S. Department of the Treasury

Mr. Robert Neis  
Benefits Tax Counsel  
U.S. Department of the Treasury

RE: Guidance for Tax-Exempt Organizations on Unrelated Business Income

Dear Ms. Lough, Ms. Cook, Ms. Judson, Ms. Ramey, and Mr. Neis:

Independent Sector is writing to offer recommendations for the implementation of unrelated business income provisions related to Public Law 115-97, commonly known as the *Tax Cuts and Jobs Act (TCJA)*. Independent Sector is a national coalition of nonprofits, foundations, and corporations whose members represent tens of thousands of organizations and individuals locally, nationally and globally who are committed to advancing the common good in America and around the world. We request that you consider these comments, based on consultation with our member organizations and others in the charitable and philanthropic community, as you develop guidance to implement new unrelated business income provisions.

The charitable sector is a critical component of the nation's economy. Nearly one in 10 workers in the United States is employed by a nonprofit organization, and with 13.5 million paid workers, we employ more people than the finance and real estate sectors combined. Further, these organizations pay nearly \$670 billion annually in wages and benefits, salaries that support families in communities across America. In 2010, 501(c)(3) organizations paid \$35.2 billion in payroll taxes.

The true impact of the charitable sector goes far beyond the number of people employed or the wages and benefits paid. Every day, charitable nonprofit organizations, among many other contributions to society, provide educational and economic opportunities for families in need; work to alleviate poverty and suffering at home and abroad; assist victims of disaster; enhance the cultural and spiritual development of individuals and

communities; facilitate scientific advances; and foster worldwide appreciation for the democratic values of justice and individual liberty that are part of the American character.

Too many of these charitable organizations – in the face of stagnant, if not declining, revenues – struggle continuously to meet increased demand for assistance. Rather than turn away those in need, tens of thousands of these employers balance a commitment to continued employment of staff with benefits, including transportation, and providing services to as many people as possible. As the leadership forum for these charitable and philanthropic organizations, Independent Sector applies this same balance when assessing the impact of federal policy proposals on the communities that benefit from the work of America’s nonprofit sector and on the dedicated staff we employ to deliver vital programs and services across the country.

Today, we are writing in regards to two areas:

1. Section 512(a)(7), Increase to Unrelated Business Taxable Income (UBTI) by Certain Disallowed Fringe Benefits, and
2. Section 512(a)(6), Requirement to Compute UBTI Separately for each Trade or Business.

### **512(a)(7), Increase in Unrelated Business Taxable Income by Certain Disallowed Fringe Benefits**

We are concerned with the approach in the new law to use the unrelated business income law to tax certain expenditures of tax-exempt organizations. This represents a fundamental departure from the original purpose of UBTI, which is to tax revenue unrelated to an organization’s charitable purposes. We ask that the Internal Revenue Service (IRS) and Treasury recognize this departure during the guidance development process. For many tax-exempt organizations, these types of expenditures promote the health of their communities and employees and are directly related to their missions. Consequently, classifying expenditures as UBTI can be a particularly confusing exercise for many organizations who have not had to deal with UBTI in the past.

Public Law 115-97 requires organizations, regardless of size, to pay taxes on certain activities that provide qualified fringe benefits to their employees. It will be the first time many organizations file a Form 990-T, or any form, with the IRS. As such, Independent Sector respectfully offers the following initial comments and recommendations on these new requirements.

#### *Delay Implementation*

Because the new law took effect for 2018, tax-exempt employers are already expected to comply, despite a lack of formal guidance to clarify how the law should be interpreted. Employers are already making estimated tax payments, but remain uncertain of how to appropriately allocate the expenses to properly comply with the statute, such as employee parking that is part of a parking lot that the organization shares with other entities or the general public. In some states, policymakers and nonprofit leaders are publicly debating whether this law applies to faith-based communities. Due to these uncertainties, Independent Sector requests a delay in the implementation for one year, to January 1, 2019. This would enable the Treasury Department and IRS to promulgate formal guidance, redesign Form 990-T or create an additional form for reporting tax incurred under this law, and educate tax-exempt organizations on their new tax liabilities. It would also allow much-needed time for nonprofit organizations to calculate the tax and budget for this new financial burden. If this delay is not sufficient to allow that process to occur, we urge you to consider a further delay.

#### *Establish a Benefit Floor*

This new law may apply to small tax-exempt organizations with little experience reporting information to the IRS or understanding of fringe benefits or unrelated business income. These organizations will experience a significant increase in administrative burden, in addition to a tax increase. For example, a church that provides a

parking space for its clergy will face a difficult learning curve to determine how to properly report the cost of the benefit and file the appropriate forms. We recommend establishing a benefit floor or de minimis threshold that triggers compliance with the new obligation to reduce the administrative burden for small organizations with negligible expenses for fringe benefits that could be subject to this rule. This would also reduce undue administrative burden on the IRS at a time when it already faces significant resource challenges.

#### *Exempt Municipally Mandated Fringe Transportation Benefits*

In some communities, organizations are required by law to provide qualified transportation fringe benefits for their employees. For nonprofits in these communities that provide certain qualified transportation fringe benefits, the new tax law results in a mandated tax increase. Independent Sector requests that Treasury and IRS consider exempting charitable organizations in these areas from paying unrelated business income tax on expenditures incurred to comply with state or local law.

#### *Exempt Publicly Available Benefits*

In service of their local communities, some tax-exempt organizations provide transportation or athletic facilities that are freely available to the public, including nonprofit employees. For example, some organizations, ranging from universities to churches, may provide transportation for their constituents or the general public. If employees use this publicly available transportation, we recommend that the Treasury and IRS confirm that such a service is not a qualified fringe benefit and that the cost from the service be excluded from the organization's UBIT liability.

#### *Acknowledge the Unique Role of Nonprofits*

Some authors of the TCJA have attempted to justify this UBIT fringe benefit provision by arguing that it creates a level of parity between the for-profit and nonprofit sectors through the creation of a comparable new tax for nonprofit organizations. Independent Sector notes that there are numerous differences between for-profit and nonprofit organizations, and they do not need to operate under identical rules. Tax-exempt organizations have a special designation in the tax code precisely because policymakers recognize that they are different and should be viewed differently under law. While Treasury and IRS understand this distinction, we sincerely hope that the unique circumstances and purpose of nonprofit employers will be taken into account when developing rules and guidelines for tax-exempt organizations' compliance with the new law.

### **Section 512(a)(6), Requirement to Compute UBTI Separately for each Trade or Business**

Public Law 115-97 also restructures how nonprofits will calculate their unrelated business taxable income under new section 512(a)(6). Historically, organizations have been able to use losses from one unrelated business activity to offset the gains from another unrelated business activity. This enabled nonprofits to more accurately determine the net amount of taxes owed as an organization, similar to the treatment of for-profit businesses with income from separate sources.

The new restrictions in the TCJA force nonprofits to calculate their UBTI separately for each activity, rather than allowing losses to offset gains across the organization's unrelated earned income portfolio. This new structure will result in increased taxes for many nonprofits with more than one unrelated business income stream. Unfortunately, it is difficult for organizations to determine how to comply with this new law, because there is a lack of clarity around what activities qualify as a separate trade or business.

#### *Delay Implementation*

Independent Sector respectfully requests a delay in the implementation of Section 512(a)(6) for one year, to January 1, 2019. This would enable Treasury and IRS to promulgate formal guidance, redesign Form 990-T or

create an additional form for reporting tax incurred under this law, and educate tax-exempt organizations on their new tax liabilities. If this delay is not sufficient to allow that process to occur, we urge you to consider a further delay. If Treasury and IRS choose to move forward in implementing this provision in 2018, we request a delay in the imposition of any underpayment penalties for the first year of reporting to allow time for organizations to determine how to comply with the law and budget for the increased financial burden.

#### *Categorical Definition of Separate Trade or Business*

Independent Sector recommends establishing a categorical definition of a separate trade or business, rather than at a more granular level. A broad, categorical definition will reduce the administrative burden on nonprofits and more accurately represent how organizations classify earned income divisions and activities. A definition consistent with how organizations group their own unrelated trade and business activities ultimately will help improve compliance.

#### *Allow Losses to Offset Other UBTI*

This new, more restrictive accounting structure appears to be limited to trades or businesses not related to an organization's charitable mission. However, some nonprofits may have UBTI that does not originate from unrelated trade or business, including taxable fringe benefits (discussed above), debt-financed income, and certain payments from controlled entities. We recommend allowing losses from an unrelated trade or business to be used to offset tax liability from other sources of UBTI not explicitly prohibited in the new law.

In addition, we would welcome the structuring of government resources and reporting documents to support a robust effort to educate tax-exempt organizations unaware of this new law on how to comply with it.

Lastly, the laws discussed in this letter, combined with other new reporting requirements related to the *Tax Cuts and Jobs Act*, have raised concerns from various professionals about the cost and administrative burden associated with annual tax-exempt filings. We may be close to reaching a tipping point that leaves nonprofit organizations unable to pay professionals to help them navigate these burdens. Independent Sector recommends the creation of clear guidance and a streamlined reporting process to help nonprofits comply with these laws.

We appreciate the opportunity to share the above recommendations as a way to balance implementation of the new tax law with preserving the ability of charitable organizations to continue serving their communities. We are happy to work with the Treasury and IRS as you continue to develop guidance and policies that impact the nonprofit sector. For additional information, please contact Ben Kershaw at [benk@independentsector.org](mailto:benk@independentsector.org).

Thank you for your consideration.

Sincerely,

Dan Cardinali  
President and CEO  
Independent Sector