

# Taxes Paid by Tax-Exempt Organizations: Impact of Wayfair, 4960 Excise Tax, Property and UBIT

WEDNESDAY, SEPTEMBER 18, 2019, 1:00-2:50 pm Eastern

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# Taxes Paid by Tax-Exempt Organizations: Impact of Wayfair, 4960 Excise Tax, Property and UBIT

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September 18, 2019

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# Notice

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# TAXES PAID BY TAX-EXEMPT ORGANIZATIONS

IMPACT OF WAYFAIR, 4960 EXCISE TAX,  
PROPERTY AND UBIT

# What We'll Cover



1. *Wayfair's* implications for nonprofits
2. Property Taxes
3. New Section 4960 excise taxes
4. Other excise taxes
5. Avoiding and minimizing UBIT
6. Other nonprofit tax considerations

# South Dakota v. Wayfair



v.



South Dakota v. Wayfair, Inc., 585 U.S. \_\_\_\_\_, 138 S. Ct. 2080, 201 L.Ed.2d 403 (2018).

# South Dakota v. Wayfair

June 21, 2018

5-4 Decision

Kennedy, Thomas, Ginsburg, Alito, Gorsuch

Dissent: Roberts, Breyer, Sotomayor, Kagan

Decision: For South Dakota



# South Dakota v. Wayfair

- Legislation in 22 States
  - Challenging *Bellas Hess* and *Quill*



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“Under this Court’s decisions in *Bellas Hess* and *Quill*, South Dakota may not require a business to collect its sales tax if the business lacks a physical presence in the State. Without that physical presence, South Dakota instead must rely on its residents to pay the use tax owed on their purchases from out-of-state sellers. “[T]he impracticability of [this] collection from the multitude of individual purchases is obvious.” *National Geographic Soc. v. California Bd. Of Equalization*, 430 U.S. 551, 555 (1977). And consumer compliance rates are notoriously low. See, e.g., GAO, Report to Congressional Requesters: Sales Taxes, States Could Gain Revenue from Expanded Authority, but Businesses Are Likely to Experience Compliance Costs 5 (GAO–18–114, Nov. 2017) (Sales Taxes Report); California State Bd. of Equalization, Revenue Estimate: Electronic Commerce and Mail Order Sales 7 (2013) (Table 3) (estimating a 4 percent collection rate). It is estimated that *Bellas Hess* and *Quill* cause the States to lose between \$8 and \$33 billion every year. See Sales Taxes Report, at 11–12 (estimating \$8 to \$13 billion); Brief for Petitioner 34–35 (citing estimates of \$23 and \$33.9 billion). In South Dakota alone, the Department of Revenue estimates revenue loss at \$48 to \$58 million annually. App. 24. Particularly because South Dakota has no state income tax, it must put substantial reliance on its sales and use taxes for the revenue necessary to fund essential services. Those taxes account for over 60 percent of its general fund.”



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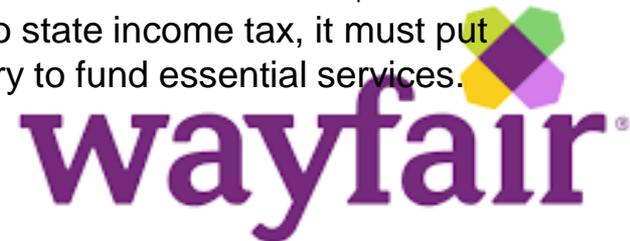
Precedent: Physical presence in the state required to have a seller collect and remit taxes.



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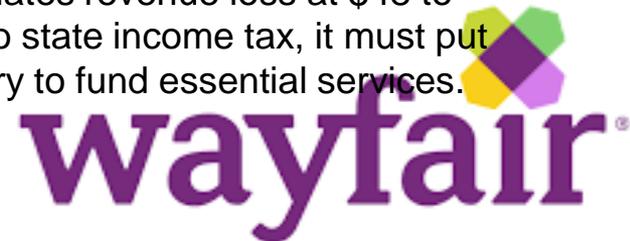


# South Dakota v. Wayfair

- Legislation in 22 States
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“Under this Court’s decisions in *Bellas Hess* and *Quill*, South Dakota is prohibited from collecting its sales tax if the **business lacks a physical presence** in the state. If a business has a physical presence, South Dakota instead must rely on its right to tax sales of tangible personal property from out-of-state sellers. “[T]he impracticability of requiring individual purchases is obvious.” *National Geographic Society v. American Board of Geographic Names*, 430 U.S. 551, 555 (1977). And consumer compliance costs are high. See GAO, Report to Congressional Requesters: Sales Taxes, State and Local Tax Authority, but Businesses Are Likely to Experience Compliance Burden (Nov. 2017) (Sales Taxes Report); California State Bd. of Equalization, *Mail Order Sales* 7 (2013) (Table 3) (estimating that **it is estimated that *Bellas Hess* and *Quill* cause the state to lose \$8 and \$33 billion every year.** See Sales Taxes Report, at 13 (estimating a loss of \$13 billion); Brief for Petitioner 34–35 (citing estimates of \$23 and \$33.9 billion). And, alone, the Department of Revenue estimates revenue loss at \$48 to \$58 million annually. p. 24. Particularly because South Dakota has no state income tax, it must put substantial reliance on its sales and use taxes for the revenue necessary to fund essential services. Those taxes account for over 60 percent of its general fund.”

**\$8 - \$33 Billion**



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# South Dakota v. Wayfair

- Legislation in 22 States
  - Challenging *Bellas Hess* and *Quill*
  - South Dakota first to have a lawsuit
    - Economic Nexus

South Dakota: Physical presence no longer enough. Economic presence / nexus should be the new test.



# South Dakota v. Wayfair

- Legislation in 22 States
  - Challenging *Bellas Hess* and *Quill*
  - South Dakota first to have a lawsuit
    - Economic Nexus
    - Thresholds = no undue burden on interstate commerce



# South Dakota v. Wayfair

- Legislation in 22 States
  - Challenging *Bellas Hess* and *Quill*
  - South Dakota first to have a lawsuit
    - Economic Nexus
    - Thresholds = no undue burden on interstate commerce

South Dakota: Safeguards of \$100,000 in sales or 200 separate transactions get around U.S. Constitution Commerce Clause.



# South Dakota v. Wayfair

- U.S. Supreme Court overturned *Bellas Hess* and *Quill*

“*Quill* is flawed on its own terms. First, the physical presence rule is not a necessary interpretation of the requirement that a state tax must be “applied to an activity with a substantial nexus with the taxing State.” *Complete Auto*, 430 U. S., at 279. Second, *Quill* creates rather than resolves market distortions. And third, *Quill* imposes the sort of arbitrary, formalistic distinction that the Court’s modern Commerce Clause precedents disavow. ... For these reasons, the Court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court’s decisions in *Quill Corp. v. North Dakota*, 504 U. S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U. S. 753 (1967), should be, and now are, overruled. ... Here, the nexus is clearly sufficient based on both the economic and virtual contacts respondents have with the State. The Act applies only to sellers that deliver more than \$100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for the delivery of goods and services into the State on an annual basis. S. B. 106, §1. This quantity of business could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota. And respondents are large, national companies that undoubtedly maintain an extensive virtual presence. Thus, the substantial nexus requirement of *Complete Auto* is satisfied in this case.



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# South Dakota v. Wayfair

- U.S. Supreme Court overturned *Bellas Hess* and *Quill*
  - No more Physical Presence Requirement
  - Thresholds of \$100,000 in sales or 200 separate transactions in the state are sufficient to not place an undue burden on interstate commerce
  - No retroactivity



# South Dakota v. Wayfair

No More Physical Presence Requirement

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States can require out-of-state / remote sellers to collect and remit state sales and use taxes.



# South Dakota v. Wayfair

No More Physical Presence Requirement

=

States can require out-of-state / remote sellers to collect and remit state sales and use taxes.

=

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# South Dakota v. Wayfair

Thresholds

=

Protections for Small Businesses



# South Dakota v. Wayfair

- Why Do Nonprofits Care?
  - Nonprofits as Purchasers
  - Nonprofits as Sellers



# South Dakota v. Wayfair

- Nonprofits as Purchasers
  - Increased costs
  - Marketplace Facilitators
  - Sales tax exemption requirements vary by state



# South Dakota v. Wayfair

- Nonprofits as Sellers
  - \$100,000 in sales or 200 separate transactions: What qualifies? (Tickets, Conferences/Events, Book Sales, etc.)
  - Donations?
  - Registration and compliance in each state of sale



# South Dakota v. Wayfair

- Why Do Nonprofits Care?
  - Out-of-State Sales
  - 12,000+ Taxing Jurisdictions
    - State and Local
    - Sales and Use Tax
  - Compliance
  - Ongoing Changes



# South Dakota v. Wayfair

- Ongoing Challenges
  - 63 bills in 2019
  - 44 states imposed sales and/or use tax on out-of-state sellers (24 follow SD thresholds)
  - 3 states planning tax reform in 2020 (KS, KY, UT)
  - States Going Rogue
    - Kansas
    - New Hampshire



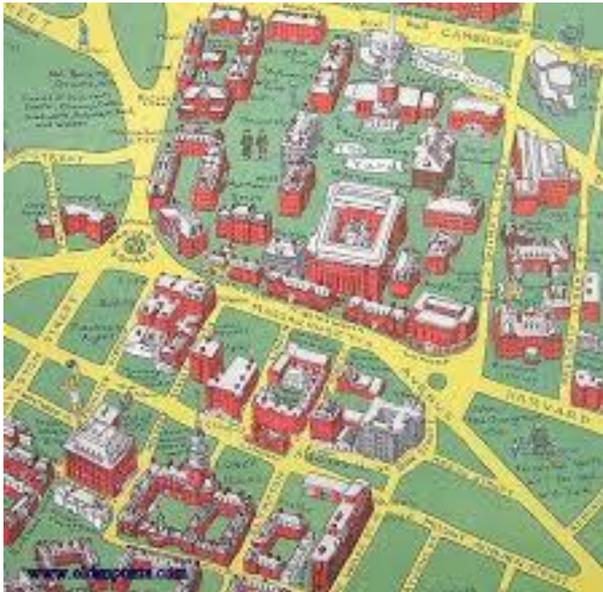
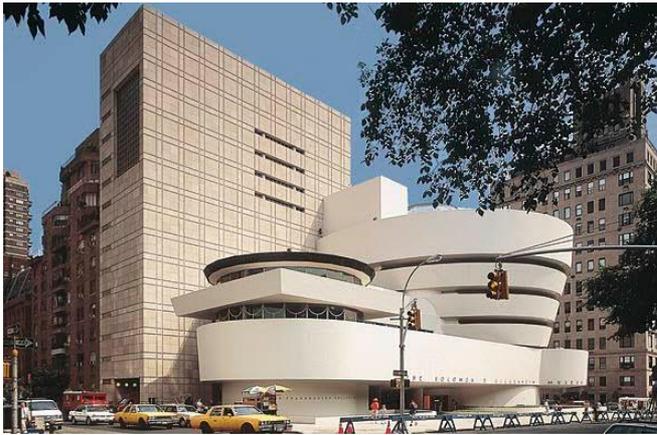
# South Dakota v. Wayfair

- Federal Fixes
  - Prohibiting out-of-state sales and use taxation from state delegations with no sales tax (S.128)
  - Simplifying collection to single tax rate and collection point (H.R. 379)
  - Requiring an interstate compact governing sales by businesses with less than \$10M in gross annual receipts (H.R. 6824 (2017-18))
- Streamlined Sales & Use Agreement





# Property Taxes



# Property Taxes



## ALL 50 STATES

Exempt the real property owned by a charitable nonprofit that uses the property for the nonprofit's charitable mission.

# Property Taxes

## Types of Challenges

★ Taxes

★ Fees

★ PILOTs



**A Tale of Three Cities**

# Property Taxes

## Types of Challengers

- Mayors, City Councils
  - Tax Court Judges
  - County Tax Assessors
  - State Legislators
  - Private Citizens
  - For-Profit Competitors
- and more

# Property Taxes

## Types of Targeted Nonprofits

Not Just **Eds & Meds**

# Property Taxes

## Types of Targeted Nonprofits

- ✓ Eds & Meds
- ✓ Cultural Organizations
- ✓ Day Care Centers
- ✓ Summer Camps
- ✓ Land Trusts
- ✓ Aquaria & Zoos
- ✓ YMCAs

# Property Taxes

## Tell Tale Signs

### That Governments Will be Asking Soon

- ❑ Nonprofit Acquisition of Taxable Property
- ❑ Cuts in State Revenue Sharing Announced
- ❑ Local Government Budget Forecast is Bleak
- ❑ Economic Decline of a Dominant Employer
- ❑ Public Sector Union Contract Negotiations
- ❑ Election of Aggressive/Populist City Officials

# Property Taxes

## Recent Challenges and Responses



# 2017 Tax Law – What It Means



# SECTION 4960

## NEW EXCISE TAXES IMPOSED ON COMPENSATION PAID BY TAX-EXEMPTS

### 1. Introduction

- a. Section 4960 was added to the Tax Code by the 2017 Tax Cuts and Jobs Act
- b. This is a new provision that imposes an excise tax – currently set at 21% - on “applicable tax-exempt organizations” that pay “excess remuneration” or “excess parachute payments”
- c. IRS guidance as to the operation of Section 4960 can be found in IRS Notice 2019-09
- d. Notice 2019-09 provides that “until further guidance is issued, to comply with the requirements of Section 4960, taxpayers may base their positions upon a good faith, reasonable interpretation of the statute, including consideration of the legislative history, if appropriate. The positions reflected in this Notice constitute a good faith, reasonable interpretation of the statute.”
  - (i) Notice 2019-09 states that “whether a taxpayer’s position that is inconsistent with this Notice constitutes a good faith, reasonable interpretation of the statute generally will be determined based upon all of the relevant facts and circumstances, including whether the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved interpretive issues based on consistent principles and in a consistent manner.”
  - (ii) The preamble to Notice 2019-09 identifies four specific interpretations of issues under Section 4960 that the IRS has concluded are not consistent with a good faith, reasonable interpretation of the statutory language

## 2. Applicable Tax-Exempt Organizations

- a. An applicable tax-exempt organization (ATEO) is defined by Section 4960 as any organization that:
  - (i) is exempt from tax under Section 501(a),
  - (ii) is a farmer's cooperative,
  - (iii) has income excluded under Section 115(1), or
  - (iv) is a political organization described in Section 527(e)(1)
- b. This definition makes Section 4960 applicable to all Section 501(c)(3) charitable organizations, all tax-exempt trade associations, social clubs and labor unions without regard to their size or number of employees

c. Among the complexities of Section 4960 is whether it extends to a state college or university

(i) This issue is discussed in Q-5 of Notice 2019-09

(ii) If the state college or university has not obtained a determination letter from the IRS and it does not exclude income under Section 115(1), then the state college or university is not an applicable tax-exempt organization

(iii) Whether a college or university excludes income under Section 115(1) depends on whether it is separately organized from a state or political subdivision of a state, in which case it has income excluded under Section 115(1), versus it is an integral part of a state or political subdivision of a state, in which case it does not exclude income under Section 115(1)

(iv) This may be good news for certain state universities that have highly paid football coaches

### 3. Covered Employees

- a. Section 4960 applies to amounts paid to covered employees who are defined as the five highest paid employees of an ATEO in any year beginning after 12/31/2016
- b. The definition of covered employee does not have as minimum dollar amount of compensation
- c. Once a person is a covered employee of an ATEO, they never cease to be a covered employee of the ATEO
  - (i) Compare Section 414(q), which defines highly compensated employees for purposes of 401(k) and other tax-qualified plan nondiscrimination testing
  - (ii) Section 414(q) is an annual test and has a minimum dollar amount of compensation
- d. Independent contractors are not covered employees

## 4. Excess Remuneration

- a. Section 4960 imposes an excise tax on ATEOs that pay annual remuneration in excess of \$1M to a covered employee. For purposes of Section 4960, remuneration includes amounts treated as income withholding tax wages and deferred compensation
- b. When remuneration is considered paid
  - (i) The general rule is that remuneration is considered paid at the time it is included in income withholding tax wages
  - (ii) Deferred compensation is subject to a special timing rule that includes an amount payable in a year after the year in which the amount vests in the year in which vesting occurs
  - (iii) The Section 4960 deferred compensation rules differ significantly from the Section 457(f) deferred compensation rules
    - > Although Section 457(f) also includes deferred compensation payable by a tax-exemption organization in the year of vesting, there are a number of important exceptions under Section 457(f)
      - Section 457(f) does not apply to so-called short-term deferrals, which are defined as amounts payable no later than 2 ½ months after the end of the year in which the amount vests
      - Section 457(f) does not apply to severance payments

(iv) These Section 457(f) exceptions are not available under Section 4960

- This distinction between Section 457(f) and Section 4960 creates the possibility of excise tax liability with respect to an ATEO covered employee whose base salary is considerably below \$1M
- Example one: covered employee with base salary of \$700K base salary and severance of one year's base salary payable over 12 months with a late year employment termination triggering right to severance
- Example two: covered employee with base salary of \$600K and a deferred bonus of \$200K per year payable in year three, with earnings, if employee is employee at the end of year three

c. Exception for remuneration paid to a licensed medical professional

(i) Remuneration paid to a licensed medical professional for medical services or veterinary services is not included for purposes of determining whether a covered employee has received excess compensation

(ii) If a licensed professional receives compensation from an ATEO for both medical services and other services (such as administrative services), the ATEO must make a “reasonable, good faith allocation” between the medical services and the other services

> Q-15(d) of Notice 2019-09 provides guidance as to how to go about making the allocation

> The Notice also discusses how to characterize research and teaching services for purposes of whether amounts allocated to such services are remuneration that qualifies for the medical services exception

## 5. Groups of Related Organizations

- a. Special rules govern the operation of ATEOs that are part a group of related organizations
- b. Generally, Section 4960 defines an organization as related to an ATEO if that organization controls or is controlled by the ATEO, or is controlled by one or more persons which control the ATEO
- c. Q-8 of Notice 2019-1-09 uses a 50% test for determining control. According to the Notice, “control” is defined as:
  - (i) 50% or more of the value or vote of a corporation’s stock
  - (ii) 50% or more of the profits interest or capital interest of a partnership
  - (iii) 50% or more of the beneficial interests of a trust
  - (iv) In the case of a nonprofit organization without owners (a nonstock organization), more than 50 percent of the directors or trustees of the ATEO or nonstock organization are either representatives of, or are directly or indirectly controlled by, the other entity or (ii) more than 50 percent of the directors or trustees of the nonstock organization are either representatives of, or are directly or indirectly controlled by, one or more persons that control the ATEO

- d. Each ATEO within a group of related organizations must separately determine its covered employees
  - (i) The ATEO does not make this determination on a consolidated basis
  - (ii) As a result, the five highest paid employees of an ATEO are determined without regard to the compensation paid to employees of related organizations
  - (iii) But the ATEO must include remuneration paid by related organizations for purposes of identifying its covered employees
  - (iv) An ATEO also calculates Section 4960 liability for excess remuneration with respect to a covered employee of the ATEO by including the remuneration paid to the covered employee by the ATEO and any related organization. The excise tax liability is then allocated among each of the organizations, including related for-profit companies, based upon the relative percentage of remuneration paid by each organization to the covered employee
  - (v) A number of commentators have identified what is viewed as an unintended consequence of the aggregation rules
    - > It is common for successful for-profit corporation to establish tax-exempt private foundations and to request that officers or other key personnel of the corporation serve as officers of the foundation
    - > Because the for-profit corporation “controls” the foundation, if the officers of the foundation are viewed as employees of the foundation, their aggregated compensation from the for-profit corporation could exceed \$1M, which would subject the for-profit corporation to most, if not all, of the Section 4960 excess remuneration tax
    - > A detailed discuss of the issues is set forth in the American Benefits Council’s April 2, 2019 comment letter to the IRS on Notice 2019-09

## 6. Excess Parachute Payments

- a. Section 4960 includes parachute payment rules modeled after the rules in Section 280G
- b. Section 280G defines parachute payments as payments made to an employee by a for-profit corporation, which are contingent on a change of control, that exceed three times the employee's five-year average annual pay
- c. Although Section 4960 uses a definition of parachute payments that is similar to the Section 280G definition, a key distinction is that Section 4960 does not have a change of control component, but instead defines a parachute payment as a payment made by an ATEO to a covered employee that is contingent on an involuntary termination of employment
- d. The Section 4960 excise tax on parachute payments has several exceptions. It does not include payments:
  - (i) Made to or from tax-qualified plans (for example, 401(k) plans and 403(b) plans)
  - (ii) Made to a licensed medical professional for the performance of medical or veterinary services
  - (iii) Made to a covered employee who is not a highly compensated employee, as defined in Section 414(q)

## 7. Record Keeping Challenges

- a. If an individual is one of the 5 most highly paid employees in a year or in any year beginning after 12/31/2016, they are a “covered employee”
- b. Therefore, if an individual is a covered employee for a year, they remain a covered employee **for all future years**
- c. Although the Section 4960 excess remuneration tax only applies to covered employees earning in excess of \$1M, the section 4960 excess parachute payments tax potentially applies to any covered employee who is a highly compensated employees under Section 414(q)
  - (i) The Section 414(q) definition of highly compensated employee looks at whether an employee’s compensation in the immediately preceding year exceeded a dollar amount that is indexed for inflation. An individual is a highly compensated employee for 2020 if their 2019 compensation exceeded \$125K
  - (ii) This feature of section 4960 imposes an obligation on the part of almost all tax-exempt organizations to keep track of compensation information over a potentially very long period of time

## 8. Effective Date

- a. Section 4960 is effective for taxable years of an ATEO beginning after 12/31/2017
- b. The effective date has important consequences for deferred compensation
  - (i) If deferred compensation vested before the Section 4960 effective date, it is not subject to Section 4960; post-effective date earnings on deferred compensation that vested before the effective date are subject to Section 4960
  - (ii) The IRS has not given any relief to deferred compensation that did not vest prior to the effective date, even though the deferred compensation may have vested over a long period of time

# Other Excise Taxes



# Taxing Tax Exempts (UBIT on Trade or Business)



# Taxing Tax Exempts (UBIT on Trade or Business)



IRC § 512(a)(6)

# Taxing Tax Exempts (UBIT on Trade or Business)

## What the law says



**IRC § 512(a)(6)**

### **26 U.S. Code § 512. Unrelated business taxable income**

**(a) DEFINITION** For purposes of this title—

**(6) SPECIAL RULE FOR ORGANIZATION WITH MORE THAN 1 UNRELATED TRADE OR BUSINESS** In the case of any organization with more than 1 unrelated trade or business—

**(A)** unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business and without regard to subsection (b)(12),

**(B)** the unrelated business taxable income of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business, less a specific deduction under subsection (b)(12), and

**(C)** for purposes of subparagraph (B), unrelated business taxable income with respect to any such trade or business shall not be less than zero.

# Taxing Tax Exempts (UBIT on Trade or Business)

## What the law says



IRC § 512(a)(6)

### 26 U.S. Code § 512. Unrelated business taxable income

(a) **DEFINITION** For purposes of this title—

(6) **SPECIAL RULE FOR ORGANIZATION WITH MORE THAN 1 UNRELATED TRADE OR BUSINESS** In the case of any organization with more than 1 unrelated trade or business—

(A) unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business and without regard to subsection (b)(12),

(B) the unrelated business taxable income of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business, less a specific deduction under subsection (b)(12), and

(C) for purposes of subparagraph (B), unrelated business taxable income with respect to any such trade or business shall not be less than zero.



# Taxing Tax Exempts (UBIT on Trade or Business)

## Background – Context



IRC § 512(a)(6)

Why?

# Taxing Tax Exempts (UBIT on Trade or Business)

## Background – Context



IRC § 512(a)(6)

### UBIT

- ❖ any trade or business the conduct of which is not substantially related to the exercise or performance by such exempt organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501. **§ 513(a)**
- ❖ Still UBIT if use revenues for nonprofit mission

# Taxing Tax Exempts (UBIT on Trade or Business)

## Background – Context



IRC § 512(a)(6)

### UBIT - Continued

- ❖ Exempt organizations exclude from the calculation of UBTI gross income from dividends, interest, annuities, etc.; royalties; rents; and gains and losses from the sale, exchange, or other disposition of property.
- ❖ Why? Such items “are not likely to result in serious competition for taxable businesses having similar income.”

# Taxing Tax Exempts (UBIT on Trade or Business)

## Background – Context

### Nonprofit Scenarios

- Advertising revenue
- Social enterprises
- Facilities rentals
- Investments
- Campus stores, coffee shops
- Partnerships
- Many others



IRC § 512(a)(6)

# Taxing Tax Exempts (UBIT on Trade or Business)

## Proposed Regulations

### Notice 2018-67

- Published 8/21/2018; comments by 12/3/2018; not final



IRC § 512(a)(6)

# Taxing Tax Exempts (UBIT on Trade or Business)

## Proposed Regulations

### Notice 2018-67

- Published 8/21/2018; comments by 12/3/2018; not final
- Defining “trade or business”
  - Reasonable, good faith interpretation (pending final regs)
  - **Safe Harbor:** Using the North American Industry Classification System 6-digit codes



IRC § 512(a)(6)

# Taxing Tax Exempts (UBIT on Trade or Business)

## Proposed Regulations Notice 2018-67



IRC § 512(a)(6)

- Defining “trade or business”
  - Reasonable, good faith interpretation (pending final regs)
    - ❖ Consider “fragmentation principle”

# Taxing Tax Exempts (UBIT on Trade or Business)

## Proposed Regulations Notice 2018-67



IRC § 512(a)(6)

- Defining “trade or business”
  - **Safe Harbor:** Using the North American Industry Classification System 6-digit codes

NORTH AMERICAN INDUSTRY CLASSIFICATION SYSTEM (2017), available at [https://www.census.gov/eos/www/naics/2017NAICS/2017\\_NAICS\\_Manual.pdf](https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf).

# Taxing Tax Exempts (UBIT on Trade or Business)

## Proposed Regulations

### Notice 2018-67

- Expenses “directly connected with the carrying on of such trade or business”
- Treatment of “net operating losses”
- Treatment of fringe benefit expenses (IRC §512(a)(7))



IRC § 512(a)(6)

# Taxing Tax Exempts (UBIT on Trade or Business)

## Minimizing UBIT



IRC § 512(a)(6)

- Determine best/fewest NAICS 6-digit codes
- Consolidate diverse operations into related entity
- Other actions?

# Taxing Tax Exempts (UBIT on Trade or Business)

## Remedial Legislation



IRC § 512(a)(6)

- ✓ H.R. 513, Nonprofits Supports Act
- ✓ H.R. 3323, Nonprofit Relief Act
- ✓ S. 1282, Preserve Charities and Houses of Worship Act

# Taxing Tax Exempts (UBIT on Transportation Benefits)



# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## What the law says

### 26 U.S. Code § 512. Unrelated business taxable income

**(a) DEFINITION** For purposes of this title—

**(7) INCREASE IN UNRELATED BUSINESS TAXABLE INCOME BY DISALLOWED FRINGE** Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any 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)). The preceding sentence shall not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business which is regularly carried on by the organization. The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for on-premises athletic facilities.

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## What the law says

### 26 U.S. Code § 512. Unrelated business taxable income

(a) **DEFINITION** For purposes of this title—

**(7) INCREASE IN UNRELATED BUSINESS TAXABLE INCOME BY DISALLOWED FRINGE** Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any 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)). The preceding sentence shall not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business which is regularly carried on by the organization.

# Taxing Tax Exempts (UBIT on Transportation Benefits)

## Background – Context



Why?

# Taxing Tax Exempts (UBIT on Transportation Benefits)



## Background – Context

### “Parity”

- Business tax cuts cost too much
- Took away deductibility of qualified transportation benefits for for-profits
- Sought to avoid “unfair advantage” for nonprofit hospitals

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Background – Context

### *Income* Tax on *Expenses*?

- Transit pass subsidies
  - ❑ Mandated in 5 cities + NJ in 2020
  - ❑ Applies to pre-tax benefits
- Free parking – partially addressed in regs (“church parking tax” firestorm)

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Proposed Regulations

### Notice 2018-99 & 2018-100

- Parking guidance only
- Calculating Expenses: Applies to employer expenses; not value of benefit received
- Reserved employee parking spaces automatically treated as unrelated business taxable income
- \$1,000 threshold

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Proposed Regulations

### Notice 2018-99 & 2018-100

- Public Parking: 4-part calculus
  1. Calculate disallowance for reserved spaces
  2. Determine the primary use of remaining spots
  3. Calculate the allowance for reserved nonemployee spots
  4. Determine remaining use and allocable expenses

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Proposed Regulations

### Notice 2018-99 & 2018-100

- Provided for waiver of tax penalties for nonprofits that failed to submit quarterly estimated tax payments for the new tax on transportation benefits.

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Minimizing UBIT

- ✓ Eliminate reserved parking spaces
- ✓ Purchase large parking lot for staff and customers/clients
- ✓ Cancel transportation benefits
- ✓ Repeal Section 512(a)(7)!

# Taxing Tax Exempts (UBIT on Transportation Benefits)



IRC § 512(a)(7)

## Remedial Legislation

- ✓ H.R. 513, Nonprofits Supports Act
- ✓ H.R. 1223, Stop the Tax Hike on Charities and Places of Worship Act
- ✓ H.R. 1545, LIFT for Charities Act
- ✓ **H.R. 3300, Economic Mobility Act**
- ✓ S. 632, LIFT for Charities Act
- ✓ S. 1282, Preserve Charities and Houses of Worship Act

# Other Nonprofit Tax Considerations





**Questions?  
Ideas?  
Reflections?**

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