June 7, 2018

The Honorable David Kautter  
Acting Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Mr. William M. Paul  
Acting Chief Counsel  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20224

Re: Request for Immediate Guidance and Delay  
On Friday December 22, 2017, President Trump signed H.R. 1 (Public Law No. 115-97, commonly referred to as the Tax Cuts and Jobs Act “TCJA”) into law, marking the most comprehensive change to the tax code since 1986. While the TCJA will impact individuals and businesses large and small, new and unique obligations will be also be placed upon the nonprofit community, including K-12 schools. The National Association of Independent Schools (“NAIS”) represents more than 1,600 nonprofit 501(c)(3), independent, day, and boarding schools throughout the United States, as well as many nonprofit associations that serve schools. NAIS would like to draw your attention to two issues stemming from the TCJA on which independent schools—and all nonprofits—require guidance and regulatory relief: section 512(a)(7), which increases a nonprofit’s unrelated business taxable income (UBTI) by amounts paid or incurred after December 31, 2017 for certain disallowed fringe benefits and section 512(a)(6), which requires nonprofits to compute UBTI separately for each trade or business.

**NAIS Joins the Nonprofit Community in Requesting Guidance and Delay of Effective Date for Section 512(a)(7) and 512 (a)(6)**

**Section 512(a)(7)**  
The core mission—and tax-exempt purpose—of independent schools is to educate the next generation. Each day, school leaders use their skillset to confront numerous challenges including ensuring student
health and well-being, pursuing equity and justice in all its forms, and preparing students to succeed in an interconnected, global world. However, their areas of expertise do not generally include robust familiarity with the ins and outs of tax policy, particularly when significant changes have been enacted. It is true that some independent schools regularly engage in activities unrelated to their exempt purposes, such as providing space and services for special events, and it is understood that they will owe UBIT on this income less expenses. However, due to section 512(a)(7), many more independent schools will owe UBIT simply for providing certain fringe benefits to their employees, without the information or knowledge to calculate this liability accurately.

According to the text of the TCJA, a tax-exempt organization’s UBTI will be increased by any amount by which a deduction is not allowed under section 274 and that is paid or incurred by the organization for any qualified transportation fringe (as defined by 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)). Qualified transportation fringe benefits include transportation in a commuter highway vehicle between an employee’s residence and place of employment, transit passes, and qualified parking. Qualified parking is further defined as parking provided to an employee on or near the employer’s business premises or on or near a location from which the employee commutes to work via other means such as mass transit, in a commuter highway vehicle, or by carpool. While practitioners and the government appear to agree that on-premises athletic facilities will not increase an organization’s UBTI because section 274 as modified by the TCJA does not disallow a deduction for such facilities, there are open questions regarding how UBTI (and the amount of UBIT owed) will be calculated for qualified transportation fringe benefits and parking facilities used in connection with qualified parking.

When it comes to qualified transportation fringe benefits and parking facilities, there are many scenarios independent schools may face depending on their size or location. Independent schools in urban or suburban environments with more extensive transportation networks may provide a transit pass or pay a monthly amount for a parking spot in a garage. It appears clear that if a school provides a $100 transit pass each month to each employee, that school’s UBTI will increase by $100 multiplied by the number of employees. However, the parking garage example may be more complicated. When

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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?

Additionally, schools in many locations—but particularly those in suburban and rural settings—may simply have a parking lot that they own as part of their property at which employees (and others) can park at no cost. Is there UTBI in this case, how would the amount be calculated, and does the answer change if the school’s property is debt-financed in some manner? Again, the IRS has issued some additional guidance on these points on the employee income inclusion side of the ledger. In a prior notice, the IRS explained that while the value of parking is calculated by fair market value—either in an arms-length transaction at that parking site or in an arms-length transaction at a comparable lot under similar circumstances—if an employer has a lot that is primarily for its customers but is also available to employees for free, then the fair market value is $0. This scenario is similar to one that many schools face—a parking lot for students, parents, and visitors, where staff members may also park at no cost. However, in terms of section 512(a)(7), which requires the business to recognize UBTI on the amount paid or incurred, is the amount paid or incurred by the school in relation to this parking equal to the fair market value of $0 or some other amount entirely?

Moreover, in certain jurisdictions employers are required to provide certain transportation benefits. In the district of Columbia, employers with more than 20 employees must provide either an employee-paid pre-tax benefit, an employer-paid direct benefit, or employer provided transportation. According to a strict reading of section 512(a)(7), employers in these areas will have no way to avoid UBTI. Additionally, in the 2018 Employer’s Tax Guide to Fringe Benefits document, the IRS indicated that for-profit employers will no longer be able to deduct qualified transportation benefits, even if they are provided through a compensation reduction agreement where employees may set aside pre-tax monies. For tax-

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2 Treas. Reg. § 1.132-9; Treas. Reg. § 1.61-21(b)(2).
3 Internal Revenue Serv., Notice 94-3, Q-10(a).
exempt organizations, does this mean they add to their UBTI if they allow their employees to set aside their own pre-tax funds for qualified transportation benefits as well, even though they as the employer have not paid for or incurred any costs?

Lastly, there is confusion in the field regarding whether parking facilities used in connection with qualified parking do in fact increase an organization’s UBTI per the final language of section 512(a)(7) and section 274, since for a fringe benefit to increase UBTI per section 512(a)(7) it also has to be disallowed as a deduction under section 274. While a prior House version of the TCJA modified section 274 to disallow a deduction for qualified transportation fringe benefits and parking facilities used in connection with qualified parking, the final version of section 274 only explicitly disallows a deduction for qualified transportation benefits. If Congress intended qualified transportation fringe benefits to also include facilities, it is unclear why the earlier version of section 274 (and section 512(a)(7)) separately delineated the two categories. If the IRS determines that parking facilities do in fact increase an organization’s UBTI, clarification on the boundaries of that definition and how it should be valued will also be needed for schools to accurately meet their obligations.

For some independent schools, the only UBIT they owe will be related to section 512(a)(7). Beyond the burdens of time and money that will be required to track, calculate, and pay new UBIT, these schools may have never filed a form 990-T before. Therefore, they may be entirely unfamiliar with the need to pay quarterly estimated tax on UBTI, which is required if expected tax for the year will be $500 or more. Currently, the Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations worksheet (Form 990-W) acknowledges that due to the TCJA, the new corporate tax rate is 21%, but provides no additional guidance for organizations which may owe estimated tax payments for the first time. Updated information for the 990-T indicates that UBTI is increased by “any amount for which a deduction is not allowable because of section 274 and which is paid or incurred by the organization after December 31, 2017, for any qualified transportation fringe (as defined in section 132(f)), or any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C))” and should be entered on line 12 of the 2017 form 990-T for organizations with a fiscal year that begins in 2017, but

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8 Disallowed Fringe Benefits.
no further guidance on how to calculate this new tax liability is provided. Since organizations who do not make estimated quarterly payments can be charged an underpayment penalty, schools who do not submit estimated payments or underestimate their tax liability due to lack of clarity will face additional financial burdens which will come at a detriment to fulfilling their tax-exempt purpose—educating children.

Section 512(a)(6)
In the past, if nonprofits had more than one stream of unrelated business income, they were not required to calculate UBTI and the resulting UBIT liability separately for each activity. However, due to section 13702 of the TCJA, organizations with more than one unrelated trade or business must determine their UBTI separately for each trade or business they operate. At this juncture, it is still unclear how a separate trade or business will be defined. For example, 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—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? If the IRS defines a trade or business too narrowly, the accounting burden could become significant, particularly if expenses such as facilities and staff are shared between activities deemed to be separate trades and businesses.

Conclusion
NAIS joins with other groups including the National Council of Nonprofits, the Council on Foundations, the American Society of Association Executives, and the National Association of College and University Business Officers in urging Treasury and the IRS to issue regulations or other guidance necessary to facilitate independent schools and other nonprofits in complying with the law practically and fairly. While some guidance on section 512(a)(6) is expected this summer, no announcements have been made regarding 512(a)(7). Moreover, NAIS agrees that accurate compliance cannot occur without

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guidance to some of these basic questions, and joins many of our fellow associations in requesting a year delay in the effective date of sections 512(a)(7) and 512(a)(6), retroactive to January 1, 2018.

Sincerely,

Debra P. Wilson, General Counsel
National Association of Independent Schools
1129 20th Street, NW, Suite 800
wilson@nais.org
(202) 973-9716
(202) 247-9692 (fax)
www.nais.org

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