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IRS ISSUES

More Nonprofit Regulations Up for Comment

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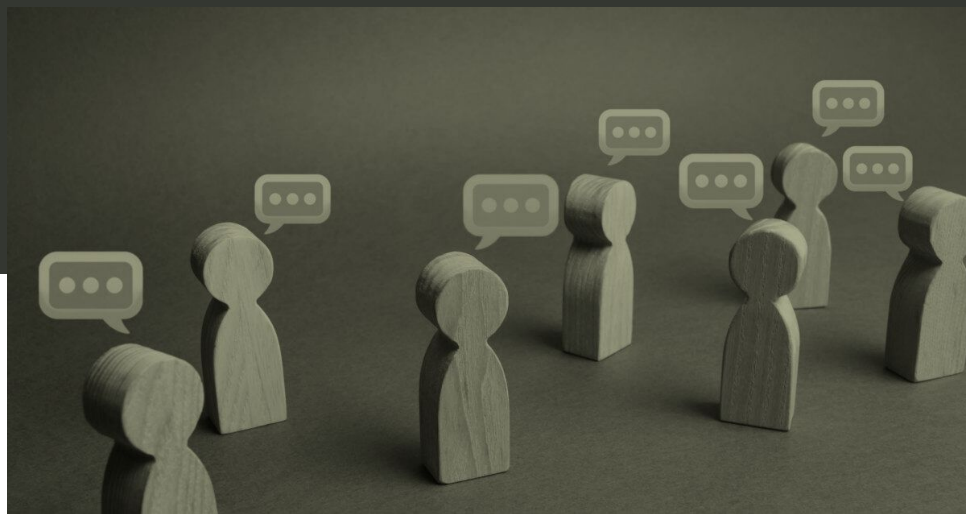

There's a new opportunity right now for interested members of the public to submit comments on proposed regulations affecting the nonprofit sector.

Regulations Arising From the 2017 Tax Act

In the final weeks of 2017, the Administration and GOP leadership rushed through their pet legislative project: the massive Tax Cuts and Jobs Act (TCJA '17). They tossed aside many of the customary procedures – helpful items like committee hearings, multiple revisions of draft bills, and meaningful bipartisan debate. When the dust settled and the bill had been signed into law just before Christmas, lots of folks were surprised – shocked even! – to learn about some of the new statutes. That bewilderment included many members of Congress who sheepishly admitted they had not read the 500-page+ legislation before voting to approve it. To make matters worse, another customary legislative nicety was discarded: There was no transition period at all. Most of the new laws took effect immediately on January 1, 2018.

From the start, the nation's nonprofit organizations and their advisors voiced concern about four new statutory provisions in the TCJA '17.

First up was the change that wiped out a popular employee fringe benefit — parking and other transportation-related freebies – widely used by many groups including the nation's houses of worship. After two and a half years of loud and frequent nagging from nonprofits, even the "ordinarily tone-deaf legislators" in Congress found a way to get rid of this "'reviled' law that 'never made sense to anyone' and that forced thousands of front-line nonprofits to divert [time] and millions of dollars away from their missions." In *Poof! The Nonprofit Parking Tax is Gone* (January 7, 2020), we explained how a retroactive repeal of this provision was quietly tossed into the final

Congressional appropriations bill of 2019 hurriedly adopted to avoid yet another government shutdown.

The second of the troubling revisions of the tax code was the bewildering addition of section 512(a)(6) to the Internal Revenue Code. Someone apparently thought it would be a good idea to discard several decades of settled unrelated business income tax (UBIT) practice by substituting a new "siloing" requirement to separate out and calculate the tax on each of a nonprofit's distinct "trades or businesses." In the fall of 2018, the government circulated Notice 2018-67, a type of interim sub-regulatory "guidance" on how an organization must self-identify the distinct trade or business silos ("buckets"). It directed the use of an existing 6-digit classification system that is already used to collect and analyze statistical data on the U.S. business economy. During the public-comment period for Notice 2018-67, the nonprofit community's reaction was swift and clear: This system would be unworkable and unfair.

The government received and considered the public comments, eventually publishing proposed regulations on section 512(a)(6) in the Federal Register in April 2020. A key concession of the revision was the substitution of a simpler, 2-digit classification system for the siloing requirement in place of the 6-digit standard. In *New UBIT "Silo" Proposed Regulations* (June 3, 2020), we reported on this development and encouraged readers to submit public comments by the June 23rd deadline. Apparently, there have been many detailed and thoughtful responses from, and on behalf of, the nonprofit community, that point out how, even with the 2-digit code protocol, the new statute remains unduly burdensome. In the next several months, when the final regulations are published, we'll see if our community's input has been accepted.

Excess Compensation Tax Regulations

The third controversial part of the Tax Cuts and Jobs Act of 2017 has been the addition of an excise tax on "excess" compensation paid to nonprofit executives. New section 4960 of the Internal Revenue Code is complex and confusing. It was designed to impose a corporate-income-tax-rate equivalent on "applicable tax-exempt organizations" (called "ATEOs") that "pay covered employees compensation" that either exceeds $1 million or is an "excess parachute payment."

You don't need to be a tax lawyer to suss out that there are at least several glaring ambiguities in the statutory language. Following the same method used to provide interim clarification of the new UBIT siloing requirement, the government issued preliminary guidance on the excess compensation tax in Notice 2019-09 dated December 31, 2018. As one legal commentator explained, there was good news and bad news for the nonprofit community in that document. "First the 'good' news: the IRS addressed many questions left open by the rather vague statutory provisions. Now the 'bad' news: the IRS narrowly construed many of the statutory provisions, which ultimately will result in additional administrative burden and cost to tax-exempt organizations subject to the rules…." The public comment period yielded fourteen responses from nonprofits and their advisors.

Just recently, the Treasury and the Internal Revenue Service followed up with official proposed regulations on section 4960 published in the Federal Register on June 11, 2020.

"The proposed regulations reassert the interim guidance originally set forth in the [earlier] Notice, with some adjustments." Based on, and responding to, comments received about Notice 2019-09, "the proposed regulations do modify or clarify the initial guidance in certain respects, including: which governmental entities will be treated as ATEOs; the definition of covered employees and the rules for identifying the five highest-compensated employees; and the calculation of, and liability for, the excise tax on excess parachute payments."

Most particularly, the proposed regulations address a key concern raised in the first round of public comments; that is, "whether the excise tax should apply to businesses that supply highly compensated volunteers to affiliated nonprofits." The government's response: "Certain employees of a related for-profit employer providing services to an ATEO will no longer be treated as one of the ATEO's five highest-compensated employees, provided that certain conditions related to the individuals' remuneration or hours of service are met."

There is a lot to chew over with these proposed regulations; they are 177 pages long. The public comment period ends on August 10, 2020. What seems clear from recent experience is that officials at IRS and Treasury are soliciting input in good faith and thoughtfully considering opinions and feedback on proposed regulations. We'll learn – perhaps in several months – how the government acts on submissions and suggestions from the nonprofit community.

Conclusion

There are developments, too, on the fourth statutory change in the Tax Cuts and Jobs Act of 2017 that raised the hackles of the nonprofit sector. The unexpected broadening of the standard set off alarm bells right away. There was genuine concern that the loss of so many itemizers would depress charitable donations. The data to date demonstrates this fear has been somewhat realized.

There has been serious talk since the enactment of the TCJA '17 about amending the law to provide a "universal charitable deduction" for all taxpayers regardless of itemizer status. According to the June 15th newsletter of the National Council of Nonprofits, there is new momentum. Six senators – three from each party – have been working hard recently to move this proposal successfully through Congress. "Substantively, their idea is to improve the above-the-line deduction in the next COVID-19 package by permitting taxpayers to deduct up to one-third of the standard deduction for charitable donations in tax years 2019 and 2020."

— Linda J. Rosenthal, J.D., FPLG Information & Research Director