



April 16, 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

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

I am writing to offer recommendations for implementation of several provisions of H.R. 1 (the Tax Cuts and Jobs Act, or TCJA), enacted in December 2017. The manner in which you implement the TCJA will have a significant impact on colleges and universities across the United States, and we urge you to please consider the following issues raised under the new law and our recommendations as you develop implementation guidance.

The National Association of College and University Business Officers (NACUBO), founded in 1962, is a nonprofit professional organization representing chief administrative and financial officers at more than 1,900 colleges and universities across the country. NACUBO's mission is to advance the economic vitality, business practices, and support of higher education institutions in pursuit of their missions.

NACUBO offers professional development programs (meetings, conferences, webcasts); issues publications; and represents business officers across a number of areas, including tax policy. Following passage of the TCJA, we consulted with numerous campus-based tax professionals, chief financial officers, and other university administrators to gather their observations and concerns. This letter reflects the collective observations from our association, as well as from colleges and universities, large and small, public and private.

Today, we are writing to specifically bring your attention to our recommendations in three areas:

1. Section 512(a)(7), Increase to Unrelated Business Taxable Income (UBTI) by Certain Disallowed Fringe Benefits,

2. Section 512(a)(6), Requirement to Compute UBTI Separately for each Trade or Business, and
3. Section 4960, Excise Tax on Executive Compensation

NACUBO also has several concerns with section 4968, which imposes a new net investment income excise tax on certain private colleges and universities, and we will provide our questions and recommendations on this section in separate correspondence.

Before delineating our concerns with specific provisions, we wish to highlight our objection to the tax policy rationale of imposing new and significant taxes on tax-exempt entities to achieve “parity” with taxable entities. The business models of taxable and tax-exempt organizations are fundamentally different. For-profit businesses seek profits for owners or for shareholders. Nonprofit entities have no owners or shareholders.

Whereas the burden of taxes imposed on for-profit businesses falls at least to some degree on the owners, the burden of taxes imposed on nonprofit colleges falls to a greater degree on students and families because there are no owners to tax. For other tax-exempt organizations, the burden might fall on the museum, library, or food pantry patron, patients, shelter residents, or countless other beneficiaries. This is not parity of treatment, as the burden on tax-exempt organizations diminishes the public good they offer. Straining a tax-exempt organization’s ability to deliver its mission is not comparable to impacting the bottom line of a for-profit entity.

Colleges and universities work strenuously to provide access to those seeking to better themselves with higher education, to contain costs, and to serve as attractive workplaces to millions of employees across the country—all while delivering on their education, research, and community service missions (at a level of excellence respected worldwide). We hope that you will appreciate, if not share, our concern and help us to keep the cost of higher education from rising unnecessarily as a result of the TCJA through your thoughtful implementation of the law.

#### 1. Section 512(a)(7), Increase in Unrelated Business Taxable Income (UBTI) by Certain Disallowed Fringe Benefits

Colleges and universities provide a vast array of transportation benefits to campus employees in urban, suburban, small-town, and rural settings across the country. Each college and university is unique in the way it provides transportation benefits to employees. In many cases, such benefits promote the public good by reducing traffic and improving local air quality.

The TCJA added Internal Revenue Code (IRC) section 512(a)(7), providing that UBTI shall be increased by any amount for which a deduction is not allowed under section 274 and which is paid or incurred for certain listed items. Of the three listed items (qualified transportation fringe benefits, parking facilities used in connection with qualified parking, and on-premises athletic facilities), only one is nondeductible under section 274, namely qualified transportation fringe benefits. Section 274 does not generally disallow deductions for a parking facility used in connection with qualified parking, nor does it generally disallow deductions for an on-premises athletic facility.

The fact that the House of Representatives intended to amend section 274 to include these items, but the Senate failed to make the revisions due to the constraints of the budget reconciliation procedures, shows that Congress believed it was necessary to amend section 274 in order to make expenses for

parking and on-premises athletic facilities nondeductible and, therefore, taxable under section 512(a)(7). As a result, the effect of the provision is to increase UBTI by any amounts paid or incurred by an organization, after December 31, 2017, for any qualified transportation fringe benefit but generally not the cost of maintenance of parking facilities and on-premises athletic facilities. Accordingly, “qualified parking” is subject to UBIT as a “qualified transportation fringe,” but expenses associated with a parking facility used in connection with qualified parking are not separately disallowed under section 274. The words “qualified parking” and “parking facility used in connection with qualified parking” are different, which suggests they should be treated differently.

For higher education institutions, this new tax is particularly complex and questions abound as to what would ultimately be classified as an amount “paid or incurred” for a qualified transportation fringe. Taking the plain language of the above phrase would lead institutions to believe that the only amounts that should be included are those that are actually incurred by the institution in providing the qualified transportation fringe.

For example, if an institution provides monthly bus passes at no cost to the employee, this would be considered as an expense “paid or incurred” by the institution. However, there have been some concerns that the Service might consider amounts paid by the employee on a pre-tax basis as “paid or incurred” by the institution. Determining amounts paid or incurred for employee participation in some of these benefits this year, without guidance, is currently presenting many challenges for higher education institutions.

Further, there has been considerable confusion in the higher education community, as this provision is unprecedented in that it characterizes certain expenses as taxable income.

**NACUBO recommends that pre-tax amounts withheld by the institution, whether for transit or parking, should not give rise to UBTI under section 512(a)(7).**

We seek clarification that the amount of the compensation reduction that is in fact payment received from employees to pay for transit passes or to park in employer-owned lots is not an expense of the employer that would be disallowed under section 274, and, therefore, that such amounts are not subject to unrelated business income tax (UBIT) under section 512(a)(7). For example, if a tax-exempt employer allows employees to pay \$50 for transit passes or parking through a salary reduction arrangement, the \$50 would not be subject to UBIT under section 512(a)(7) because the \$50 is not an expense of the employer. It is, rather, an expense borne by the employee. Or, if the employer pays \$15 per month for an employee’s parking and the employee pays \$50 per month, only the employer payment of \$15 associated with providing parking would be UBTI under section 512(a)(7).

**Alternatively, if the IRS intends to include employee pre-tax withholding as includable in UBTI under section 512(a)(7), we recommend that institutions be permitted to include the lesser of the pre-tax amounts withheld *or* the costs incurred to provide qualified transportation fringe benefits to employees.** We believe this would result in a more equitable result since each institution has different approaches to providing transportation benefits to its employees. Requiring an institution to include both the pre-tax amounts withheld and the costs of providing qualified transportation fringe benefits, we believe, results in an overly broad application of the law. This will likely lead many institutions to curtail beneficial transportation options to employees, as it would be cost prohibitive to provide reasonable employee benefits.

## **Allocation of costs to employee usage**

***Bus/Transit Benefits.*** Many institutions provide local bus or subway transit benefits to their campus communities. It is not uncommon for an institution to pay an annual lump sum to their local bus authority to cover the cost of students, faculty, and staff ridership for the year, with no tracking of actual use. In a small town, for example, employee use of transit may represent a tiny fraction of the university community's local bus ridership compared to student use. Some institutions operate their own transportation services, which may be freely accessible to the general public. In this type of arrangement, **we seek confirmation that if the bus service (or parking) is freely available to the public and meets the needs of the general public, then it is not an employee benefit at all. Alternatively, we recommend that only costs associated with providing such a benefit to employees should be subject to UBTI under section 512(a)(7), and an employer may use any reasonable allocation method to determine the allocation of costs to employees.**

***Operation of College-Owned Parking Facilities.*** Colleges and universities offer many types of parking arrangements to their campus communities. Some institutions own or lease space in garages that charge for parking and are open to the public as well as to campus employees and students. Some institutions might offer both free and pay parking to employees, depending on the location of the parking facility.

Colleges and universities with academic medical centers or hospitals incur significant costs in owning, leasing, or sharing parking facilities with other health-care/medical service provider organizations in providing such medical and health-care services as part of their exempt purpose. Such parking is provided for health-care employees, the public, and patients seeking medical care.

Only the parking provided to employees is a qualified transportation benefit, and only amounts "paid or incurred for qualified transportation benefits" are subject to UBIT under section 512(a)(7). Therefore, the employer will need to determine how the expenses should be allocated between employees and other users of the parking facilities.

To ensure that only the costs associated with employee parking are captured similar to bus/transit benefits, **we request that an employer may use any reasonable allocation method to determine the allocation of costs attributable to employees.**

It is common for rural and suburban campuses to provide parking lots and garages that are free to the public, employees, and students. In the case of parking provided that is available to students and the public as well as staff free of charge, the cost of which is not ascertainable, **we urge the Service to adopt the position set forth in Notice 94-3, Question 10(c), in determining the fair market value of employee parking for purposes of Section 512(a)(7):**

c. PARKING AVAILABLE PRIMARILY TO CUSTOMERS. Employer-provided parking that is available primarily to customers of the employer, free of charge, will be deemed to have a fair market value of \$0.

**Since forthcoming guidance is unlikely to be published until almost halfway through the tax year, we strongly urge the Service to include a one-year delay in the effective date of section 512(a)(7).** This provision went into effect as of January 1 this year, unlike other TCJA provisions that

go into effect at later dates. We were surprised that it did not appear on Treasury's Priority Guidance Plan. Universities and colleges, some potentially facing multimillion-dollar unbudgeted tax liabilities, need to estimate the new tax burden and assess whether estimated taxes should be submitted due to an increase in UBTI. Without clarifying language, it will be difficult for institutions to fully understand the impact on their financial situation.

The delay will enable campus administrators, in keeping with the definitions and parameters of anticipated published guidance, to budget for this potentially dramatic tax increase, estimate new tax burdens, submit properly estimated taxes, and communicate and implement new arrangements with employees. If a delay is not granted, we request that any penalties that might arise due to underpayment resulting from lack of guidance related to taxable fringe benefits under section 512(a)(7) be waived.

## 2. Section 512(a)(6), Requirement to Compute UBTI Separately for each Trade or Business (i.e., the “basketing” or “siloeing” requirement)

**Definition of “Separate Trade or Business.”** Under the TCJA, section 512(a)(6) provides that organizations with two or more unrelated trades or businesses shall compute UBTI separately for each such unrelated trade or business. The fundamental question in implementing this provision is: What activity constitutes a separate trade or business?

UBTI that does not arise from an unrelated trade or business includes taxable fringe benefits under section 512(a)(7) (as discussed above), debt-financed income under section 514 (currently reported on Line 7/ Schedule E of Form 990-T), and certain payments from controlled entities under section 512(b)(13) (currently reported on Line 8/ Schedule F of Form 990-T). **NACUBO therefore recommends that UBTI from fringe benefits should be computed similarly and reported in Part I of Form 990-T.**

For UBTI that does arise from an unrelated trade or business, **NACUBO recommends aligning the definition of “a separate trade or business” with the various statutory groupings already provided in sections 511-514.** For example, advertising services is an unrelated trade or business identified in section 513. Further, a separate trade or business (or basket or silo) may include gross receipts and sales that constitute trades or businesses that are regularly carried on and that are not substantially related to the entity's exempt mission or purpose. This methodology is consistent with Part I of the Form 990-T when reporting income from an unrelated trade or business.

Further, this methodology enables exempt organizations and institutions to rely on a well-recognized body of law in determining and computing their UBTI. Reliability on these long-held categories will promote consistency and facilitate compliance. Conversely, to categorize “a separate trade or business” at a more granular level may unfavorably impact compliance with UBTI reporting and needlessly increase the administrative burden of compliance.

**Investments.** Finally, we believe UBTI arising from investment activities should be treated as one activity. Colleges and universities typically manage their investments as a consolidated, single pool of assets, guided by high-level investment objectives. These investments are governed according to policies created and regularly reviewed by the institution's trustees, who are themselves held to established fiduciary standards. Trustees, whether through service on an investment committee or during their discussions at the full board level, establish and regularly review investment guidelines,

asset allocation rules, and spending policies, and monitor investment performance and the institution's investment management practices. The spending policy (the rules that determine the amount of funds available for withdrawal from the pool and spent by the institution) is typically based on the investment pool's market value. **We strongly urge you to consider treating all investment activities as a single basket in computing UBTI pursuant to section 512(a)(6), which is a logical extension of the governance approach to managing investment pools.**

### 3. Section 4960, Excise Tax on Executive Compensation

The TCJA added section 4960, which levies an excise tax on certain highly compensated executives of tax-exempt employers. The tax, effective for tax years beginning in 2018, is imposed at the new corporate tax rate of 21 percent on tax-exempt organizations if any of their five highest-salaried employees receive more than \$1 million in annual compensation, or receive an excess parachute payment.

***Definition of “remuneration.”*** We understand that “remuneration” is treated as paid if there is no substantial risk of forfeiture. This appears to include salary, incentive payments, vested deferred compensation plans, 457(f) plans, sign-on or retention bonuses, and anything else of taxable value. Remuneration paid by a related entity, such as a campus foundation, is aggregated for purposes of this tax. This calculation excludes payments from qualified retirement and annuity plans and 457(b) plans. **We recommend defining compensation in the same way as wages are defined for income tax purposes and reported in Box #1 (taxable income) of Form W-2.**

***Scope of covered employees.*** According to the TCJA, a covered employee is one of the five highest-compensated employees of an organization (based on section 162(m), which denies deduction for executive compensation of more than \$1 million annually, and only applies to public companies) for the taxable year. It would be helpful to include in forthcoming guidance specific examples of how the lookback period operates for determining covered employees.

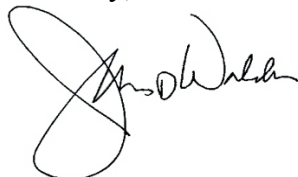
In addition to the five highest-compensated employees of the organization in a taxable year, the TCJA includes “...employees of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.” Rather than tracking the five highest paid for each year in perpetuity, **we recommend the adoption of the five-year limit for covered employees, which is the approach taken by the Service for Form 990, Part VII and Schedule J reporting purposes.** An individual is deemed “former” if he/she appeared on the Form 990 for the organization for any one or more of the five prior years.

**We also recommend that the Service adopt guidance that excludes an employee from being covered solely due to a one-time vesting event.** (If not for the vesting event, they would not appear on the list of the top five highly compensated employees.)

***Reporting and remitting the excise tax.*** We understand that the IRS is considering repurposing a form that is currently applicable to private foundations: Form 4720. **We urge the IRS to instead revise and use the Form 720, which deals with excise taxes, for reporting the excise tax on executive compensation.** Exempt organizations, including colleges and universities, are already familiar with this form and the deposit requirements. We also respectfully request a delay in imposition of any underpayment penalties for the first year of reporting, as colleges and universities need to properly budget for and calculate their new tax liabilities.

We are grateful for the opportunity to share our suggestions with you as you develop guidance implementing the TCJA and welcome communication between our organizations as you continue to work on provisions affecting colleges and universities. Please contact Mary Bachinger, director of tax policy, at 202-861-2581, [mary.bachinger@nacubo.org](mailto:mary.bachinger@nacubo.org) or Liz Clark, senior director of federal affairs, at 202-861-2553, [liz.clark@nacubo.org](mailto:liz.clark@nacubo.org).

Sincerely,

A handwritten signature in black ink, appearing to read "John D. Walda". The signature is fluid and cursive, with a large loop at the beginning and a long, sweeping tail.

John D. Walda  
President and Chief Executive Officer

Cc:

David Kautter, Assistant Secretary for Tax Policy, U.S. Department of the Treasury

Thomas West, Tax Legislative Counsel, U.S. Department of the Treasury

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