The Legislature Should Remove the State Tax on Nonprofits’ Commuter Benefits Imposed by the Federal Tax Cut & Jobs Act of 2017

As of January 1, 2018, a new state tax has been imposed on nonprofit organizations that provide employees with commuter benefits. The new tax will strip nonprofits of resources that should be used for soup kitchens, community centers and other charitable activities. This fact sheet explains the tax’s impact and why the legislature should repeal it.

What is the tax?
The federal Tax Cut and Jobs Act of 2017 imposes federal Unrelated Business Income Tax (UBIT) on any amount a nonprofit employer has “paid or incurred” for commuter benefits such as a Buffalo NFTA Metro Pass, NYC Metrocard, Rochester RTS Pass, or employee parking.¹ New York law imposes a state UBIT whenever federal law does so. As a result, NY will automatically follow the new federal statute, imposing an additional 9% tax.²

How much will the new law cost nonprofits?
If the nonprofit pays for all or part of the employee’s commuter benefits, it will have to pay both the federal tax and the 9% NY tax. This will add up quickly. If the employer subsidizes the maximum allowable benefit of $260/month, it will owe state tax of $280 for each employee each year. With more than 1.3 million nonprofit employees statewide,³ the tax could divert millions of dollars from the nonprofit sector each year.

The IRS has not yet clarified whether the employer will also have to pay tax on any pre-tax compensation that an employee directs to commuter benefits. If it does, the financial impact will be even greater. For NYC employers, the new tax will be unavoidable, because they are required by local law to allow employees to direct up to $260/month of their pre-tax compensation to commuter benefits.⁴

Why did New York impose this tax?
No one in NY ever decided to impose this new tax. It was imposed automatically as a result of the 2017 federal tax bill, because NY’s UBIT statute is based on the federal UBIT statute.

The extension of the new tax to a nonprofit’s charitable work is not supported by Congress’ asserted interest in “parity”.

Reacting to a concern that some nonprofits were engaged in business unrelated to their charitable purposes, in 1970 the state imposed the UBIT obligation on a nonprofit’s “unrelated business taxable income” (UBTI). The goal of this tax is to “even the playing field among tax-exempt organizations and their for-profit rivals ... by ensuring that tax-exempt entities pay taxes on revenue unrelated to their tax-exempt purpose. That way, tax-exempt organizations do not receive an unfair advantage in the market based on an unrelated-tax-exempt purpose.”⁵
Like for-profits, nonprofits can deduct business expenses from their UBTI. As part of the 2017 tax reforms, Congress prohibited all employers, including nonprofits, from taking tax deductions for commuter benefits. The problem is that Congress extended the tax beyond nonprofits’ unrelated business activities, to cover nonprofits’ charitable activities.

The new tax violates the state’s long-standing policy of exempting nonprofits’ charitable endeavors from the franchise tax.

Nonprofit organizations provide essential services to people around the state. Many partner with the State to provide these services. Nonprofit organizations usually survive on donations and government grants, meaning that new costs cannot be passed on to a consumer. In order to permit nonprofit organizations to continue providing essential services, and in recognition of the inelastic nature of their funding sources, nonprofits are exempt from the state’s franchise tax.

The work performed by a nonprofit’s employees – and the compensation paid to them, including transportation benefits – is undeniably part of the nonprofit’s mission. Unfortunately, however, the federal Tax Cut and Jobs Act taxes commuter benefits that a nonprofit employer incurs in the course of its charitable activities. Because this new tax is incompatible with the state’s long-standing tax treatment of charitable income, the state should de-link this aspect of its UBIT scheme from federal law.

What is the solution?

The State should not impose an unrelated business income tax on transportation benefits. Section 13-292 of the Tax Law should be amended to read:

Unrelated business taxable income. (a) The unrelated business taxable income of a taxpayer subject to the tax imposed by section two hundred ninety shall be such taxpayer’s federal unrelated business taxable income, as defined in the laws of the United States for the taxable year, with the following modifications:

(4) There shall be subtracted from federal unrelated business taxable income any amount which is included therein solely by reason of the application of section 501(m)(2)(A) or 512(a)(7) of the internal revenue code.

For further information, contact Laura Abel, Senior Policy Counsel, label@lawyersalliance.org or (212) 219-1800 x283 (April 30, 2018)

---

i Internal Revenue Code § 512(a)(7).
ii NY Tax Law § 13-292.
iii NYS Comptroller, Profile of Nonprofit Organizations in New York State (2016), p. 3.
v Hatem v. Schwarzenegger, 449 F.3d 423 (2d Cir. 2006).
vi 20 NYCRR 1-3.4(b)(6).