

As a writer for the City News, one of the most important voices of the African-American community in New Jersey, she married her special wit and biting insight into all the black political players. And she was one of the most astute political minds I have ever known.

Mr. President, New Jerseyans will miss Connie Woodruff's scholarship and leadership, and I will also miss her friendship. Countless individuals were helped by her and touched by her. And she made a difference in the lives of thousands of ordinary people. A champion for women's rights, human rights and civil rights, Connie Woodruff proved that good and great can exist in the same individual.●

#### UNFAIR NONPROFIT COMPETITION

● Mr. SHELBY. Mr. President, language included in the Senate report of the Subcommittee on Treasury, Postal Service and General Government appropriations, and included by reference in the fiscal year 1997 Omnibus Appropriations bill, directs the Department of the Treasury to review the problem of unfair nonprofit competition with small firms. The language also directs the Treasury to take "steps, if necessary, to develop regulations clarifying the substantially related test as it applies to tax-exempt travel and tour activities." I want to speak briefly to the need for such regulatory clarification.

Mr. President, the travel and tour industry in this Nation is comprised predominantly of the smallest entrepreneurial firms—tour operators and promoters, travel agents, hotel and motel owners, bus owners and operators. Small businesses that organize tours, small businesses that conduct tours, and small marketers that sell tours combined comprise one of the largest sectors of our economy. Although not often thought of as such, these entrepreneurs are vital exporters. By providing a large flow of service to foreign visitors they constitute one of the most successful exporting blocs in the United States. They export America and an understanding of America, from the national parks to our many other great attractions.

Mr. President, I raise these points not only to recognize the immense size and contribution of this industry, but to help us appreciate how important it is to ensure that our policies support and nurture a vibrant, competitive travel and tour industry. To an increasing extent these small businesses have been besieged by a source of unfair competition from nonprofit organizations, who now comprise more than 10 percent of our GDP. Some of the Nation's wealthiest tax-exempt organizations have discovered that travel and tour activities, albeit primarily a commercial venture, are an easy way to supplement income.

Now, Mr. President, small businesses support nonprofits in financing many

of their endeavors. Small businesses recognize the important work of many nonprofits. They are partners with nonprofits. Indeed, while their contributions are not often publicized in the Conference Board, the U.S. Small Business Administration has determined that small firms are the largest contributors to nonprofits on an employee-by-employee basis. Small firms also do not fear competition from tax-exempt organizations, any more than they do from large firms, foreign firms, or any other entity. They embrace competition as a necessary part of their daily routine.

But what small businesses do resent, however, is competition where one party has been given an unfair advantage. And the competitive playing field between small firms and nonprofits has not been level for some time. Today, nonprofits make extensive use of privileged franking on mail, and they often cross-subsidize their travel activities using capital acquired for other purposes. And last but not least, when they directly compete against small firms they frequently enjoy the largest benefit taxpayers can bestow upon them—complete absolution from the income tax.

Mr. President, my concerns and the concerns expressed by this Congress are not new. Congress has tried to address this concern of unfair competition in the past. Indeed, more than 45 years ago, the Congress passed what is known as the unrelated business income tax, which taxes income that is not substantially related to the tax-exempt's mission. And, in 1986, the Supreme Court in *U.S. v. American Bar Endowment*, 477 U.S. 105, reiterated that "[t]he undisputed purpose of the unrelated business income tax was to prevent tax-exempt organizations from competing with businesses whose earnings were taxed."

However, growth in the number of nonprofits, an increased emphasis on commercial as opposed to donative sources of revenue, and most importantly, a paucity of guidance over what is meant by substantially related have combined to make that standard virtually meaningless.

The Congress is not alone in its concern over the failure of the law to prevent unfair competition. Even the IRS itself believes the substantially related standard, without adequate definition, is virtually unenforceable. And equally important, the U.S. Small Business Administration believes that guidance is necessary. I offer for inclusion in the RECORD a recent letter sent by the SBA chief counsel to the Department of the Treasury urging a regulation.

For many small tour operators, the discernible distinction between their activities and that of the nonprofit is not in the markets they serve or in the services they market, but rather in the inexplicable and unjustifiable distinction that, on the income predicted, one pays taxes and the other does not. And to make matters worse, a rationale for

this cross-subsidization does not exist. As businesses point out, rather than enabling nonprofits to serve the needy for which an exemption is warranted, the exemption enables nonprofit travel and tour promoters to tap and maintain access to the high-end, most lucrative part of the market—the segment with the greatest disposable income, the greatest number of professionals, and the highest component of educated customers. When this competition occurs, there is a distinct and quantifiable competitive advantage nonprofits enjoy from total relief from the income tax.

Mr. President, for these reasons, the Senate report which accompanied the appropriations bill for the Treasury, Postal Service and General Government Appropriations Subcommittee, directed the IRS to review this situation. Action on this issue is requested by Congress. It is being requested by the U.S. Small Business Administration. It is sought by the IRS field agents. And last but not least, it is urged by the millions of small businesses that suffer from unfair competition.

The letter follows:

U.S. SMALL BUSINESS ADMINISTRATION,  
Washington, DC, June 27, 1996.

Re unrelated business income tax travel and tour-related services—need for clarification.

Hon. DONALD C. LUBICK,  
Acting Assistant Secretary for Tax Policy, U.S.  
Department of the Treasury, Washington,  
DC.

DEAR ASSISTANT SECRETARY LUBICK: This office has heard from numerous small business groups for more than a decade about the problems that taxpaying small businesses have when they are in competition with tax exempt organizations. As you know, resolving this issue was a recommendation of the White House Conference on Small Business and, we believe, the intent of the unrelated business income tax (UBIT) was to maintain an equitable business environment when tax-exempt organizations produced income from activities that are beyond the activities on which their exemption status is based. Most recently, a concern has been expressed within the travel and tourism industry (an industry made up predominantly of small businesses) that the line has become so imprecise that their industry is being damaged. They fear that the area will be regulated or is being regulated in a manner which prevents their participation in the regulation drafting process. We share their concern.

I am writing to urge the Treasury Department to incorporate a rule-making into the 1997 IRS Business Plan that would clarify the "substantially related" test for purposes of determining unrelated business income arising from the travel and tour activities of tax-exempt entities. A regulation would provide guidance where there is little existing guidance and would address an important, persistent and growing concern of small businesses over an issue of fundamental fairness. It would raise additional revenue through greater compliance in an area of known non-compliance, and standardize inconsistent application of the law by clarifying a hazy area of the law.

As you know, whether or not income from a commercial travel and tour activity by a university, a museum or other nonprofit is taxable depends upon whether or not the activity is "substantially related" to the organization's exempt function.

Unfortunately, the inherently subjective nature of the "substantially related" test, difficulties in its administration, and extremely limited guidance have contributed to a perception of fundamental unfairness by the small business community, particularly in the travel industry. This helps to explain why the issue rose to such prominence in the 1995 White House Conference on Small Business (and, for that matter, in the 1986 White House Conference on Small Business). Rather than enabling nonprofits to serve traditional educational tour markets for which exemption is appropriate, small businesses complain that this exemption has emboldened tax-exempts to maintain and expand into those market segments with the highest disposable income, the largest number of professionals, the most educated customers, and the least need for tax exemption.

Under current guidance, Technical Advice Memoranda or Private Letter Rulings, the Service has a fairly well established set of criteria under which it has found such activ-

ity to be exempt. However, the industry tells us that the subjective nature of the criteria gives a little reliable guidance for determining when commercial tours and travel will be taxable. It is in the resulting gray area that most of the commercial activity is currently undertaken. Despite substantial increases in tax-exempt travel and tour activity and greater commercial character of that activity, the tax treatment of such activity remains largely undefined, fueling the perception of unfairness and increasing overlap in the travel and tour activities conducted by both sectors.

Guidance in the form of a regulation, with examples, would better define the contours of the "substantially related" test and fill these gaps. Promulgation of a proposed regulation will ensure that the issue is framed in terms of the central focus of the debate—the application of the UBIT to what are essentially commercial travel and tour activities. A rulemaking will attract the greatest level of factual input from both the for-profits and nonprofits. Moreover, a rulemaking may

even save Federal resources by eliminating the need for extensive audits with limited guidance and negative and inconsistent court rulings that may result from inadequate guidance. Indeed, it is our understanding that guidance has also been requested by the nonprofit community in order to alleviate increased audit activity.

We understand that the Treasury, in its proposed 1997 business plan will be focusing on several issues affecting nonprofits. We would welcome your including the regulatory guidance under the "substantially related" test—already identified to be of central concern to small businesses—as one of the priorities under that plan.

The Office of Advocacy, and specifically Russ Orban of my staff, would welcome the opportunity to work with you, and would be pleased to discuss how such a regulation might be fashioned.

Sincerely yours,

JERE W. GLOVER,  
*Chief Counsel.* ●