

## Part III - Administrative, Procedural, and Miscellaneous

Request for Comments Regarding the Calculation of Unrelated Business Taxable Income under § 512(a)(6) for Exempt Organizations with More than One Unrelated Trade or Business; Interim and Transition Rules for Aggregating Certain Income in the Nature of Investments; and the Treatment of Global Intangible Low-Taxed Income Inclusions for Purposes of the Unrelated Business Income Tax

Notice 2018-67

### SECTION 1. PURPOSE

Section 13702 of “An Act to provide for reconciliation pursuant to titles II and IV of the concurrent resolution on the budget for fiscal year 2018,” Public Law 115-97 (131 Stat. 2054 (2017)) (the Act), enacted December 22, 2017, added new § 512(a)(6) to the Internal Revenue Code (Code). Section 512(a)(6) requires an organization subject to the unrelated business income tax under § 511, with more than one unrelated trade or business, to calculate unrelated business taxable income (UBTI) separately with respect to each trade or business. This notice discusses, and solicits comments regarding, various issues arising under § 512(a)(6) and sets forth interim guidance and transition rules relating to that section. This notice also provides guidance on the treatment of

global intangible low-taxed income (GILTI) under § 951A for purposes of the unrelated business income tax under § 511.

The contents of this notice are as follows. Section 2 provides a general background of the law on UBTI and § 512(a)(6). Section 3 outlines general concepts for identifying separate trades or businesses for purposes of § 512(a)(6) and provides interim reliance on a reasonable, good-faith standard for making such a determination. Section 4 discusses the possible treatment of income described in § 512(b)(4), (13), and (17). Section 5 discusses general principles surrounding income from partnerships. Section 6 sets forth interim and transition rules under § 512(a)(6) for aggregating income from partnerships and debt-financed income from partnerships. Section 7 discusses the application of § 512(a)(6) to certain organizations subject to the UBTI rules of § 512(a)(3). Section 8 discusses the effect of § 512(a)(6) on income described in § 512(a)(7) (fringe benefits). Section 9 provides information on how to calculate net operating losses (NOLs) within the framework of § 512(a)(6). Section 10 concludes that, for purposes of calculating UBTI, an inclusion of GILTI is treated as a dividend and follows the treatment of dividends under § 512(b)(1) and 512(b)(4). Section 11 summarizes reliance on rules provided in this notice. Section 12 requests comments and provides information for submitting comments.

## SECTION 2. BACKGROUND

Under § 501(a), organizations described in §§ 401(a) and 501(c) generally are exempt from federal income taxation. However, § 511(a)(1) imposes a tax (computed

as provided in § 11) on the UBTI of organizations described in § 511(a)(2), which includes organizations described in §§ 401(a) and 501(c) (other than a trust described in § 511(b) or an instrumentality of the United States described in § 501(c)(1)) as well as state colleges and universities. Additionally, § 511(b)(1) imposes a tax (computed as provided in § 1(e)) on the UBTI of certain trusts described in § 511(b)(2).<sup>1</sup>

Organizations described in § 511(a)(2) and trusts described in § 511(b)(2) are collectively called “exempt organizations” throughout this notice, unless otherwise stated.

Section 512(a)(1) defines UBTI as the gross income derived by any exempt organization from an unrelated trade or business regularly carried on by it, less the deductions allowed by Chapter 1 that are directly connected with the carrying on of such trade or business, both computed with the modifications described in § 512(b). An exempt organization determines whether it has income from an unrelated trade or business under the general principles of §§ 511 through 514 and the Treasury regulations thereunder.

Section 513(a) defines “unrelated trade or business” as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or

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<sup>1</sup> Section 408(e) states that an individual retirement account (IRA) is subject to the taxes imposed by § 511. Accordingly, any reference to an exempt organization in this notice includes an IRA, without regard to whether it is a traditional IRA, Roth IRA, simplified employee pension (SEP-IRA), or savings incentive match plans for employees (SIMPLE IRA).

performance by such exempt organization, other than trusts described in § 513(b)(2), of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501 (or, in the case of a state college or university, to the exercise or performance of any purpose or function described in § 501(c)(3)). In the case of a trust that is exempt from tax under § 501(a) and described in § 401(a) (qualified retirement plans) or § 501(c)(17) (supplemental unemployment compensation benefits trusts (SUBs)), however, § 513(b) defines “unrelated trade or business,” as any trade or business regularly carried on by such trust or by a partnership of which it is a member.

An exempt organization may conduct an unrelated trade or business directly or indirectly through another entity, such as a partnership (including any entity treated as a partnership for federal tax purposes). Section 512(c) provides that, if a trade or business regularly carried on by a partnership of which an exempt organization is a partner is an unrelated trade or business with respect to such organization, the exempt organization includes in UBTI – subject to the exceptions, additions, and limitations of § 512(b) – its distributive share of partnership gross income (whether or not distributed) and partnership deductions directly connected with such gross income. See § 1.512(c)-1 (describing how UBTI is calculated in a situation in which an exempt organization’s distributive share of partnership income consists of both UBTI and income that is excluded from the calculation of UBTI). In determining whether a partnership conducts one or more trades or businesses that are unrelated trades or businesses with respect to an exempt organization partner, the exempt organization would use the applicable

definition of “unrelated trade or business” in § 513(a) or (b).<sup>2</sup> Section 512(c) applies regardless of whether an exempt organization is a general or limited partner. Rev. Rul. 79-222, 1979-2 C.B. 236.

Except as described in § 512(a)(3) (discussed in section 7 of this notice), exempt organizations exclude from the calculation of UBTI gross income from dividends, interest, annuities, etc.; royalties; rents; and gains and losses from the sale, exchange, or other disposition of property. See § 512(b)(1), (2), (3), & (5). The reason that these and “similar items” are excluded from UBTI is because Congress indicated that such items “are not likely to result in serious competition for taxable businesses having similar income.” S. Rep. No. 81-2375, at 30-31 (1950). Additionally, Congress stated that “investment-producing incomes of these types have long been recognized as a proper source of revenue for [exempt] organizations and trusts.” Id. However, gross income from other sources in the nature of investments are not specifically excluded by § 512(b) and are generally included in the calculation of UBTI. Such gross income could include an exempt organization’s share (whether or not distributed) of the gross income of a partnership when the exempt organization is a partner and the partnership is engaged in one or more trades or businesses that are unrelated trades or businesses

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<sup>2</sup> Because IRAs described in § 408 are subject to the tax imposed by § 511, under § 408(e), and IRAs are most similar to § 401(a) trusts, it is reasonable to apply the definition of “unrelated trade or business” described in § 513(b) to IRAs. The Treasury Department and the IRS intend to provide that the § 513(b) definition of unrelated trades or businesses should be used in application of § 511 for accounts subject to the tax in § 511 pursuant to § 408(e).

with respect to the exempt organization partner.<sup>3</sup>

An exempt organization may engage in more than one unrelated trade or business. Prior to the enactment of § 512(a)(6), § 1.512(a)-1(a) provided that, with respect to an exempt organization that derives gross income from the regular conduct of two or more unrelated trades or businesses, UBTI was the aggregate gross income from all such unrelated trades or businesses less the aggregate deductions allowed with respect to all such unrelated trades or businesses. However, § 512(a)(6) changes this calculation for exempt organizations with more than one unrelated trade or business. Congress intended “that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year.” H.R. Rep. No. 115-466, at 548 (2017). Specifically, § 512(a)(6) provides that, in the case of any exempt organization with more than one unrelated trade or business:

(A) UBTI, including for purposes of determining any net operating loss (NOL) deduction, shall be computed separately with respect to each trade or business and without regard to § 512(b)(12) (allowing a specific deduction of \$1,000),

(B) The UBTI of such organization shall be the sum of the UBTI so computed with respect to each trade or business, less a specific deduction under § 512(b)(12), and

(C) For purposes of § 512(a)(6)(B), UBTI with respect to any such trade or business shall not be less than zero.

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<sup>3</sup> In the case of a trust that is exempt from tax under § 501(a) that is described in § 401(a) or § 501(c)(17), § 513(b) defines “unrelated trade or business” as any trade or business regularly carried on a partnership of which it is a member.

Thus, § 512(a)(6) no longer allows aggregation of income and deductions from all unrelated trades or businesses. Section 512(a)(6) applies to taxable years beginning after December 31, 2017, but, as discussed in more detail in section 9 of this notice, not to NOLs arising before January 1, 2018, that are carried over to taxable years beginning on or after such date.

Separately, section 14201 of the Act added new § 951A of the Code. Section 951A(a) provides that “each person who is a United States shareholder of any controlled foreign corporation for any taxable year of such United States shareholder shall include in gross income such shareholder’s global intangible low-taxed income for such taxable year.”

### SECTION 3. SEPARATE TRADE OR BUSINESS

#### .01 In General

In the case of any exempt organization with more than one unrelated trade or business, § 512(a)(6)(A) requires the organization to calculate UBTI, including for purposes of determining any NOL deduction (discussed in section 9 of this notice), separately with respect to each such trade or business. In enacting § 512(a)(6), Congress did not provide criteria for determining whether an exempt organization has more than one unrelated trade or business or how to identify separate unrelated trades or businesses for purposes of calculating UBTI. The Treasury Department and the IRS intend to propose regulations for determining whether an exempt organization has more than one unrelated trade or business for purposes of § 512(a)(6) and how to identify

separate trades or businesses for purposes of calculating UBTI under § 512(a)(6)(A).

.02 Reasonable, Good-Faith Interpretation of §§ 511 through 514

Pending issuance of proposed regulations, and pursuant to additional interim guidance provided in section 6 of this notice, exempt organizations may rely on a reasonable, good-faith interpretation of §§ 511 through 514, considering all the facts and circumstances, when determining whether an exempt organization has more than one unrelated trade or business for purposes of § 512(a)(6). A reasonable, good-faith interpretation includes using the North American Industry Classification System 6-digit codes described in section 3.03.

The Treasury Department and the IRS note that the fragmentation principle in § 513(c) and § 1.513-1(b), and related guidance, may also provide helpful guidance. Prior to the passage of § 512(a)(6), the fragmentation principle was primarily used to separate unrelated trades or businesses from exempt activities, but it might also have utility in identifying separate trades or businesses for purposes of § 512(a)(6)(A). The fragmentation principle provides that an activity does not lose its identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of an organization. For example, the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose its status as a trade or business merely because the pharmacy also furnishes supplies to the hospital and patients of the hospital in accordance with its exempt purposes or in compliance with



the terms of § 513(a)(2) (stating, in part, that the term “trade or business” does not include any trade or business that is carried on by an organization described in § 501(c)(3) or a state college or university primarily for the convenience of its members, students, patients, officers, or employees). See § 1.513-1(b). Similarly, activities of soliciting, selling, and publishing commercial advertising do not lose their statuses as trades or businesses even though the advertising is published in an exempt organization periodical that contains editorial matter related to the exempt purposes of the organization. Id. Additionally, several revenue rulings provide examples of how the fragmentation principle has been applied. See, e.g., Rev. Rul. 78-145, 1978-1 C.B. 169 (regarding the sale of blood products by a blood bank).

#### .03 Possible Methods for Identifying Separate Trades or Businesses

There is no general statutory or regulatory definition defining what constitutes a “trade or business” for purposes of the Internal Revenue Code. Whether an activity constitutes a trade or business may vary depending on which Code section is involved. See generally Commissioner v. Groetzinger, 480 U.S. 23, 27 (1987). The Treasury Department and the IRS request comments regarding rules to identify separate trades or businesses that achieve the intent of Congress in enacting § 512(a)(6) and are administrable for exempt organizations and the IRS.

Several Code sections describe factors for determining whether an organization is engaged in a trade or business or a line of business, including §§ 132, 162, 183, 414, and 469 (see also section 5.02 of this notice), and the regulations thereunder. The

Treasury Department and the IRS have considered these Code sections and are concerned that they do not provide useful models for identifying separate trades or businesses for purposes of § 512(a)(6). Nonetheless, the Treasury Department and the IRS request comments describing whether and how these and other Code sections (and the regulations thereunder) may aid in determining how to identify an exempt organization's separate trades or businesses for purposes of § 512(a)(6)(A).

Although some commenters have suggested the creation of a facts and circumstances test to identify separate trades or businesses for purposes of § 512(a)(6), the Treasury Department and the IRS would like to set forth a more administrable method than a facts and circumstances test alone for identifying separate trades or businesses for purposes of § 512(a)(6). A facts and circumstances test would increase the administrative burden on exempt organizations in complying with § 512(a)(6) because such organizations would have to perform a fact-intensive analysis with respect to each of their trades or businesses, document the analysis, and then track and keep records consistent with such analysis. Additionally, such a test would likely result in inconsistency across the exempt organization sector in light of differing approaches in budgeting and staffing and thus create unequal burdens and cause exempt organizations to make business decisions such as budgeting and staffing solely to avoid the requirements of § 512(a)(6). Finally, such a test would also increase the administrative burden on the IRS in implementing and enforcing § 512(a)(6) because verifying whether an exempt organization calculated its UBTI correctly would require a

fact-intensive analysis of the organization's trades or businesses and the determinations made with respect to identifying separate trades or businesses for purposes of calculating UBTI under § 512(a)(6)(A).

To provide additional guidance in proposed regulations for determining whether an exempt organization has more than one unrelated trade or business for purposes of § 512(a)(6) and how to identify separate trades or businesses for purposes of calculating UBTI under § 512(a)(6)(A), the Treasury Department and the IRS are considering the use of North American Industry Classification System (NAICS) codes. Prior to proposed regulations, the Treasury Department and the IRS will consider the use of NAICS 6-digit codes to be a reasonable, good-faith interpretation under section 3.02 of this notice.

The NAICS is an industry classification system for purposes of collecting, analyzing, and publishing statistical data related to the United States business economy. See EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, NORTH AMERICAN INDUSTRY CLASSIFICATION SYSTEM (2017), available at [https://www.census.gov/eos/www/naics/2017NAICS/2017\\_NAICS\\_Manual.pdf](https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf). For example, under a NAICS 6-digit code, all of an exempt organization's advertising activities and related services (NAICS code 541800) might be considered one unrelated trade or business activity, regardless of the source of the advertising income. Use of all 6 digits of the NAICS codes would result in more specific categories of trades or businesses whereas use of fewer than 6 digits of the NAICS codes would result in

broader categories of trades or businesses. Exempt organizations filing Form 990-T, “Exempt Organization Business Income Tax Return,” already are required to use the 6-digit NAICS codes when describing the organization’s unrelated trades or businesses in Block E. The Treasury Department and the IRS request comments regarding whether using less than 6 digits of the NAICS codes, or combining NAICS codes with other criteria, would appropriately identify separate trades or businesses for purposes of achieving the objective of § 512(a)(6). The Treasury Department and the IRS also request comments on the utility of this method, other methods, or a combination of methods that could be used for making this determination.

#### .04 Allocation of Directly Connected Deductions

Section 512(a)(1) permits an exempt organization with an unrelated trade or business to reduce the income from that trade or business by the deductions allowed by Chapter 1 of the Code that are directly connected with the carrying on of such trade or business. To be “directly connected” with a trade or business, an item of deduction must have a proximate and primary relationship to the carrying on of the unrelated trade or business generating the gross income. See § 1.512(a)-1(a). Expenses, depreciation, and similar items attributable solely to the conduct of an unrelated trade or business are proximately and primarily related to that trade or business and qualify to reduce income from such trade or business under § 512(a)(1) to the extent such items meet the requirements of §§ 162 (trade or business expenses), 167 (depreciation), and other relevant provisions.

To the extent that an exempt organization may have items of deduction that are shared between an exempt activity and an unrelated trade or business, the Treasury regulations at § 1.512(a)-1(c) and (d) provide special rules for allocating such expenses. For example, if facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, then expenses, depreciation, and similar items attributable to such facilities must be allocated between the two uses on a reasonable basis. See § 1.512(a)-1(c).

The Treasury Department and the IRS currently have an item on the Priority Guidance Plan regarding methods of allocating expenses relating to dual use facilities. The allocation issues under § 512(a)(1) also are relevant under § 512(a)(6) because an exempt organization with more than one unrelated trade or business must not only allocate indirect expenses among exempt and taxable activities as described in § 1.512(a)-1(c) and (d) but also among separate unrelated trades or businesses. The Treasury Department and the IRS therefore are considering modifying the underlying reasonable allocation method in § 1.512(a)-1(c) and providing specific standards for allocating expenses relating to dual use facilities and the rules under § 512(a)(6). The Treasury Department and the IRS are requesting comments regarding possible rules or defined standards for the allocation of indirect expenses between separate unrelated trades or businesses for purposes of calculating UBTI under § 512(a)(6)(A), and, in particular, regarding what allocation methods should be considered “reasonable.”

## SECTION 4. INCOME TREATED AS AN ITEM OF GROSS INCOME FROM AN UNRELATED TRADE OR BUSINESS

Sections 512(b)(4), (13), and (17) treat unrelated debt financed income, specified payments received from controlled entities, and certain insurance income (as defined in § 953) as items of gross income derived from an unrelated trade or business and therefore includable in the calculation of UBTI under § 512(a) even though such amounts ordinarily would be excluded from the calculation of UBTI under § 512(b)(1), (2), (3), or (5). At least one commenter has questioned how income that is included in UBTI under § 512(b)(4), (13), and (17) is treated for purposes of § 512(a)(6) because that commenter states that amounts included in UBTI under these provisions do not have a nexus to an unrelated trade or business.

The Treasury Department and the IRS note that, in the absence of § 512(b)(1), (2), (3), and (5), interest, royalties, rents, and gains (or losses) from the sale, exchange, or other disposition of property would be included in the calculation of UBTI to the extent that such amounts are “gross income derived by any organization from any unrelated trade or business . . . regularly carried on by it” under § 512(a)(1). Accordingly, the Treasury Department and the IRS see no distinction between “gross income derived by any organization from any unrelated trade or business . . . regularly carried on by it” within the meaning of § 512(a)(1) and amounts included in UBTI “as an item of gross income derived from an unrelated trade or business” under § 512(b)(4), (13), and (17).

However, the Treasury Department and the IRS recognize that one interpretation of

§ 512(a)(6) might impose a significant burden on organizations required to include amounts in UBTI under § 512(b)(4), (13), or (17). For example, one interpretation of § 512(a)(6) might require treating each debt-financed property owned by an exempt organization as a separate trade or business for purposes of § 512(a)(6)(A), because the debt/basis percentage used to calculate the portion of income that is unrelated debt-financed income included in the calculation of UBTI under § 512(b)(4) is specific to each property. Similarly, an exempt organization might be required to report income from each controlled entity as income from a separate trade or business for purposes of § 512(a)(6)(A). The exempt organization would have to track and report each debt-financed property owned directly by an exempt organization or income from each controlled entity separately, which imposes a burden both on the exempt organization and on the IRS. Accordingly, aggregating income included in UBTI under § 512(b)(4), (13), or (17) may be appropriate in certain circumstances. The Treasury Department and the IRS therefore request comments regarding the treatment under § 512(a)(6) of income that is not from a partnership, but is included in UBTI under § 512(b)(4), (13), and (17).

## SECTION 5. ACTIVITIES IN THE NATURE OF INVESTMENTS

### .01 Partnership Interests

In general, for exempt organizations, the activities of a partnership are considered

the activities of the partners.<sup>4</sup> Section 512(c) requires an exempt organization that is a partner in a partnership that conducts a trade or business that is an unrelated trade or business with respect to the exempt organization to include in UBTI its distributive share of gross partnership income (and directly connected partnership deductions) from such unrelated trade or business. Whether a trade or business engaged in by the partnership is an unrelated trade or business with respect to the exempt organization is determined under §§ 511 through 514, and the regulations thereunder. Based on § 512(c) and the fragmentation principle, as discussed in section 3.02 of this notice, one interpretation of § 512(a)(6) might require an exempt organization to calculate UBTI separately with respect to each unrelated trade or business regularly carried on by the partnership in which the exempt organization is a direct or indirect partner. For example, if an exempt organization is a partner in a holding partnership that is a partner in multiple partnerships, many of which engage in one or more unrelated trades or businesses with respect to the exempt organization partner, the exempt organization may be engaged in multiple separate unrelated trades or businesses through its interest in the partnership.

.02 Permitting the Aggregation of Gross Income and Directly Connected Deductions from Certain “Investment Activities”

The Treasury Department and the IRS have received comments regarding the

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<sup>4</sup> See IRC §§ 512(c), 513(a); Treas. Reg. § 1.513-1(d)(1) and (2); Plumstead Theatre Society, Inc. v. Commissioner, 74 T.C. 1324 (1980); 675 F.2d 244 (9<sup>th</sup> Cir. 1995); Service Bolt & Nut Co. Profit Sharing Trust v. Commissioner, 724 F.2d 519 (6<sup>th</sup> Cir.1983), affg, 78 T.C. 812 (1982); Rev. Rul. 98-15, 1998-1 C.B. 718.



potential significant reporting and administrative burden imposed by § 512(a)(6) on exempt organizations with various activities in the nature of an investment including ownership interests in multi-tier partnership structures that generate UBTI if the Treasury Department and the IRS adopt the interpretation of § 512(a)(6) discussed in section 5.01 of this notice. The administrative burden related to owning partnership interests would be heightened by the difficulty of obtaining sufficient information regarding the trade or business activities of lower-tier partnerships. Accordingly, as a matter of administrative convenience, the Treasury Department and the IRS intend to propose regulations treating certain activities in the nature of an investment (“investment activities”) of an exempt organization as one trade or business for purposes of § 512(a)(6)(A) in order to permit exempt organizations to aggregate gross income and directly connected deductions from such “investment activities.” The Treasury Department and the IRS expect that treating these “investment activities” as one trade or business for this purpose will reduce the reporting and administrative burden on organizations required to comply with § 512(a)(6) and will also reduce the burden the IRS may experience in implementing and enforcing § 512(a)(6).

The Treasury Department and the IRS request comments regarding the scope of the activities, both investment partnership interests or other activities in the nature of an investment that may generate unrelated business income, that should be included in the category of “investment activities” for purposes of § 512(a)(6). The Treasury Department and the IRS have received some comments suggesting the definition of

material participation in § 469 could serve as a basis for separating investment activities from more active involvement in an unrelated trade or business. The Treasury Department and the IRS are concerned that the criteria for finding material participation under § 469 are more extensive than appropriate. With respect to partnership interests that could be included in the category of “investment activities” for purposes of § 512(a)(6), the Treasury Department and the IRS note that “investment activities” as discussed in section 6 of this notice should capture only partnership interests in which the exempt organization does not significantly participate in any partnership trade or business.

## SECTION 6. INTERIM AND TRANSITION RULES FOR PARTNERSHIP INVESTMENTS

### .01 Aggregation of Income and Directly Connected Deductions

(1) In General. Except as provided in section 6.01(2) through (4) of this notice, exempt organizations with partnership investments should use a reasonable, good-faith interpretation of §§ 511 and 514, considering all the facts and circumstances, when identifying separate trades or businesses for purposes of § 512(a)(6)(A) until the issuance of proposed regulations (see section 3.02 of this notice).

(2) Interim Rule for Aggregation of Qualifying Partnership Interests under the *De Minimis* and Control Tests. Pending publication of proposed regulations, an exempt organization may aggregate its UBTI from its interest in a single partnership with multiple trades or businesses, including trades or businesses conducted by lower-tier

partnerships, as long as the directly-held interest in the partnership meets the requirements of either the *de minimis* test (described in section 6.02 of this notice) or the control test (described in section 6.03 of this notice) (“qualifying partnership interest”). Additionally, under this interim rule, an exempt organization may aggregate all qualifying partnership interests and treat the aggregate group of qualifying partnership interests as comprising a single trade or business for purposes of § 512(a)(6)(A).

(3) Transition Rule. Pending publication of proposed regulations, an exempt organization may follow the transition rule (described in section 6.04 of this notice) for partnership interests with respect to which it is not applying the interim rule described in section 6.01(2) of this notice.

(4) Limitations. The interim rule and the transition rule do not apply to exempt organizations described in § 501(c)(7) that are subject to § 512(a)(3). See section 7 of this notice. Furthermore, these rules do not otherwise impact the application of § 512(c) and the fragmentation principle under § 513(c).

#### .02 De minimis test

(1) In general. A partnership interest is a qualifying partnership interest that meets the requirements of the *de minimis* test if the exempt organization holds directly no more than 2 percent of the profits interest and no more than 2 percent of the capital interest. But see section 6.02(2)(b) of this notice for rules requiring the combining of related interests in certain circumstances.

(2) Percentage Interest. (a) Reliance on Schedule K-1. In determining the exempt organization's percentage interest in a partnership, the exempt organization may rely on the Schedule K-1 it receives from the partnership. In Part II, line J, a partnership enters the partner's share of profit, loss, and capital interests at the beginning and the ending of the partnership's taxable year. An organization will be considered to have no more than 2 percent of the profits or capital interests in the case of a partnership, if the average of the organization's percentage interest at the beginning and the end of the partnership's taxable year, or, in the case of a partnership interest held for less than a year, the percentage interest held at the beginning and end of the period of ownership within the partnership's taxable year, entered in Part II, line J, of Schedule K-1 is no more than 2 percent (without regard to the number of days each such percentage is held during the taxable year). For example, if an exempt organization acquires an interest in a partnership that files on a calendar year basis in May and the partnership reports in Part II, Line J, of Schedule K-1 that the partner held a 3 percent profits interest at the date of acquisition but held a 1 percent profits interest at the end of the calendar year, the exempt organization will be considered to have held 2 percent of the profits interest in that partnership for that year  $((3 \text{ percent} + 1 \text{ percent})/2 = 2 \text{ percent})$ . To the extent that a specific profits interest is not identified in Part II, Line J, of Schedule K-1, an organization does not meet the *de minimis* test.

(b) Combining Related Interests. (i) In General. When determining an exempt organization's percentage partnership interest, the interest of a disqualified person, a

supporting organization, or a controlled entity in the same partnership will be taken into account. For example, if an exempt organization owns 1.5 percent of the profits interests in a partnership and a disqualified person with respect to the exempt organization owns an additional 1 percent profits interest in that partnership, the exempt organization would not meet the requirements of the *de minimis* test because its aggregate percentage interest exceeds 2 percent. However, the exempt organization may still be able to aggregate the income (and directly connected deductions) from that partnership interest with other qualifying partnership interests if the partnership interest meets the requirements of the control test (described in section 6.03 of this notice).

(ii) Disqualified Person. For purposes of section 6.02(2)(b)(i) of this notice, the term “disqualified person” has the same meaning as in § 4958(f).

(iii) Supporting Organization. For purposes of section 6.02(2)(b)(i) of this notice, the term “supporting organization” has the same meaning as in § 509(a)(3).

(iv) Controlled Entity. For purposes of section 6.02(2)(b)(i) of this notice, the term “controlled entity” has the same meaning as in § 512(b)(13)(D).

### .03 Control Test

(1) In General. A partnership interest is a qualifying partnership interest that meets the requirements of the control test if the exempt organization (i) directly holds no more than 20 percent of the capital interest; and (ii) does not have control or influence over the partnership. The rules in section 6.02(2)(b) of this notice requiring the combination of related interests also apply for purposes of the control test.

(2) Reliance on Schedule K-1. When determining the exempt organization's percentage interest in a partnership the exempt organization may rely on the Schedule K-1 it receives from the partnership. An organization will be considered to have no more than 20 percent of the capital interest, if the average of the organization's percentage interest at the beginning and the end of the partnership's taxable year, or, in the case of a partnership interest held for less than a year, the percentage interest held at the beginning and end of the period of ownership within the partnership's taxable year, entered in Part II, line J, of Schedule K-1 is no more than 20 percent (without regard to the number of days each such percentage is held during the taxable year).

(3) Control or Influence. All facts and circumstances are relevant for determining whether an exempt organization has control or influence over a partnership. An exempt organization has control or influence if the exempt organization may require the partnership to perform, or may prevent the partnership from performing, any act that significantly affects the operations of the partnership. An exempt organization also has control or influence over a partnership if any of the exempt organization's officers, directors, trustees, or employees have rights to participate in the management of the partnership or conduct the partnership's business at any time, or if the exempt organization has the power to appoint or remove any of the partnership's officers, directors, trustees, or employees.

#### .04 Transition rule

A previously acquired partnership interest may be difficult to modify to meet the *de*

*minimis* test (as described in section 6.02 of this notice) or control test (as described in section 6.03 of this notice) under the interim rule and the exempt organization may have to incur significant transactions costs to do so. Thus, an organization may choose to apply the following transition rule, if applicable, for a partnership interest acquired prior to August 21, 2018: an exempt organization may treat each such partnership interest as comprising a single trade or business for purposes of § 512(a)(6) whether or not there is more than one trade or business directly or indirectly conducted by the partnership or lower-tier partnerships. For example, if an organization has a thirty-five percent interest in a partnership prior to August 21, 2019, it can treat the partnership as being in a single unrelated trade or business even if the partnership's investments generated UBTI from various lower-tier partnerships that were engaged in multiple types of trades or businesses.

.05 Unrelated Debt-Financed Income. The income from qualifying partnership interests permitted to be aggregated under the interim rule includes any unrelated debt-financed income (within the meaning of § 514) that arises in connection with the qualifying partnership interest that meets the requirements of either the *de minimis* test or the control test. See §§ 512(b)(4) and 514. For example, assume an exempt organization has an interest in a hedge fund that is treated as a partnership for federal income tax purposes, the interest is a qualifying partnership interest that meets the requirements of the *de minimis* test, and the hedge fund regularly trades stock on margin. Ordinarily, the dividends from such stock and any income (or loss) from the

sale, exchange, or other disposition of such stock would be excluded from UBTI under § 512(b)(1) and (5). However, because all or a portion of the stock's purchase is debt-financed, § 512(b)(4) requires that all of or a portion (depending on the debt-basis percentage applied) of the dividend income (if any) and any income (or loss) from the sale of the stock be included in UBTI. For the purpose of the interim rule, the exempt organization may aggregate unrelated debt-financed income generated by the hedge fund with any other UBTI generated by any of the hedge fund's trades or businesses that are unrelated trades or businesses with respect to the exempt organization.

Similarly, any unrelated debt-financed income that arises in connection with a partnership interest that meets the requirements of the transition rule may be aggregated with the other UBTI that arises in connection with that partnership interest.

#### SECTION 7. SOCIAL CLUBS, VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATIONS, AND SUPPLEMENTAL UNEMPLOYMENT COMPENSATION BENEFITS TRUSTS

Section 512(a)(3) provides special rules applicable to exempt organizations described in § 501(c)(7) (social clubs), (9) (voluntary employees' beneficiary associations (VEBAs)), and (17) (supplemental unemployment compensation benefits trusts (SUBs)). For these exempt organizations, § 512(a)(3)(A) provides that UBTI means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 of the Code that are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications



provided in § 512(b)(6) (the NOL deduction), (10) (charitable contribution deduction by exempt organizations), (11) (charitable contribution deduction by certain trusts), and (12) (specific deduction). Thus, social clubs, VEBAs, and SUBs are taxed under § 511 on their non-exempt function income, which generally includes investment income and income derived from an unrelated trade or business.

In particular, § 512(a)(3)(B) defines “exempt function income” as the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the organization’s tax-exempt status. However, § 512(a)(3)(B) specifically excludes from the definition of “exempt function income” gross income derived from any unrelated trade or business regularly carried on by such organization (computed as if the organization were subject to § 512(a)(1)).<sup>5</sup> For example, a social club’s nonmember income is treated as gross income from an unrelated trade or business under § 512(a)(3). See Rev. Rul. 2003-64, 2003-1 C.B. 1036. Accordingly, even though § 512(a)(3) uses terminology different from § 512(a)(1), § 512(a)(6) applies to an organization subject to § 512(a)(3) if such organization has more than one unrelated trade or business. For example, a social club that receives non-member income from multiple sources, such as from a dining facility and from a retail store, would have more

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<sup>5</sup> However, VEBAs and SUBs are taxed on income to the extent that the amount of assets in the VEBA or SUB at the close of the taxable year exceed the account limit described in § 512(a)(3)(E) and § 1.512(a)-5T. See also Prop. Reg. § 1.512(a)-5.

than one unrelated trade or business and therefore be subject to the requirements of § 512(a)(6).

The Treasury Department and the IRS anticipate that any rules issued regarding how an exempt organization identifies separate trades or businesses for purposes of § 512(a)(6)(A) will apply equally under § 512(a)(1) and (3).<sup>6</sup> Nonetheless, because social clubs, VEBAs, and SUBs are taxed differently than other exempt organizations under § 511, the Treasury Department and the IRS request comments regarding any additional considerations that should be given to how § 512(a)(6) applies within the context of § 512(a)(3). In particular, the Treasury Department and the IRS request comments regarding how these exempt organizations' investment income should be treated for purposes of § 512(a)(6).

## SECTION 8. TOTAL UBTI

### .01 In General

To determine total UBTI under § 512(a)(6)(B), an exempt organization takes the sum of the UBTI computed with respect to each separate trade or business under § 512(a)(6)(A), less a specific deduction under § 512(b)(12). However, in calculating total UBTI under § 512(a)(6)(B), § 512(a)(6)(C) provides that UBTI with respect to any trade or business cannot be less than zero.

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<sup>6</sup> However, the rules in section 6 of this notice for aggregating UBTI from partnership interests do not apply to social clubs described in § 501(c)(7).

## .02 Fringe Benefits

Section 512(a)(7) increases UBTI by any amount for which a deduction is not allowable under this chapter by reason of § 274 and which is paid or incurred by such exempt organization for any qualified transportation fringe (as defined in § 132(f)), any parking facility used in connection with qualified parking (as defined in § 132(f)(5)(C)), or any on-premises athletic facility (as defined in § 132(j)(4)(B)). However, § 512(a)(7) does not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business that is regularly carried on by the organization. Unlike other paragraphs of § 512, § 512(a)(7) does not treat amounts included in UBTI as a result of that section as an item of gross income derived from an unrelated trade or business (see section 4 of this notice). Furthermore, the Treasury Department and the IRS do not believe that the provision of the fringe benefits described in § 512(a)(7) is an unrelated trade or business. Accordingly, any amount included in UBTI under § 512(a)(7) is not subject to § 512(a)(6).

## SECTION 9. NOLS AND UBTI

Prior to the Act, § 172 allowed an NOL deduction equal to the sum of NOLs permitted to be carried back to the taxable year from succeeding taxable years and the NOLs permitted to be carried forward from preceding taxable years. An NOL generally could be carried back two years and carried forward twenty years. See § 172(b) (prior to the Act). Section 512(b)(6), which was not changed by the Act, generally permits exempt organizations subject to the unrelated business income tax under § 511,

including exempt organizations with more than one unrelated trade or business, to take the NOL deduction provided in § 172. In particular, § 512(b)(6)(A) states that the NOL for any taxable year, the amount of the NOL carryback or carryover to any taxable year, and the NOL deduction for any taxable year shall be determined under § 172 without taking into account any amount of income or deduction that is excluded under § 512(b) in computing UBTI. For example, a loss attributable to an unrelated trade or business is not to be reduced by reason of the receipt of dividend income. See § 1.512(b)-1(e)(1). An NOL carryover is allowed only from a taxable year for which the taxpayer is subject to the provisions of § 511, or a corresponding provision of prior law. See § 512(b)(6)(B); § 1.512(b)-1(e)(3).

However, § 512(a)(6) changes how an exempt organization with more than one unrelated trade or business calculates and takes NOLs into account with respect to a particular trade or business. In particular, § 512(a)(6)(A) requires such an organization to calculate UBTI, including for purposes of determining any NOL deduction, separately with respect to each trade or business for taxable years beginning after December 31, 2017 (post-2017 NOLs). The Congressional intent behind this change is to allow an NOL deduction “only with respect to a trade or business from which the loss arose.” H.R. Rep. No. 115-466, at 547-48. In the first taxable year beginning after December 31, 2017, no exempt organization with more than one unrelated trade or business will have an NOL deduction to take against the UBTI of a particular trade or business calculated under § 512(a)(6)(A).

Additionally, in order to preserve NOLs from tax years prior to the effective date of the Act, Congress created a special transition rule to permit the carryover of any NOL arising in a taxable year beginning before January 1, 2018 (pre-2018 NOLs). In particular, section 13702(b)(2) of the Act provides that § 512(a)(6)(A) does not apply to pre-2018 NOLs; rather, pre-2018 NOLs are taken against total UBTI calculated under § 512(a)(6)(B). Accordingly, even though an exempt organization with more than one unrelated trade or business will not have any NOL deductions when calculating UBTI with respect to a separate trade or business under § 512(a)(6)(A) for the first taxable year beginning after December 31, 2017, such an organization may be able to take an NOL deduction against total UBTI calculated for such year under § 512(a)(6)(B) if the organization has pre-2018 NOLs.

In the second taxable year beginning after December 31, 2017, an exempt organization with more than one unrelated trade or business may have both pre-2018 NOLs and post-2017 NOLs. Section 512(a)(6) may have changed the order in which an organization would ordinarily take losses because § 512(a)(6)(A) requires an organization with more than one unrelated trade or business to calculate UBTI separately (including for purposes of determining any NOL deduction) with respect to each such trade or business before calculating total UBTI under § 512(a)(6)(B). If § 512(a)(6) is read as an ordering rule for purposes of calculating and taking the NOL deduction, post-2017 NOLs will be calculated and taken before pre-2018 NOLs because the UBTI with respect to each separate trade or business is calculated under

§ 512(a)(6)(A) before calculating total UBTI under § 512(a)(6)(B).

Furthermore, section 13302 of the Act made extensive changes to § 172, including limiting post-2017 NOLs to the lesser of (1) the aggregate NOL carryovers to such year, plus the NOL carrybacks to such year, or (2) 80 percent of taxable income computed without regard to the deduction generally allowable under § 172. The limitation in § 172(a) applies only to post-2017 NOLs, but a question exists regarding how the § 172(a) 80 percent income limitation applies when both pre-2018 and post-2017 NOLs exist. The Treasury Department and the IRS intend to issue guidance regarding how § 172 generally applies. However, because § 512(a)(6) provides a more specific rule than the one found in § 172 regarding how the NOL deduction is calculated and taken in the context of calculating UBTI, the Treasury Department and the IRS are requesting comments regarding how the NOL deduction should be taken under § 512(a)(6) by exempt organizations with more than one unrelated trade or business and, in particular, by such organizations with both pre-2018 and post-2017 NOLs. The Treasury Department and the IRS also request comments on the ordering of pre-2018 and post-2017 NOLs and the potential treatment of pre-2018 NOLs that may expire in a given tax year if not taken before post-2017 NOLs.

#### SECTION 10. TREATMENT OF GLOBAL INTANGIBLE LOW-TAXED INCOME

Commenters have asked whether an exempt organization must include GILTI (included in gross income under § 951A) in the calculation of UBTI. In particular, these commenters have questioned whether GILTI is treated in the same manner as an

inclusion of subpart F income under § 951(a)(1)(A) for purposes of the unrelated business income tax under § 511.

The IRS treats an inclusion of subpart F income as a dividend for purposes of § 512(b)(1). Accordingly, subpart F income generally is excluded from the calculation of UBTI. Congress approved of the IRS's long-standing position when it enacted § 512(b)(17) as part of the Small Business Job Protection Act of 1996, Public Law 104-188 (110 Stat. 1755 (1996)). See H.R. Rep. No. 105-586, at 136 (1996) (stating that “income inclusions under subpart F have been characterized as dividends for unrelated business income tax purposes” and citing several private letter rulings issued by the IRS taking this position). Although an inclusion of subpart F income under § 951(a)(1)(A) is generally excluded from the calculation of UBTI as a dividend under § 512(b)(1), § 512(b)(17) requires any amount included in gross income under § 951(a)(1)(A) that is attributable to insurance income (as defined in § 953) which, if derived directly by the organization, would be treated as gross income from an unrelated trade or business to be included in the calculation of UBTI.

GILTI is not an inclusion of subpart F income under § 951(a)(1)(A), but instead is a separate inclusion under § 951A(a). Nonetheless, an inclusion of GILTI is generally treated in a manner similar to an inclusion of subpart F income for other purposes of the Code. See H.R. Rep. No. 115-446, at 641 (stating that, “[u]nder the provision, a U.S. shareholder of any [controlled foreign corporation] must include in gross income for a taxable year its [GILTI] in a manner generally similar to inclusions of subpart F income”).

The Treasury Department and the IRS have determined that an inclusion of GILTI under § 951A(a) should be treated in the same manner as an inclusion of subpart F income under § 951(a)(1)(A) for purposes of § 512(b)(1) and (4). Accordingly, an inclusion of GILTI will be treated as a dividend which is generally excluded from UBTI under § 512(b)(1).

Commenters have also questioned whether § 512(b)(17) will apply to treat as UBTI an inclusion of GILTI to the extent attributable to insurance income (as defined in § 953) that does not constitute subpart F income. The Treasury Department and the IRS note that Congress made no changes to § 512(b) when enacting § 951A, and has not otherwise specifically required the inclusion of such insurance income in UBTI. Accordingly, unless provided otherwise in proposed regulations, the Treasury Department and the IRS will not treat GILTI included in gross income under § 951A(a) that is attributable to insurance income as includible in the UBTI of a tax-exempt organization.

## SECTION 11. RELIANCE

For taxable years beginning after December 31, 2017, organizations described in § 511(a)(2) and trusts described in § 511(b)(2), collectively called “exempt organizations” throughout this notice, may rely on methods of aggregating or identifying separate trades or businesses under § 512(a)(6) provided in this notice until proposed regulations are published. All such organizations may rely on a reasonable, good-faith interpretation of §§ 511 through 514 taking into account all the facts and circumstances



when determining whether an exempt organization has more than one unrelated trade or business for purposes of § 512(a)(6). For an exempt organization this also includes using a reasonable, good-faith interpretation when determining:

- Whether to separate debt-financed income described in §§ 512(b)(4) and 514;
- Whether to separate income from a controlled entity described in § 512(b)(13); and
- Whether to separate insurance income earned through a controlled foreign corporation as described in § 512(b)(17).

The use of NAICS 6-digit codes will be considered a reasonable, good-faith interpretation until regulations are proposed.

For taxable years beginning after December 31, 2017, exempt organizations, other than organizations described in § 501(c)(7) (social clubs), may also rely on the rules provided for aggregating income from partnerships in section 6 of this notice until proposed regulations are published. These aggregation rules include any unrelated debt-financed income that is earned through a partnership that meets the requirements of the rules described in section 6 of this notice. The rules described in section 6 of this notice include:

- The interim rule that permits the aggregation of qualifying partnership interests that meet either the *de minimis* test or control test into a single trade or business; and

- The transition rule, which allows for aggregating income within each direct partnership interest acquired before August 21, 2018.

Finally, exempt organizations may rely on sections 8.02 and 10 of this notice. These sections provide that:

- Income under § 512(a)(7) is not income from a trade or business for purposes of § 512(a)(6); and
- For purposes of calculating UBTI, an inclusion of GILTI under § 951A(a) is treated as a dividend and follows the treatment of dividends under § 512(b)(1) and (b)(4).

## SECTION 12. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments regarding the application of § 512(a)(6) to exempt organizations with more than one unrelated trade or business. Specifically, the Treasury Department and the IRS seek comments on the general interim rule for distinguishing between trades and businesses under § 512(a)(6) (section 3 of this notice); whether other Code sections (and the regulations thereunder) may provide an administrable model for identifying an exempt organization's separate trades or businesses (section 3.03 of this notice); whether NAICS 6-digit (or less) codes might be the basis of a method for identifying separate trades or businesses (section 3.03 of this notice); the general rules for allocating deductions between trades or businesses (section 3.04 of this notice); the treatment of income treated as an item of gross income from an unrelated trade or business, including the treatment of debt-financed income

(§ 512(b)(4), (13) and (17)) (section 4 of this notice); the scope of the activities that should be included in the category of “investment activities” (section 5.02 of this notice); the treatment of income derived from activities in the nature of an investment through partnerships (sections 5 and 6 of this notice); any additional considerations that should be given to how § 512(a)(6) applies within the context of § 512(a)(3) (section 7 of this notice); and the calculation and ordering of pre-2018 and post-2017 NOLs and the treatment of pre-2018 NOLs that will expire in a given tax year if not taken before post-2017 NOLs (section 9 of this notice). Comments should be submitted on or before **December 3, 2018**. Please include Notice 2018-67 on the cover page. Comments should be sent to the following address:

Internal Revenue Service  
CC:PA:LPD:PR (Notice 2018-67), Room 5203  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Internal Revenue Service  
Courier's Desk  
1111 Constitution Ave., N.W.  
Washington, DC 20224  
Attn: CC:PA:LPD:PR (Notice 2018-67)

Submissions may also be sent electronically to the following e-mail address:

[Notice.Comments@irs.counsel.treas.gov](mailto:Notice.Comments@irs.counsel.treas.gov).

Please include “Notice 2018-67” in the subject line.

All comments will be available for public inspection and copying.

### SECTION 13. PAPERWORK REDUCTION ACT

The collection of information in this notice is the requirement under § 512(a)(6) that an exempt organization with more than one unrelated trade or business calculate UBTI separately with respect to each such trade or business. The collection of information contained in this notice is reflected in the collection of information for Form 990-T that has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545-0687.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

### SECTION 14. DRAFTING INFORMATION

The principal authors of this notice are Stephanie N. Robbins and Jonathan A. Carter of the Office of Associate Chief Counsel (TEGE). For further information regarding this notice contact Mr. Carter at (202) 317-5800 (not a toll-free call).