Notice 2018-67: UBTI update

The United States Department of Treasury and the Internal Revenue Service in **Notice 2018-67** (the "Notice") have requested comments regarding the calculation of Unrelated Business Taxable Income (UBTI) under section 512(a)(6) of the Internal Revenue Code (the "Code") for exempt organizations with more than one unrelated trade or business. Also included in the Notice are interim and transition rules for aggregating certain income related to investment partnerships, and the treatment of global intangible low-taxed income inclusions for purposes of the unrelated business income tax.

Background

The 2017 Tax Act[1] added new section 512(a)(6), which provides a special rule for exempt organizations with more than one unrelated trade or business. Section 512(a)(6) requires an exempt organization subject to the unrelated business income tax under section 511, with more than one unrelated trade or business, to calculate UBTI separately with respect to each trade or business. Section 511(a)(1) imposes a tax on the UBTI of exempt organizations described in section 511(a)(2), which includes, among other organizations, colleges and universities. As many colleges and universities are investors in vehicles such as hedge funds, private equity funds, and real estate funds, and may receive investment reporting from multiple entities, it is important to understand the impact of new section 512(a)(6).

The Notice requests comments regarding the application of section 512(a)(6) to exempt organizations with more than one unrelated trade or business. Specifically, the Treasury Department and the IRS are asking for:

- comments on distinguishing between trades and businesses under section 512(a)(6),
- whether other sections of the Code and related regulations may provide an administrable model for identifying an exempt organization's separate trades or businesses, and
- whether North American Industry Classification System codes might be the basis of a method for identifying separate trades or businesses.

The Notice also requests feedback on:

- the general rules for allocating deductions between trades or businesses,
- the treatment of income treated as an item of gross income from an unrelated trade or business, including the treatment of debt-financed income,
- the scope of the activities that should be included in the category of "investment activities"
- the treatment of income derived from activities in the nature of an investment through partnerships, and
- any additional considerations that should be given to how section 512(a)(6) should apply.

The Notice includes interim and transition rules for partnership investments. These rules apply to investments in partnerships in which the exempt organization does not significantly participate in any partnership trade or business. The Notice states that in general, with some exceptions, exempt organizations with partnership investments should use a reasonable, good-faith interpretation of sections 511 and 514, considering all the facts and circumstances, when identifying separate trades or businesses for purposes of section 512(a)(6)(A) until the issuance of proposed regulations. The Notice goes on to state that pending publication of proposed regulations, an exempt organization may apply an interim rule to 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 or the control test. In addition,

[1] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (the Act).

an exempt organization may aggregate all interests in partnerships satisfying either of those tests and treat the aggregate group of qualifying interests as comprising a single trade or business for section 512(a)(6).

An organization will satisfy the *de minimis* test so long as it holds no more than 2% of the profits interest and no more than 2% of the capital interest in the partnership. An organization will satisfy the control test so long as it (1) holds no more than 20% of the capital interest in the partnership, and (2) does not have control or influence over the partnership. The ownership interests held by certain related parties are included when considering whether these ownership thresholds are met.

The Notice also provides a transition rule for partnership investments. The transition rule allows an organization to treat any partnership interest acquired before August 21, 2018 as comprising a single trade or business for purpose of section 512(a)(6). Unlike with the interim rule, an organization may not aggregate its partnership interests that qualify only for the transition rule.

The Notice does not address the reporting obligations of partnerships with exempt organizations as partners. Although exempt organizations may elect to apply the interim rule or the transition rule to its partnership investments, it appears that partnerships are still required to report to exempt organizations information on each trade or business conducted directly, or through lower-tier partnerships, by the partnership.

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