

November 15, 2018

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

*Via Email: Notice.Comments@irscounsel.treas.gov*

RE: Comments Regarding Notice 2018-67

To Whom it May Concern,

The Council on Foundations (Council) is pleased to submit comments in response to the above referenced Notice. Specifically, our comments address five issues regarding the application of § 512(a)(6) to exempt organizations with more than one unrelated trade or business, as outlined in Notice 2018-67 in sections Three, Five, and Six.

The Council is a nonprofit leadership association of grantmaking foundations, corporations, and public charities qualified under § 501(c)(3) of the Internal Revenue Code. Our members include approximately 700 charitable foundations and our mission is to provide the opportunity, leadership, and tools needed by these organizations to expand, enhance, and sustain their ability to advance the common good.

These comments were developed by the Government Relations and Legal Affairs staff at the Council and reviewed and approved by the Council's President and CEO. Council staff are in daily contact with our numerous members and these comments are informed by the issues and challenges our members have expressed. We appreciate your consideration of these recommendations and welcome the opportunity to discuss these items with you further. If you have any questions, please feel free to contact Peter Gordon at (703) 879-0733 or peter.gordon@cof.org, Serena Jezior at (703) 879-0629 or Serena.Jezior@cof.org, or Suzanne Friday at (703) 879-0705 or Suzanne.Friday@cof.org.

Sincerely,



Associate Director of  
Government Relations



Associate Director of  
Public Policy



Senior Counsel and Vice  
President of Legal Affairs

**Notice 2018-67, Section 3.03.**

**Whether NAICS 6-Digit (Or Less) Codes Might Be the Basis of a Method for Identifying Separate Trades or Businesses:**

Section 3 of this Notice describes a framework for using the North American Industry Classification System (NAICS) codes<sup>1</sup> (including, potentially, six digits of the NAICS codes) for purposes of distinguishing which unrelated business income (UBI) streams should be aggregated and which should be siloed. The Council believes that using the NAICS codes to identify separate trades or businesses is generally a reasonable proposal. The Council also believes that Treasury Department's (Treasury) and Internal Revenue Service's (IRS) intent in proposing the use of the NAICS codes can be achieved with the use of only four digits, as it is unnecessary for siloing purposes to further narrow the classification categories beyond "industry group." The Council's members that claim UBI and file the Form 990-T are already familiar with this system, so the administrative burden would be minimal given that there would be no need to learn a new system.

As noted above, the Council recommends that only four digits of the NAICS codes be required for classifying UBI. We know of examples where our members and other charitable organizations generate UBI from general advertising activities (i.e., administering a nonprofit "job bank" or advertising nonprofit directors' insurance on their website; NAICS Codes: 541810 – Advertising Agencies, and 541800 – Other Services Related to Advertising). From the standpoint of one of our member organizations, such activities are not materially distinct in purpose and the taxable UBI generated is often minimal. For example, the UBI generated by one of our member charitable organizations from its 541800 (Advertising, Public Relations, and Related Services) activities was roughly 0.3% of the organization's overall budget for 2016. If this organization, or others that are similarly situated, were required to silo similar activities within this category beyond four digits, it would create such an administrative burden that these organizations would likely stop pursuing these UBI opportunities.

Another common example of UBI that the Council's members claim is from passive investments in partnership activities (NAICS Code: 525990 – Other Financial Vehicles). Investment income is, by definition, the primary source of revenue to fund private (and to some degree, community) foundations' activities. Our members use this income to fund their programs and operations which are core to their charitable purpose. What makes this income structure unique from some other charitable organizations is that these investments allow foundations to exist in perpetuity without the need for continual fundraising to sustain long-term, strategic giving to address some of society's most systemic issues. Because of this investment income, foundations are able to provide stability to the charitable sector without being as vulnerable to the ebbs and flows of giving patterns in any given year. As such, any regulations on this issue should acknowledge that creating a siloing regime that overly-complicates how foundations generate and classify investment income would undercut the very purpose foundations intend to serve.

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<sup>1</sup> NAICS uses a six-digit coding system to identify particular industries and their placement in this hierarchical structure of the classification system. The first two digits of the code designate the sector, the third digit designates the subsector, the fourth digit designates the industry group, the fifth digit designates the NAICS industry, and the sixth digit designates the national industry. A zero as the sixth digit generally indicates that the NAICS industry and the U.S. industry are the same.

A single foundation can have hundreds of different passive partnership investments. One of our members reported receiving over 400 Schedule K-1s in 2017. The primary purpose of the foundation's involvement in any of these partnership investments is to passively generate revenue in order to fund its programs in furtherance of its mission. The administrative burden of requiring foundations to separate out and calculate each of these investment activities as distinctly different would be unreasonable. Further, unlike a for-profit corporation or a fundraising entity, a private foundation's internal organization and structure is intentionally designed to focus the foundation's resources on the grantmaking aspect of its operations rather than on the active management of generating revenue. As such, the Council believes that utilizing a material participation standard is an acceptable basis for separating investment activities from more active involvement in an unrelated trade or business.

In addition, given that most investment activity by foundations merely serves the same purpose (i.e., providing a source of funding for their activities), such activity naturally fits together in the context. Thus, any IRS and Treasury guidance on aggregating or disaggregating UBI streams should allow foundations to group such activity together under the NAICS Code: 5259 – Other Investment Pools and Funds. Requiring foundations to use more than four digits to further distinguish the activities into subcategories would be both unnecessary and administratively burdensome.

**Notice 2018-67, Section 3.04.**

**General Rules for Allocating Deductions Between Trades or Businesses:**

§1.512(a)-1(c) of the Income Tax Regulations provides, “Where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead), shall be allocated between the two uses on a reasonable basis. Similarly, where personnel are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses and similar items attributable to such personnel (as, for example, items of salary) shall be allocated between the two uses on a reasonable basis.” The Council believes that the “reasonable basis” standard has been working well and sees no reason to believe it would not continue to work well under the new changes. Therefore, the Council does not believe that Treasury and IRS need to create additional rules or defined standards for the allocation of indirect expenses between separate unrelated trades or businesses for purposes of calculating UBI under section 512(a)(6)(A).

**Notice 2018-67, Section 5.02.**

**Scope of the Activities that Should be Included in the Category of “Investment Activities”:**

As noted earlier, investment activity by foundations is mostly passive and for the purpose of generating revenue to fund their charitable, mission-related activities. Given that the nature of multiple types of investment activities undertaken by foundations are not viewed by a foundation as being distinct or separate in purpose (i.e., they are all somewhat interchangeable revenue-generating activities designed to fit within a strategy of prudently overseeing the foundation's financial resources), and because the foundation is not a material participant, the Council believes that “investment activities” should be defined to include all passive activities under Sec.

469. This definition is sufficient because it captures comparable activity in the context of a private foundation and allows foundations to reasonably calculate taxes owed on UBI.

**Notice 2018-67, Sections 5 and 6.**

**Treatment of Income Derived from Activities in the Nature of an Investment Through Partnerships:**

Regarding the rules proposed for calculating income generated from partnership investments, the Council agrees with the interim rule for aggregation of qualifying partnership interests (which provides that the *de minimis* test and the control test may be used to determine a “qualifying partnership interest”) and believes it does not create an unnecessary administrative burden for foundations. Additionally, the Council agrees with the transition rule set forth in Section 6.04 of the Notice.

Furthermore, the Council suggests revising the Schedule K-1 to include a checkbox (or some other similar indicator) to indicate that an organization meets the requirements of either the *de minimis* test or the control test with regard to partnership interests. This addition would significantly reduce the administrative burden on foundations completing the Form 990-T by eliminating the need for these organizations to have to perform the *de minimis* test or the control test for every K-1 they file (which, as mentioned previously, can be in excess of 120 in some instances).