

**Chair:**

Ms. Barbara A. Boigegrain

**Secretary/Treasurer:**

Mr. Andrew Q. Hendren, Esquire

Wespath Benefits and Investments  
1901 Chestnut Avenue  
Glenview, Illinois 60025  
(847) 866-4200

**Vice Chair:**

Mr. James F. Sanft  
Concordia Plan Services  
1333 South Kirkwood Road  
St. Louis, MO 63122  
314-885-6730

**Members:**

Rev. Dr. Todd Adams  
*Christian Church (Disciples of Christ)*

Mr. Louis Barbarin\*  
*American Baptist Churches*

Mr. Brian Bodager  
*United Church of Christ*

Ms. Barbara A. Boigegrain\*  
*United Methodist Church*

Mr. John H. Bolt  
*Christian Reformed Church in North America*

Mr. John Brummitt  
*National Association of Free Will Baptists*

Mr. Gary D. Campbell  
*Presbyterian Church in America*

Mr. Mark Dowley  
*Free Methodist Church of North America*

Mr. Nevin Dulabaum  
*Church of the Brethren*

Dr. Craig A. Dunn  
*Wesleyan Church*

Mr. Matthew Frizzell  
*Community of Christ*

Dr. O. S. Hawkins \*  
*Southern Baptist Convention*

Mr. Paul Hawkinson  
*Evangelical Covenant Church*

Mr. Reggie Hundley  
*Christian Churches Pension Plan*

Mr. Jeffrey A. Jenness\*  
*Board of Pensions of the Church of God (IN)*

Rev. Dr. Jeffrey J. Jeremiah  
*Evangelical Presbyterian Church*

Mr. Raymond Jimenez  
*General Conference of Seventh-Day Adventists*

Mr. Marlo J. Kauffman  
*Mennonite Church*

Mr. Michael Kimmel  
*Reform Pension Board*

Rev. Richard Nugent  
*Unitarian Universalist Association*

Ms. Kelly Oliveira  
*Reformed Church in America*

Mr. Joshua Peterman  
*Wisconsin Evangelical Lutheran Synod*

Mr. Jonathan Phillips  
*International Church of the Foursquare Gospel*

Mr. John M. Preis \*  
*Young Men's Christian Association*

Br. Michael F. Quirk, FSC\*  
*Christian Brothers Services*

Mr. Arthur D. Rhodes  
*Church of God Benefits Board (TN)*

Ms. Rachel Roth  
*American Conference of Cantors*

Mr. James F. Sanft\*  
*Lutheran Church-Missouri Synod*

Mr. Stephen Schultz  
*Baptist General Conference—Converge Worldwide*

Mr. Mitchell J. Smilowitz\*  
*Joint Retirement Board for Conservative Judaism*

Rev. Frank C. Spencer \*  
*Presbyterian Church (U.S.A.) Board of Pensions*

Rev. Ric Stanghelle  
*Evangelical Free Church of America*

Rev. Jeffrey Thiemann\*  
*Evangelical Lutheran Church in America*

Mr. James P. Thomas, CPA  
*Churches of God, General Conference*

Rev. Bruce Verkruyse, Jr.  
*Association of Unity Churches International*

Rev. Don L. Walter  
*Church of the Nazarene*

Ms. Mary Kate Wold\*  
*Episcopal Church*

\* Steering Committee Members

# CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

**Counsel:**

**K&L Gates LLP**  
1601 K Street NW  
Washington D.C. 20006  
Tel (202) 778-9000  
Fax (202) 778-9100

December 3, 2018

By electronic submission ([Notice.Comments@irscounsel.treas.gov](mailto:Notice.Comments@irscounsel.treas.gov))

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

Re: Comments in Response to Notice 2018-67

To Whom It May Concern:

## I. Introduction

The Church Alliance submits this comment in response to Notice 2018-67 (the “Notice”), on unrelated business taxable income (“UBTI”) under Internal Revenue Code (“Code”) Section 512(a)(6). Church Alliance members (“we”) appreciate the Notice’s interim and transitional guidance. The Notice requests comments in advance of proposed rulemaking (“Proposed Regulations”), which prompted us to write.

The Church Alliance commented previously on Code Section 512(a)(6). In our letter of June 26, 2018, we requested a delay in implementation of changes relating to Code Sections 512(a)(6) (“silo” provision) and 512(a)(7), which were enacted as part of the 2017 Tax Cuts and Jobs Act (Pub. L. No. 115-97). We repeat our request for such a delay, and in this letter also are responding to matters as requested by the Notice.

## II. The Church Alliance

The Church Alliance is a coalition of chief executive officers of a diverse ecumenical group of denominational benefit plan administrators (“Church Alliance Organizations”), from mainline and evangelical Protestant, Catholic, and Jewish faith traditions (“denominations”), which provide retirement and health benefits to over one million clergy and lay workers (hereinafter “church workers”), and their families.

The Church Alliance Organizations serve over 155,000 churches and synagogues (hereinafter “churches”) and church-affiliated organizations such as schools, colleges and universities, nursing homes, children’s

homes, homeless shelters, food banks, and other ministries (hereinafter “ministries”).

The Church Alliance Organizations and the churches and ministries that they serve, i.e., the sponsors that participate in our plans, are tax-exempt organizations.

### **III. Investments of Church Alliance Organizations**

Church Alliance Organizations receive contributions from individual churches and other ministries, and from the employees of those churches and ministries, which are used to pay benefits to church workers pursuant to the terms of the applicable employee benefits plans. Often the benefits must also be paid pursuant to rules of the denomination.

Most of these contributions are held in church retirement plans, but some are held in church welfare plans (disability and health plans, etc.). Because the benefits are to be paid in the future, it is prudent and expected for the plan contributions to be invested, so the contributions can be sufficient to cover intended benefits at a future date. Investment of the contributions in church plans is a core part of Church Alliance Organizations’ mission to provide care for church workers. In other words, investing plan assets is related to each Church Alliance Organization’s tax-exempt purpose; it is not an unrelated trade or business.

This investing is not even a “trade or business” as described in Code Section 513(c), which includes “any activity which is carried on for the production of income from the sale of goods or the performance of services.” When a Church Alliance Organization invests in a partnership or other entity that operates a business, it is not carrying on the sale of goods or performance of services that produces the income.

Nevertheless, income from certain specific types of investments of Church Alliance Organizations, primarily partnerships, statutorily is treated as UBTI. (*See* Code Section 512(c)(1).) Church Alliance Organizations have accepted and complied with that statutory treatment, even though Code Section 512(a)(6) significantly complicates and burdens our compliance efforts.

In addition, Code Section 512(a)(6) has increased the cost of compliance, including possibly significantly increasing the amount of tax due. This does not seem to be supported from a policy perspective given that generally the assets of retirement and disability plans, including church plans, will eventually be taxed at individual income tax rates, e.g., as individuals retire and receive their distributions from retirement plans or become disabled and receive disability benefits. This was a factor noted in the legislative history when Congress excluded certain property acquired by Code Sections 401 and 403(b)(9) retirement plans from the unrelated debt-financed income rules of Code Section 514. *See* Senate Report No. 96-1036, 96 U.S.C.C.A.N. 7293, 7316. “The committee believes that it is appropriate to limit this change to ... investments of qualified retirement trusts because, in addition to the considerations discussed above, the assets of such trusts will ultimately be used to pay taxable benefits to individual recipients whereas the investment assets of other organizations exempt under Code 501(a) are not likely to be used for the purpose of providing benefits taxable at individual rates.” We respectfully suggest that the Treasury Department (“Treasury”) and the Internal Revenue Service (“IRS”)

consider this factor in formulating the Proposed Regulations, perhaps in considering whether such investment is one trade or business.

#### **IV. Separate Trade or Business**

The Notice requested comments on rules to identify separate trades or businesses and stated that the Treasury and the IRS are considering the use of North American Industry Classification System (“NAICS”) codes. We note that these codes may not always be on the K-1 Schedules that Church Alliance Organizations receive from partnerships, and suggest that in the absence of an NAICS code, a reasonable, good-faith interpretation standard be applied to limited partners for purposes of Code Section 512(a)(6).

The next question is whether taxable income as described in Section III of this letter should be divided into silos. The answer we suggest for all church plan investments – absent control – is along the lines of the paradigm suggested by the Notice, i.e., keep all “passive investing” in one silo.

This also makes practical sense for church benefit plans, since they are formulated with an exempt purpose of supporting church workers while working and while retired, and are unlikely to be competing with other businesses. (*See* Senate Report for the Revenue Act of 1950 describing the purpose of unrelated business income tax as preventing unfair competition. 81<sup>st</sup> Congress, 2d Session, Report No. 2375, p. 28.)

#### **V. Partnership Interests**

The Church Alliance is grateful for the interim and transitional rules for partnership investments set forth in the Notice. We also are grateful that we may rely on the K-1 Schedules that we receive. However, at times we receive K-1 Schedules that we know are incorrect. We suggest that the Proposed Regulations allow exempt organizations the flexibility to refrain from relying on a K-1 Schedule known by the exempt organization to be incorrect (at least with respect to the entries on the K-1 Schedule known to be incorrect).

The Notice states that Treasury and the IRS intend to propose regulations treating investment activities as one trade or business for purposes of Section 512(a)(6)(A), which we endorse. The Notice also states that partnership interests that could be included as “investment activities” should only capture partnership interests in which the exempt organization does not significantly participate.

##### **A. Control Test – Facts and Circumstances**

Thus, the primary practical question is how to define significant participation, including control, for the purpose of aggregating the UBTI arising from various partnership investments. One element of the control test in Section 6.03 of the Notice considers the facts and circumstances of the partnership interest. We think this is reasonable as a general proposition. However, the Notice appears to conclude that the existence of certain circumstances (e.g., having the power to appoint any officer, director, trustee, or employee) would be deemed to constitute control. We

believe that the appointment of one such individual should not be deemed as control, because actual control would not exist in all such situations.

We suggest that retaining a general facts and circumstances element is reasonable. However, we recommend that the Proposed Regulations clarify that none of the following will be deemed to demonstrate control, although they will be considered in the facts and circumstances element: (1) the ability to appoint or remove individual officers, directors, trustees, or employees; (2) the right to appoint or remove a general partner; (3) the right to appoint representatives to investor committees or advisory committees; and (4) membership on a limited partner advisory committee.

### B. Control Test – Percentage of Capital Interest

The other element of the control test in Section 6.03 of the Notice considers the percent of the capital interest directly held in the partnership, limiting it to no more than 20 percent. We recommend increasing the percentage in that element of the control test from 20 percent to 50 percent. The percentage then would be in conformity with the provisions of Code Section 512(b)(13) and the definition of control as set forth in the instructions to IRS Form 990, Schedule R.

In addition to conformity with the language of Section 512 regarding controlled entities, an increase to the percentage in the control test is further supported by the specific challenges that arise relating to the treatment of certain tax attributes when the ownership interest of an investment fluctuates above and below 20 percent in any given tax year. There are instances where a tax-exempt organization's ownership interest could equal or exceed 20 percent during the first taxable year of a limited partnership only to subsequently be reduced following the admission of additional investors (i.e., limited partners). On the other hand, tax-exempt organizations are typically passive investors, so it is unlikely that a tax-exempt organization's ownership interest would ever equal or exceed 50 percent during any taxable year.

Several questions arise, as described in the next few paragraphs, which highlight the challenges of applying 20 percent in the control test and support the application of 50 percent in the control test, in order to reduce the likelihood of these issues arising. For example, would an investment that fluctuated above 20 percent in any given tax year be required to be segregated for UBTI purposes for all future years even if the exempt organization's ownership interest falls below 20 percent at some point in the future? We would hope and suggest it would not. However, if the taxpayer is allowed to aggregate UBTI relating to an investment that falls below 20 percent in future years with other UBTI investments, we have questions about what would happen to any net operating losses, suspended passive activity losses, and any other "deferred" tax attributes that are required to be segregated during the period when aggregation was impermissible.

Code Section 172(b)(1) provides that net operating losses may be carried forward indefinitely. In the example above, where a taxpayer's interest falls below 20 percent in a future tax year, would the segregated net operating loss remain suspended indefinitely or would the segregated net operating loss follow the investment and be placed into the aggregated bucket with all other UBTI generating investments? What would be the response to these questions if, in a future tax year, the ownership interest of an investment increases above 20 percent?

Another issue to consider is the treatment of the segregated net operating loss when the segregated limited partnership is divested. Will the remaining net operating loss (post-disposition of the segregated investment) be allowed to be used to offset any other UBTI of the taxpayer, whether generated within the aggregated bucket or within another segregated limited partnership? Would there be ordering rules for the use of this segregated net operating loss carryforward post-disposition of the segregated investment?

These issues and concerns surrounding the use of segregated net operating loss carryforwards also apply to all other types of tax attributes (e.g., passive activity loss carryforward, foreign tax credit carryover, capital loss carryforward, charitable contribution carryforward, etc.). These issues and concerns weigh in favor of a 50 percent element in the control test, as opposed to the 20 percent element set forth in the Notice. Moreover, such questions are examples of the uncertainty that exists despite the Notice, and highlight the wisdom of a delay in implementation of Code Section 512(a)(6).

## **VI. Conclusion**

The Church Alliance respectfully requests that the Treasury and the IRS consider the suggestions in this letter to provide compliance certainty to our Church Alliance Organizations and the churches and ministries they serve. We also continue to request a delay in implementation of Code Section 512(a)(6), due to the questions and uncertainty that exists today. We are grateful for the opportunity to provide these comments in response to the Notice. Please do not hesitate to contact the undersigned at (202) 778-9128 with any questions or if we may be of any assistance.

Sincerely,

A handwritten signature in black ink, appearing to read 'Karishma Shah Page', with a long horizontal flourish extending to the right.

Karishma Shah Page  
Partner, K&L Gates LLP  
On Behalf of the Church Alliance