INTERNAL REVENUE
BULLETIN

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2018–36
September 4, 2018

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

Employee Plans

Notice 2018–68, page 418.

The notice provides initial guidance on the application of § 162(m) of the Code, as amended by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (Act), Public Law 115–97 (2017). Section 162(m)(1) generally limits the allowable deduction for a taxable year for remuneration by any publicly held corporation paid with respect to a covered employee. The Act made significant amendments to § 162(m), and also provided a transition rule applicable to certain outstanding arrangements (commonly referred to as the grandfather rule). The notice provides guidance on the amended rules for identifying covered employees and the operation of the grandfather rule.

REV. PROC. 2018–42, page 424.

This revenue procedure modifies Rev. Proc. 2017–41, 2017–29 I.R.B. 92, to extend the deadline for submitting on-cycle applications for opinion letters for pre-approved defined contribution plans for the third six-year remedial amendment cycle from October 1, 2018, to December 31, 2018.

Exempt Organizations

Notice 2018–67, page 409.

This notice solicits comments regarding the application of new § 512(a)(6) of the Internal Revenue Code ("Code"), which was added to the Code by 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)). 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. The notice requests comments on various topics, including possible methods for separating trades or businesses and the treatment of activities in the nature of investments and income from fringe benefits required to be included in UBTI under § 512(a)(7) for purposes of § 512(a)(6). The notice also sets forth interim and transition rules under § 512(a)(6) with respect to aggregating gross income and directly connected deductions of certain activities in the nature of investments. Finally, the notice concludes that global intangible low-taxed income ("GILTI") under new § 951A will be treated in the same manner as subpart F inclusions under § 951(a)(1)(A) for purposes of the unrelated business income tax.

Income Tax

Notice 2018–68, page 418.

The notice provides initial guidance on the application of § 162(m) of the Code, as amended by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" (Act), Public Law 115–97 (2017). Section 162(m)(1) generally limits the allowable deduction for a taxable year for remuneration by any publicly held corporation paid with respect to a covered employee. The Act made significant amendments to § 162(m), and also provided a transition rule applicable to certain outstanding arrangements (commonly referred to as the grandfather rule). The notice provides guidance on the amended rules for identifying covered employees and the operation of the grandfather rule.

REV. PROC. 2018–43, page 425.

This revenue procedure provides the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through Exchanges for taxpayers to use in determining their maximum individual shared responsi-

Finding Lists begin on page ii.

bility payment under § 5000A(c)(1)(B) of the Internal Revenue Code and § 1.5000A–4 of the Income Tax Regulations.

REV. RUL. 2018–23, page 405.

Federal rates; adjusted federal rates; adjusted federal long-term rate, the long-term exempt rate, and the blended annual rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for September 2018.

REV. RUL. 2018–24, page 407.

This revenue ruling provides that the exchange of mortgage-backed securities pursuant to the Single Security Initiative does not constitute a taxable exchange for purposes of section 1001 of the Internal Revenue Code.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property (Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7872.)

Rev. Rul. 2018–23

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2018 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2018–23 TABLE 1

Applicable Federal Rates (AFR) for September 2018

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
		Short-term		
AFR	2.51%	2.49%	2.48%	2.48%
110% AFR	2.76%	2.74%	2.73%	2.72%
120% AFR	3.01%	2.99%	2.98%	2.97%
130% AFR	3.27%	3.24%	3.23%	3.22%
		Mid-term		
AFR	2.86%	2.84%	2.83%	2.82%
110% AFR	3.14%	3.12%	3.11%	3.10%
120% AFR	3.44%	3.41%	3.40%	3.39%
130% AFR	3.72%	3.69%	3.67%	3.66%
150% AFR	4.31%	4.26%	4.24%	4.22%
175% AFR	5.03%	4.97%	4.94%	4.92%
		Long-term		
AFR	3.02%	3.00%	2.99%	2.98%
110% AFR	3.33%	3.30%	3.29%	3.28%
120% AFR	3.63%	3.60%	3.58%	3.57%
130% AFR	3.94%	3.90%	3.88%	3.87%

REV. RUL. 2018–23 TABLE 2

Adjusted AFR for September 2018

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	1.90%	1.89%	1.89%	1.88%
Mid-term adjusted AFR	2.17%	2.16%	2.15%	2.15%
Mid-term adjusted AFR	2.29%	2.28%	2.27%	2.27%

REV. RUL. 2018–23 TABLE 3	
Rates Under Section 382 for September 2018	
Adjusted federal long-term rate for the current month	2.29%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months	2.32%

REV. RUL. 2018–23 TABLE 4	
Appropriate Percentages Under Section 42(b)(1) for September 2018	
Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	7.68%
Appropriate percentage for the 30% present value low-income housing credit	3.29%

REV. RUL. 2018–21 TABLE 5	
Rate Under Section 7520 for September 2018	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	3.4%

Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 467.—Certain Payments for the Use of Property or Services

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 7520.—Valuation Tables

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2018. See Rev. Rul. 2018–23, page 405.

Section 1001.—Determination of amount of and recognition of gain or loss
(Also §§ 1.1001–1; 1.1001–3)

Rev. Rul. 2018–24

ISSUE

Does the Conversion (as defined below) constitute a taxable exchange of property for purposes of section 1001 of the Internal Revenue Code?

FACTS

Participation Certificates

The Federal Home Loan Mortgage Corporation (Freddie Mac) acquires mortgages and participation interests in residential mortgage loans (Mortgages) that were originated by unrelated financial institutions and deposits the Mortgages into a trust in exchange for Participation Certificates (PCs), which are sold to investors. Each PC is a pass-through certificate that is backed by the pool of Mortgages that are held in an arrangement that is classified as a trust under § 301.7701–4(c) of the Procedure and Administration Regulations for the benefit of the person that holds the PC. Freddie Mac acts as trustee, depositor, master servicer, administrator, and guarantor with respect to the PCs. As trustee for these trusts, Freddie Mac creates and issues under a trust agreement PCs representing undivided beneficial ownership interests in pools of mortgages and related assets held by those trust funds (Mortgage Pools).

Freddie Mac fulfills its duties as master servicer for the Mortgages by contracting with third parties to perform most servicing functions on Freddie Mac's behalf in accordance with standards that Freddie Mac has established. PC holders receive a coupon with respect to the outstanding principal amount of the Mortgages. Payments on the PCs do not include the amounts of any fees, charges, or interest in excess of the applicable certificate coupon that may be paid on the Mortgages.

In its capacity as administrator of the PCs, Freddie Mac generally pays principal and interest to PC holders on a specified date (Payment Date) in the month following the month in which payments on the underlying Mortgage are received. The Payment Date is generally 45 days following the first day of such preceding month. This period from the time Freddie Mac collects payments from the mortgage servicers to the time that it remits payments to holders on the Payment Date is referred to as the Remittance Cycle. As guarantor of the PCs, Freddie Mac guarantees that PC holders receive timely payments of amounts provided for in the terms of the PC whether or not Freddie Mac receives payments from the servicers of the Mortgages.

Mortgage-Backed Securities

The Federal National Mortgage Association (Fannie Mae) issues Mortgage-Backed Securities (MBSs) to the market. The terms and conditions of MBSs are substantially identical to PCs. In particular, the key features and terms of the MBSs largely align with the key features and terms of the PCs. A difference between PCs and MBSs is their respective Remittance Cycle. While the Remittance Cycle for PCs is 45 days, the Remittance Cycle for MBSs is 55 days, meaning that an MBS holder receives monthly payments 10 days later than a PC holder.

Uniform Mortgage-Backed Securities

Freddie Mac and Fannie Mae are both regulated by the Federal Housing Finance Agency (FHFA). The FHFA proposes to standardize pass-through certificates issued by Freddie Mac and Fannie Mae. Accordingly, the FHFA will require Freddie Mac to cease issuing PCs and Fannie Mae to cease issuing MBSs, and will require both entities to issue Uniform Mortgage-Backed Securities (UMBSs) instead. UMBSs issued by Freddie Mac and Fannie Mae will have the same features and terms, including identical 55-day Remittance Cycles.

Freddie Mac will also permit holders of existing PCs the opportunity to exchange their PC for a UMBS that represents the same proportionate undivided beneficial interest in the pool of Mortgages as their existing PC on a voluntary basis (Conversion). Thus, a PC holder that agrees to the exchange will receive a UMBS that provides for the same coupon rate as the PC coupon rate and is guaranteed to the same extent as the PC they surrender, except that the UMBS will provide for Payment Dates that are determined under a 55-day Remittance Cycle instead of the 45-day Remittance Cycle associated with a PC and a UMBS that is issued in exchange for a PC will be given a new CUSIP number. Freddie Mac will not charge holders of PCs a fee for an exchange made pursuant to the Conversion.

The Make Whole Payment

Because a UMBS provides for a 55-day Remittance Cycle instead of the 45-day Remittance Cycle associated with the corresponding PC, the holder of a UMBS will receive scheduled payments of principal and interest 10 days later than the holder would receive those payments under the PC. Freddie Mac will make a one-time payment to PC holders that choose to participate in the Conversion (Make Whole Payment). The Make Whole Payment will be calculated based on the present value of 10 additional days of payment delay over the expected term of the relevant PC. At present market rates, the amount of the Make Whole Payment is expected to be between 5 and 15 basis points multiplied by the outstanding principal balance of the PC, though a compensation schedule has not been published and the exact amount of compensation is unknown at this time.

The Inducement Fee

For a limited time when Freddie Mac first makes the Conversion available, Freddie Mac may also offer a holder of a PC a payment intended to induce the holder to participate in the Conversion (Inducement Fee). Any Inducement Fee, should it be offered, would be paid to any PC holder that agrees to participate in the Conversion within a timeframe prescribed by Freddie Mac.

The combined amount of the Make Whole Payment and any Inducement Fee will not be more than 25 basis points multiplied by the outstanding principal balance of the PC.

LAW

Section 1001 provides rules for the computation and recognition of gain or loss from a sale or other disposition of property.

Section 1.1001–1(a) of the Income Tax Regulations generally provides that gain or loss is realized upon an exchange of property for other property differing materially either in kind or in extent. *See Cottage Savings Association v. Commissioner*, 499 U.S. 554, 566 (1991), 1991–2 CB 34, 38 ("Under [the Court's] interpretation of section 1001(a), an exchange of property gives rise to a realization event so long as the exchanged properties are 'materially different'—that is, so long as they embody legally distinct entitlements.")

Section 1.1002–1(d) provides that, ordinarily, to constitute an exchange, a transaction must be a reciprocal transfer of property, as distinguished from a transfer of property for a money consideration only.

Section 1.1001–3(a)(1) provides rules for determining whether a modification of the terms of a debt instrument results in an exchange for purposes of § 1.1001–1(a). This section applies to any modification of a debt instrument, regardless of the form of the modification. For example, § 1.1001–3 applies to an exchange of a new instrument for an existing debt instrument, or to an amendment of an existing debt instrument. This section also applies to a modification of a debt instrument that the issuer and holder accomplish indirectly through one or more transactions with third parties.

Section 1.1001–3(b) provides that for purposes of § 1.1001–1(a), a significant modification of a debt instrument results in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent; and a modification that is not a significant modification is not an exchange for purposes of § 1.1001–1(a).

Section 1.1001–3(e) describes when a modification is significant.

Section 1.1001–3(e)(1) provides that (unless an exception applies) a modification is a significant modification only if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant.

Under § 1.1001–3(e)(2)(ii), a modification is treated as significant if it changes the yield of a debt instrument by more than the greater of ¼ of 1 percent (25 basis points) or 5 percent of the annual yield of the unmodified instrument.

Under § 1.1001–3(e)(3), a modification that changes the timing of payments is a significant modification if it results in a material deferral of scheduled payments. *See also* § 1.1001–3(g), Example 2 (deferral of payments tested under § 1.1001–3(e)(2) and (e)(3)).

HOLDING

The Conversion will not constitute a taxable exchange of property for purposes of section 1001.

DRAFTING INFORMATION

The principal author of this revenue ruling is Caitlin Holzem of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, please contact Ms. Holzem at (202) 317-6842 (not a toll-free number).

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 (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).[1] 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 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.

[1] 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 plan for employees (SIMPLE IRA).

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).[2] 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 with respect to the exempt organization partner.[3]

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 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.

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

[2]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).

[3]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.

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 Managementand Budget, North American Industry Classification System (2017), available at 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.[4] 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 orga-

[4]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), *aff'd*, 675 F.2d 244 (9th Cir. 1982); *Service Bolt & Nut Co. Profit Sharing Trust v. Commissioner*, 724 F.2d 519 (6th Cir.1983), *aff'g*, 78 T.C. 812 (1982); Rev. Rul. 98–15, 1998–1 C.B. 718.

nization 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 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 percent + 1 percent)/2 = 2 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, 2018, 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)).[5] 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 nonmember income from multiple sources, such as from a dining facility and from a retail store, would have more 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).[6] 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.

.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 corre-

[5] 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.

[6] 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).

sponding 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 (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@irscounsel.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 number).

Guidance on the Application of Section 162(m)

Notice 2018–68

I. PURPOSE

This notice provides initial guidance on the application of section 162(m) of the Internal Revenue Code (Code), as amended by section 13601 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Public Law 115–97 (2017) (the Act). Section 162(m)(1) generally limits the allowable deduction for a taxable year for remuneration paid by any publicly held corporation with respect to a covered employee. Section 13601 of the Act made significant amendments to section 162(m) and provided a transition rule applicable to certain outstanding arrangements (commonly referred to as the grandfather rule).

Stakeholders have submitted comments indicating that they would benefit from initial guidance on certain aspects of the amendments made by section 13601 of the Act, in particular on the amended rules for identifying covered employees and the operation of the grandfather rule, including when a contract will be considered materially modified so that it is no longer grandfathered. This notice addresses these limited issues. The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) anticipate that further guidance on the amendments made by section 13601 of the Act will be issued in the form of proposed regulations, which will incorporate the guidance provided in this notice.

II. BACKGROUND

Section 162(m)(1) disallows the deduction by any publicly held corporation for applicable employee remuneration paid to any covered employee to the extent that such remuneration for the taxable year exceeds $1,000,000.

A. Amendments to the Definition of Publicly Held Corporation

Section 162(m)(2) defines the term "publicly held corporation" for purposes of identifying the entities subject to the deduction limitation of section 162(m)(1). Before the amendments made by section 13601(c) of the Act, section 162(m)(2) defined the term "publicly held corporation" as any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934. Section 13601(c) of the Act amended the definition of "publicly held corporation" in section 162(m)(2) to mean any corporation which is an issuer (as defined in section 3 of the Securities Exchange Act of 1934) (A) the securities of which are required to be registered under section 12 of the Securities Exchange Act of 1934, or (B) that is required to file reports under section 15(d) of the Securities Exchange Act of 1934.

B. Amendments to the Definition of Covered Employee

Section 162(m)(3) defines the term "covered employee" for purposes of identifying employees whose remuneration may be subject to the deduction limitation under section 162(m)(1). Before the amendments made by section 13601(b) of the Act, section 162(m)(3) defined the term "covered employee" as any employee of the taxpayer if (A) as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is an individual acting in such capacity, or (B) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the four highest compensated officers for the taxable year (other than the chief executive officer). Section 13601(b) of the Act amended the definition of "covered employee" in section 162(m)(3) to mean any employee of the taxpayer if (A) such employee is the principal executive officer (PEO) or principal financial officer (PFO) of the taxpayer at any time during the taxable year, or was an individual acting in such a capacity, (B) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the three highest compensated officers for the taxable year (other than any individual described in subparagraph (A)), or (C) such employee was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

Section 13601(c) of the Act also added flush language to section 162(m)(3) providing that the term "covered employee" includes any employee who would be described in section 162(m)(3)(B) if the reporting described in such subparagraph were required as so described. The legislative history to section 13601 of the Act explains that the term "covered employee" includes "officers of a corporation not required to file a proxy statement but which otherwise falls within the revised definition of a publicly held corporation." House Conf. Rpt. 115–466, 489. Furthermore, the legislative history provides that the term "covered employee" includes "officers of a publicly traded corporation that would otherwise have been required to file a proxy statement for the year (for example, but for the fact that the corporation delisted its securities or underwent a transaction that resulted in the nonapplication of the proxy statement requirement)." *Id.*

C. Amendments to the Definition of Applicable Employee Remuneration

Section 162(m)(4) defines the term "applicable employee remuneration" for purposes of identifying the remuneration of a covered employee that may be subject to the deduction limitation under section

162(m)(1). Section 162(m)(4) generally provides that the term "applicable employee remuneration" means, with respect to any covered employee for any taxable year, the aggregate amount allowable as a deduction for such taxable year (determined without regard to section 162(m)) for remuneration for services performed by such employee (whether or not during the taxable year). Before the amendments made by section 13601(a) of the Act, the term "applicable employee remuneration" did not include remuneration payable on a commission basis (as defined in section 162(m)(4)(B)) or qualified performance-based compensation (as described in section 162(m)(4)(C)). Section 13601(a) of the Act amended the definition of "applicable employee remuneration" in section 162(m)(4) to remove these two exclusions. Section 13601(d) of the Act also amended the definition of "applicable employee remuneration" by adding a special rule for remuneration paid to beneficiaries. As amended, section 162(m)(4)(F) provides that remuneration shall not fail to be applicable employee remuneration merely because it is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee.

D. Grandfather Rule

Section 13601(e) of the Act generally provides that the amendments made to section 162(m) shall apply to taxable years beginning after December 31, 2017. However, section 13601(e) of the Act further provides that the amendments to section 162(m) shall not apply to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date. The text of section 13601(e) of the Act is almost identical to the text of pre-amendment section 162(m)(4)(D), which provides a grandfather rule addressing the initial addition of section 162(m) to the Code and grandfathers remuneration payable under a written binding contract which was in effect on February 17, 1993, and which was not modified thereafter in any material respect before such remuneration was paid. Section 1.162–27(h) of the Income Tax Regulations (Regulations) provides guidance under pre-amendment section 162(m)(4)(D) on the definitions of "written binding contract" and "material modification" for purposes of applying that original grandfather provision.

III. GUIDANCE

A. Application of Amended Definition of Covered Employee

Section 162(m)(3)(A)[7] provides that the term "covered employee" includes any employee who is the PEO or PFO of the publicly held corporation at any time during the taxable year, or was an individual acting in such a capacity.

Section 162(m)(3)(B) provides that a "covered employee" also includes any employee whose total compensation for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the three highest compensated officers for the taxable year (other than the PEO or PFO, or an individual acting in such capacity). Stakeholders have asked whether an employee must have served as an executive officer at the end of the taxable year to be a covered employee under section 162(m)(3)(B). The statutory provisions do not impose an end-of-year requirement, and nothing in the legislative history indicates that Congress intended such a requirement to apply. Accordingly, the Treasury Department and the IRS have determined that there is no end-of-year requirement under section 162(m)(3)(B).

Some commenters have asserted that an end-of-year requirement should apply under section 162(m)(3)(B) because the Securities and Exchange Commission (SEC) rules relating to executive compensation disclosure under the Securities Exchange Act of 1934 require disclosure of the compensation of the registrant's three most highly compensated executive officers other than the PEO and the PFO who were serving as executive officers at the end of the last completed fiscal year. See Item 402 of Regulation S-K, 17 CFR § 229.402(a)(3)(iii).[8] The SEC rules, however, do not limit the disclosure of compensation by reason of an executive officer being among the highest compensated executive officers solely to executive officers who serve at the end of the last completed fiscal year. For example, in addition to requiring the disclosure of the three most highly compensated executive officers (other than the PEO and PFO) who were serving as executive officers at the end of the last completed fiscal year, the SEC rules also require disclosure of the compensation of up to two additional individuals for whom disclosure would have been required pursuant to 17 CFR § 229.402(a)(3)(iii) but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year. See Item 402 of Regulation S-K, 17 CFR § 229.402(a)(3)(iv).[9] Moreover, as previously noted, the section 162(m)(3)(B) statutory language and legislative history do not impose an end-of-year requirement. While certain aspects of section 162(m) are interpreted consistent with the SEC rules, the SEC rules do not serve as the sole basis for interpreting section 162(m).

Stakeholders have also questioned whether an employee whose compensation is not required to be disclosed under the SEC rules could nevertheless be a covered employee under section 162(m)(3)(B). The flush language at the end of section 162(m)(3) provides that the term "covered employee" includes any employee who would be described in section 162(m)(3)(B) if the reporting described there were required. Although this flush

[7]References to section 162(m) in sections III, IV and V of this notice refer to section 162(m) as amended by section 13601 of the Act, except as otherwise explicitly provided herein.

[8]References to Item 402 in this Notice refer to Item 402 of Regulation S-K, 17 CFR § 229.402, which contains the SEC rules regarding the executive compensation disclosure requirements.

[9]*See also* Item 402(m)(2) of Regulation S-K, 17 CFR § 229.402(m)(2) (SEC rules for executive compensation disclosure requirements for smaller reporting companies and emerging growth companies). These rules require disclosure of compensation with respect to (i) all individuals serving as the PEO or acting in a similar capacity during the last completed fiscal year, regardless of compensation level; (ii) the two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year; and (iii) up to two additional individuals for whom disclosure would have been provided based on compensation level but for the fact that the individual was not serving as an executive officer at the end of the last completed fiscal year.

language was added by a conforming amendment under section 13601(c) of the Act, which expanded the definition of publicly held corporation to include issuers required to file reports under section 15(d) of the Securities Exchange Act of 1934, the legislative history clarifies that the flush language was intended to apply more broadly, explaining that this language applies, for example, to a corporation that does not file a proxy statement for the year because it delists its securities. See House Conf. Rpt. 115–466, 489. Thus, executive officers of publicly held corporations can be covered employees under section 162(m)(3)(B) even when disclosure of their compensation is not required under the SEC rules.

Accordingly, the term "covered employee" for any taxable year means any employee who is among the three highest compensated executive officers for the taxable year (other than the PEO or PFO, or an individual acting in such capacity), regardless of whether the executive officer is serving at the end of the publicly held corporation's taxable year, and regardless of whether the executive officer's compensation is subject to disclosure for the last completed fiscal year under the applicable SEC rules. The determination of the amount of compensation used to identify the three most highly compensated executive officers for purposes of section 162(m)(3)(B) is made consistent with the Instructions to Item 402(a)(3) and the Instructions to Item 402(m)(2), 17 CFR § 229.402(a)(3), § 229.402(m)(2). In cases in which a publicly held corporation's last completed fiscal year and the taxable year do not end on the same date (for example, due to a short taxable year as a result of a corporate transaction), the publicly held corporation will have three most highly compensated executive officers under section 162(m)(3)(B) for the taxable year. The Treasury Department and IRS request comments on the application of the SEC executive compensation disclosure rules to determine the three most highly compensated executive officers for a taxable year that does not end on the same date as the last completed fiscal year. Until additional guidance is issued, to determine the three most highly compensated employees for purposes of section 162(m)(3)(B), taxpayers should base their determination upon a reasonable good faith interpretation of the statute, taking into account the guidance provided under this notice.

Pursuant to section 162(m)(3)(C), the term "covered employee" also includes any individual who was a covered employee of the publicly held corporation (or any predecessor) for any taxable year beginning after December 31, 2016. For taxable years beginning prior to January 1, 2018, "covered employees" are identified pursuant to section 162(m)(3) as in effect before the amendments made by section 13601(b) of the Act. Accordingly, covered employees identified for the taxable year beginning during 2017 (in accordance with the pre-amendment rules for identifying covered employees) will continue to be covered employees for taxable years beginning in 2018 and beyond.

The following examples illustrate how these rules apply under certain circumstances, including how their application may differ from the application of the SEC's executive compensation disclosure requirements. For each example, assume that none of the employees were covered employees for the 2017 taxable year (since being a covered employee for the 2017 taxable year would provide a separate and independent basis for classifying that employee as a covered employee for the 2018 taxable year). For each example, assume that the corporation has a fiscal year ending December 31 for SEC reporting purposes.

Example 1. (i) *Facts*. Corporation Z is a calendar year taxpayer and a publicly held corporation within the meaning of section 162(m)(2). Corporation Z is not a smaller reporting company or emerging growth company under the SEC rules. For 2018, Employee A served as the sole PEO of Corporation Z and Employees B and C both served as the PFO of Corporation Z at different times during the year. Employees D, E, and F were, respectively, the first, second, and third most highly compensated executive officers of Corporation Z for 2018 other than the PEO and PFO, and all three retired before the end of 2018. Employees G, H, and I were, respectively, Corporation Z's fourth, fifth, and sixth highest compensated executive officers other than the PEO and PFO for 2018, and all three were serving at the end of 2018. On March 1, 2019, Corporation Z filed its Form 10–K, Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 with the SEC. With respect to Item 11, Executive Compensation (as required by Part III of Form 10–K), Corporation Z disclosed the compensation of Employee A for serving as the PEO, Employees B and C for serving as the PFO, and Employees G, H, and I pursuant to Item 402 of Regulation S-K, 17 CFR § 229.402(a)(3)(iii). Corporation Z also disclosed the compensation of Employees D and E pursuant to Item 402 of Regulation S-K, 17 CFR § 229.402(a)(3)(iv).

(ii) Conclusion: PEO. Because Employee A served as the PEO during 2018, Employee A is a covered employee under section 162(m)(3)(A) for 2018.

(iii) Conclusion: PFO. Because Employees B and C served as the PFO during 2018, Employees B and C are covered employees under section 162(m)(3)(A) for 2018.

(iv) Conclusion: Three Highest Compensated Executive Officers. Even though the SEC rules require Corporation Z to disclose the compensation of Employees D, E, G, H, and I for 2018, Corporation Z's covered employees for 2018 under section 162(m)(3)(B) are Employees D, E, and F, because these are the three highest compensated executive officers other than the PEO and PFO for 2018.

Example 2. (i) *Facts*. Assume the same facts as in *Example 1*, except that Corporation Z is a smaller reporting company or emerging growth company under the SEC rules. Accordingly, with respect to Item 11, Executive Compensation (as required by Part III of Form 10–K), Corporation Z disclosed the compensation of Employee A for serving as the PEO, Employees G and H pursuant to Item 402(m) of Regulation S-K, 17 CFR § 229.402(m)(2)(ii), and Employees D and E pursuant to Item 402(m) of Regulation S-K, 17 CFR § 229.402(m)(2)(iii).

(ii) *Conclusion*. The results are the same as in *Example 1*. For purposes of identifying a corporation's covered employees under section 162(m)(3), it is not relevant whether the SEC rules for smaller reporting companies and emerging growth companies apply to the corporation, nor is it relevant whether the specific executive officers' compensation must be disclosed under the SEC rules applicable to the corporation.

Example 3. (i) *Facts*. Corporation Y is a domestic publicly held corporation within the meaning of section 162(m)(2) for its 2018 taxable year and a calendar year taxpayer. Corporation X is a domestic corporation and a calendar year taxpayer; however, Corporation X is not a publicly held corporation within the meaning of section 162(m)(2) for its 2018 and 2019 taxable years. On July 31, 2019, Corporation X acquires for cash 80% of the only class of outstanding stock of Corporation Y. The group (comprised of Corporations X and Y) elects to file a consolidated income tax return. As a result of this election, Corporation Y has a short taxable year ending on July 31, 2019. Corporation Y does not change its fiscal year for SEC reporting purposes to correspond to the short taxable year. Corporation Y remains a domestic publicly held corporation within the meaning of section 162(m)(2) for its short taxable year ending on July 31, 2019 and its subsequent taxable year ending on December 31, 2019, for which it files a consolidated income tax return with Corporation X.

For Corporation Y's taxable year ending July 31, 2019, Employee N serves as the only PEO, and Employee O serves as the only PFO. Employees J, K, and L are the three most highly compensated executive officers of Corporation Y for the taxable year ending July 31, 2019, other than the PEO and

PFO. As a result of the acquisition, effective July 31, 2019, Employee N ceases to serve as the PEO of Corporation Y. Instead, Employee M begins serving as the PEO of Corporation Y on August 1, 2019. Employee N continues to provide services for Corporation Y and never serves as PEO again (or as an individual acting in such capacity). For Corporation Y's taxable year ending December 31, 2019, Employee M serves as the only PEO, and Employee O serves as the only PFO. Employees J, K, and L continued to be the three most highly compensated executive officers of Corporation Y, other than the PEO and PFO, for the taxable year ending December 31, 2019.

(ii) Conclusion: Employee N. Because Employee N served as the PEO during Corporation Y's taxable year ending July 31, 2019, Employee N is a covered employee for Corporation Y's taxable year ending July 31, 2019. Furthermore, Employee N is a covered employee for Corporation Y's taxable year ending July 31, 2019, even though Employee N's compensation is required to be disclosed pursuant to the SEC executive compensation disclosure rules only for the fiscal year ending December 31, 2019. Because Employee N was a covered employee for Corporation Y's taxable year ending July 31, 2019, Employee N is also a covered employee for Corporation Y's taxable year ending December 31, 2019.

(iii) Conclusion: Employee O. Because Employee O served as the PFO during Corporation Y's taxable years ending July 31, 2019, and December 31, 2019, Employee O is a covered employee for these taxable years. Furthermore, Employee O is a covered employee for Corporation Y's taxable year ending July 31, 2019, even though Employee O's compensation is required to be disclosed pursuant to the SEC executive compensation disclosure rules only for the fiscal year ending December 31, 2019. Employee O would be a covered employee for Corporation Y's taxable year ending December 31, 2019 even if Employee O did not serve as the PFO during this taxable year because Employee O was a covered employee for Corporation Y's taxable year ending July 31, 2019.

(iv) Conclusion: Employees J, K, and L. Employees J, K, and L are covered employees for Corporation Y's taxable years ending July 31, 2019, and December 31, 2019, because these employees are the three highest compensated executive officers for these taxable years. Employees J, K, and L would be covered employees for Corporation Y's taxable year ending December 31, 2019, even if Employees J, K, and L were not the three highest compensated executive officers during this taxable year because Employees J, K, and L were covered employees for Corporation Y's taxable year ending July 31, 2019. Accordingly, Employees J, K, and L would be covered employees for Corporation Y's taxable years ending July 31, 2019 and December 31, 2019, even if their compensation would not be required to be disclosed pursuant to the SEC executive compensation disclosure rules.

(v) Conclusion: Employee M. Because Employee M served as the PEO during Corporation Y's taxable year ending December 31, 2019, Employee M is a covered employee for Corporation Y's taxable year ending December 31, 2019.

B. Remuneration Provided pursuant to a Written Binding Contract

1. Written Binding Contract

The amendments to section 162(m) made by the Act do not apply to remuneration payable under a written binding contract which was in effect on November 2, 2017, and which is not modified in any material respect on or after such date. Remuneration is payable under a written binding contract that was in effect on November 2, 2017, only to the extent that the corporation is obligated under applicable law (for example, state contract law) to pay the remuneration under such contract if the employee performs services or satisfies the applicable vesting conditions. Accordingly, the amendments to section 162(m) made by the Act apply to any amount of remuneration that exceeds the amount of remuneration that applicable law obligates the corporation to pay under a written binding contract that was in effect on November 2, 2017, if the employee performs services or satisfies the applicable vesting conditions.

The Act's amendments to section 162(m) also apply to a written binding contract that is renewed after November 2, 2017. A written binding contract that is terminable or cancelable by the corporation without the employee's consent after November 2, 2017, is treated as renewed as of the date that any such termination or cancellation, if made, would be effective. Thus, for example, if the terms of a contract provide that it will be automatically renewed or extended as of a certain date unless either the corporation or the employee provides notice of termination of the contract at least 30 days before that date, the contract is treated as renewed as of the date that termination would be effective if that notice were given. Similarly, for example, if the terms of a contract provide that the contract will be terminated or canceled as of a certain date unless either the corporation or the employee elects to renew within 30 days of that date, the contract is treated as renewed by the corporation as of that date (unless the contract is renewed before that date, in which case, it is treated as renewed on that earlier date). Alternatively, if the corporation will remain legally obligated by the terms of a contract beyond a certain date at the sole discretion of the employee, the contract will not be treated as renewed as of that date if the employee exercises the discretion to keep the corporation bound to the contract. A contract is not treated as terminable or cancelable if it can be terminated or canceled only by terminating the employment relationship of the employee. A contract is not treated as renewed if upon termination or cancellation of the contract the employment relationship continues but would no longer be covered by the contract. However, if the employment continues after such termination or cancellation, payments with respect to such employment are not made pursuant to the contract (and, therefore, are not grandfathered).

If a compensation plan or arrangement is binding, the amount that is required to be paid as of November 2, 2017, to an employee pursuant to the plan or arrangement will not be subject to the Act's amendments to section 162(m) even though the employee was not eligible to participate in the plan or arrangement as of November 2, 2017. However, the Act's amendments to section 162(m) will apply to such compensation plan or arrangement unless the employee was employed on November 2, 2017, by the corporation that maintained the plan or arrangement, or the employee had the right to participate in the plan or arrangement under a written binding contract as of that date.

2. Material Modification

The Act's amendments to section 162(m) will apply to any written binding contract that is materially modified after November 2, 2017. A material modification occurs when the contract is amended to increase the amount of compensation payable to the employee. If a written binding contract is materially modified, it is treated as a new contract entered into as of the date of the material modification. Thus, amounts received by an employee under the contract before a material modification are not affected, but amounts received subsequent to the material modification are treated as paid pursuant to a new contract, rather than as paid pursuant to a written binding contract in effect on

November 2, 2017. A modification of the contract that accelerates the payment of compensation is a material modification unless the amount of compensation paid is discounted to reasonably reflect the time value of money. If the contract is modified to defer the payment of compensation, any compensation paid or to be paid that is in excess of the amount that was originally payable to the employee under the contract will not be treated as resulting in a material modification if the additional amount is based on either a reasonable rate of interest or a predetermined actual investment (whether or not assets associated with the amount originally owed are actually invested therein) such that the amount payable by the employer at the later date will be based on the actual rate of return on the predetermined actual investment (including any decrease, as well as any increase, in the value of the investment).

The adoption of a supplemental contract or agreement that provides for increased compensation, or the payment of additional compensation, is a material modification of a written binding contract if the facts and circumstances demonstrate that the additional compensation is paid on the basis of substantially the same elements or conditions as the compensation that is otherwise paid pursuant to the written binding contract. However, a material modification of a written binding contract does not include a supplemental payment that is equal to or less than a reasonable cost-of-living increase over the payment made in the preceding year under that written binding contract. In addition, the failure, in whole or in part, to exercise negative discretion under a contract does not result in the material modification of that contract.

The following examples illustrate the rules in this section III.B of this notice. For each example, assume for all relevant years that the corporation is a publicly held corporation within the meaning of section 162(m)(2) and is a calendar year taxpayer.

Example 1. (i) *Facts*. On October 2, 2017, Corporation W executed a 3-year employment agreement with Employee V for an annual salary of $2,000,000 beginning on January 1, 2018. Employee V serves as the PFO of Corporation W for the 2017, 2018, 2019, and 2020 taxable years. The terms of the agreement provide for automatic extensions after the 3-year term for additional 1-year periods, unless the corporation exercises its option to terminate the agreement within 30 days before the end of the 3-year term or, thereafter, within 30 days before each anniversary date. Termination of the employment agreement does not require the termination of Employee V's employment relationship with Corporation W. Under applicable law, the agreement constitutes a written binding contract in effect on November 2, 2017, to pay $2,000,000 of annual salary to Employee V for three years through December 31, 2020.

(ii) *Conclusion*. Employee V is a covered employee for Corporation W's 2018, 2019, and 2020 taxable years. Before the Act's amendments to section 162(m)(3), an individual serving as a PFO was not considered a covered employee. Thus, Employee V is a covered employee solely as a result of the Act's amendment to section 162(m)(3). Because the employment agreement executed on October 2, 2017, is a written binding contract under applicable law to pay Employee V an annual salary of $2,000,000, the Act's amendments to section 162(m) do not apply to Employee V's annual salary. Accordingly, Employee V's annual salary of $2,000,000 for the 2018, 2019, and 2020 taxable years is not subject to the deduction limitation under section 162(m). However, the employment agreement is treated as renewed on January 1, 2021, unless it is previously terminated, and the Act's amendments to section 162(m) apply to any payments made under the employment agreement on or after that date.

Example 2. (i) *Facts*. On December 31, 2015, Employee U, an employee of Corporation V, makes an election to defer the entire amount that would otherwise be paid to Employee U under Corporation V's 2016 annual bonus plan. Pursuant to the deferral election, the bonus, plus earnings based on a predetermined actual investment, is to be paid in a lump sum at Employee U's separation from service. Employee U earns a $200,000 bonus for the 2016 taxable year. Under applicable law, the deferred compensation agreement into which Corporation V and Employee U entered on December 31, 2015 constitutes a written binding contract. On January 1, 2018, Employee U is promoted to serve as PEO of Corporation V. Prior to January 1, 2018, Employee U was never a covered employee as defined in section 162(m)(3). On December 15, 2020, Employee U separates from service and, on that date, Corporation V pays $225,000 (the deferred $200,000 bonus plus $25,000 in earnings) to Employee U.

(ii) *Conclusion*. Employee U is a covered employee for Corporation V's 2020 taxable year because Employee U served as the PEO of Corporation V during the taxable year. Moreover, Employee U is a covered employee for Corporation V's 2020 taxable because Employee U was a covered employee of Corporation V for a prior taxable year beginning after December 31, 2016. Before the Act's amendment to section 162(m)(3), a PEO qualified as a covered employee under section 162(m)(3)(A) only if that employee served as the PEO as of the close of the taxable year, and the rule in section 162(m)(3)(C) did not apply. Thus, Employee U is a covered employee for the 2020 taxable year solely as a result of the Act's amendment to section 162(m)(3). Because, under applicable law, the deferred compensation agreement into which Corporation V and Employee U entered on December 31, 2015, constitutes a written binding contract to pay the bonus plus earnings based on a predetermined actual investment, the Act's amendments to section 162(m) do not apply to the $225,000 payment Corporation V is obligated to pay Employee U at Employee U's separation from service. Accordingly, the $225,000 payment is not subject to the deduction limitation under section 162(m).

Example 3. (i) *Facts*. Employee P serves as the PEO of Corporation U for the 2017 and 2018 taxable years. On February 1, 2017, Corporation U establishes a bonus plan, under which Employee P will receive a cash bonus of $1,500,000 if a specified performance goal is satisfied; the outcome of the performance goal is uncertain on February 1, 2017. The compensation committee retains the right, if the performance goal is met, to reduce the bonus payment to no less than $400,000 if, in its judgment, other subjective factors warrant a reduction. On November 2, 2017, under applicable law, which takes into account the employer's ability to exercise negative discretion, the bonus plan established on February 1, 2017 constitutes a written binding contract to pay $400,000. On March 1, 2018, the compensation committee certifies that the performance goal was satisfied. However, the compensation committee reduces the award to $500,000 due to the sale of certain corporate assets that resulted in the lowering of the fair market value of Corporation U's goodwill. On April 1, 2018, Corporation U pays $500,000 to Employee P. The payment satisfies the requirements of § 1.162–27(e) as qualified performance-based compensation.

(ii) *Conclusion*. Employee P is a covered employee for Corporation U's 2018 taxable year. Prior to the Act's amendment to section 162(m)(4), section 162(m) did not apply to qualified performance-based compensation because such compensation was excluded from the definition of applicable employee remuneration. Thus, the $500,000 payment constitutes applicable employee remuneration solely as a result of the amendment to section 162(m)(4). Because, under applicable law, as of November 2, 2017, the bonus plan established on February 1, 2017, constitutes a written binding contract to pay $400,000, the Act's amendments to section 162(m) do not apply to $400,000 of the $500,000 payment to Employee P. Furthermore, the failure of the compensation committee to exercise negative discretion to reduce the award to $400,000, instead of $500,000, does not result in a material modification of the contract. Accordingly, the $400,000 is not subject to the deduction limitation under section 162(m). The remaining $100,000 of the $500,000 payment is subject to the deduction limitation under section 162(m) regardless of whether the payment satisfies the requirements of § 1.162–27(e) as qualified performance-based compensation.

Example 4. (i) *Facts*. Employee Q serves as the PFO of Corporation T for the 2016, 2017, and 2018 taxable years. On January 4, 2016, Corporation T and Employee Q enter into a nonqualified deferred compensation arrangement that is an account balance plan. Under the terms of the plan, Corporation T will pay Employee Q's account balance on April 1, 2019, but only if Employee Q continues to serve as the PFO through December 31, 2018. Pursuant to the terms of the plan, Corporation T credits $100,000 to Employee Q's account annually for three years on December 31 of each year beginning on December 31, 2016, and credits earnings on each principal amount on each subsequent December 31. The plan also provides that Corporation T may, at any time, amend the plan to either stop or reduce the amount of future credits to the account balance in its discretion; however, Corporation T may not deprive Employee Q of any benefit accrued before the date of any such amendment. Under applicable law, the plan constitutes a written binding contract in effect on November 2, 2017, to pay $100,000 of remuneration that Corporation T credited to the account balance on December 31, 2016. On April 1, 2019, Corporation T pays Employee Q $350,000 (including earnings).

(ii) *Conclusion*. Employee Q is a covered employee for Corporation T's 2019 taxable year. Prior to the Act's amendment to section 162(m)(3), an individual serving as a PFO was not considered a covered employee. Thus, Employee Q is a covered employee solely as a result of the amendment to section 162(m)(3). Because, as of November 2, 2017, the nonqualified deferred compensation arrangement between Corporation T and Employee Q is a written binding contract under applicable law only with respect to the $100,000 credited as of that date, the Act's amendments to section 162(m) do not apply to $100,000 of the payment. Accordingly, $250,000 of the $350,000 payment (the difference between the $350,000 payment on April 1, 2019 and the $100,000 credited to the account balance on December 31, 2016) is subject to the deduction limitation under section 162(m).

Example 5. (i) *Facts*. Assume the same facts as in *Example 4*, except that under the plan earnings are credited quarterly; thus, under applicable law, the plan constitutes a written binding contract in effect on November 2, 2017, to pay the account balance as of November 2, 2017, to Employee Q on April 1, 2019. On November 2, 2017, the account balance under the plan is $110,000 (the $100,000 credited on December 31, 2016, plus earnings).

(ii) *Conclusion*. Employee Q is a covered employee for Corporation T's 2019 taxable year. Prior to the Act's amendment to section 162(m)(3), an individual serving as a PFO was not considered a covered employee. Thus, Employee Q is a covered employee solely as a result of the Act's amendment to section 162(m)(3). Because the nonqualified deferred compensation arrangement between Corporation T and Employee Q is a written binding contract under applicable law to pay only the $110,000 account balance as of November 2, 2017, to Employee Q on April 1, 2019, the Act's amendments to section 162(m) do not apply to $110,000 of the $350,000 payment. Accordingly, $240,000 of the $350,000 payment (the difference between the $350,000 payment on April 1, 2019 and the $110,000 account balance on November 2, 2017) is subject to the deduction limitation under section 162(m).

Example 6. (i) *Facts*. Assume the same facts as in *Example 4*, except that, Employee Q serves as PEO (rather than PFO) of Corporation T for the 2016, 2017, and 2018 taxable years, and continues to serve as the PEO through December 31, 2019.

(ii) *Conclusion*. Employee Q is a covered employee for Corporation T's 2019 taxable year because Employee Q served as the PEO of Corporation T during the taxable year. Moreover, Employee Q is a covered employee for Corporation T's 2019 taxable year because Employee Q was a covered employee of Corporation T for a prior taxable year beginning after December 31, 2016. Prior to the Act's amendments to section 162(m)(3)(A), a PEO was a covered employee if such employee served as the PEO as of the close of the taxable year. Because Employee Q continues to serve as the PEO through December 31, 2019, Employee Q is a covered employee not solely as a result of the amendments to section 162(m)(3). Accordingly, the entire $350,000 payment is subject to the deduction limitation under section 162(m).

Example 7. (i) *Facts*. On January 2, 2017, Corporation S executed a 4-year employment agreement with Employee R to serve as its PEO. Employee R serves as the PEO of Corporation S for four years and receives an annual salary of $1,000,000. Pursuant to the employment agreement, on January 2, 2017, Corporation S granted to Employee R nonstatutory stock options to purchase 1,000 shares of Corporation S stock, stock appreciation rights (SARs) on 1,000 shares, and 1,000 shares of Corporation S restricted stock. On the date of grant, the stock options had no readily ascertainable fair market value as defined in § 1.83–7(b) and neither the stock options nor the SARs provided for a deferral of compensation under section 409A and § 1.409A–1(b)(5)(i)(A). The stock options and SARs vest and become exercisable on January 2, 2019. Employee R can exercise the stock options and the SARs at any time from January 2, 2019, through January 2, 2022. On January 2, 2019, Employee R exercises the stock options and the SARs, and the 1,000 shares of restricted stock become substantially vested (as defined in § 1.83–3(b)). The grants of the stock options, SARs, and shares of restricted stock constitute a written binding contract under applicable law. The compensation attributable to the stock options and the SARs satisfy the requirements of § 1.162–27(e) as qualified performance-based compensation.

(ii) *Conclusion*. Employee R is a covered employee for Corporation S's 2019 taxable year. Because the January 2, 2017, grants of the stock options, SARs, and shares of restricted stock constitute a written binding contract in effect on November 2, 2017, under applicable law, the Act's amendments to section 162(m) do not apply to compensation received pursuant to the exercise of the stock options and the SARs, or the restricted stock becoming substantially vested (as defined in § 1.83–3(b)). Section 162(m) does not disallow Corporation S's deduction for compensation attributable to the stock options or the SARs, because the compensation satisfies the requirements of § 1.162–27(e) as qualified performance-based compensation, and the Act's elimination of the exception for qualified performance-based compensation does not apply. However, Corporation S's deduction for the compensation attributable to the restricted stock is disallowed by section 162(m) even though the Act's amendments do not apply to this compensation.

Example 8. (i) *Facts*. Assume the same facts as in *Example 7*, except that the employment agreement provides that the stock options, SARs, and restricted stock will be granted on January 2, 2018, subject to the approval of the board of directors of Corporation S. As of November 2, 2017, under applicable law, the potential grants of stock options, SARs, and restricted stock do not constitute a written binding contract.

(ii) *Conclusion*. Because, under applicable law, as of November 2, 2017, the potential grants of the stock options, SARs, and shares of restricted stock do not constitute a written binding contract, the Act's amendments to section 162(m) apply to compensation paid pursuant to the exercise of the stock options and SARs, and the restricted stock becoming substantially vested (as defined in § 1.83–3(b)). Accordingly, section 162(m) disallows Corporation S's deduction with respect to compensation attributable to the stock options, SARs, and restricted stock.

Example 9. (i) *Facts*. On January 2, 2015, Corporation R executes a deferred compensation agreement with Employee T providing for a payment of $3,000,000 if Employee T continues to provide services through December 31, 2017. On October 2, 2017, Employee T terminates employment with Corporation R, executes an employment agreement with Corporation Q to serve as its PFO, and commences employment with Corporation Q. The employment agreement, which is a written binding contract under applicable law, provides that, on April 1, 2018, Employee T will participate in the nonqualified deferred compensation plan available to all executive officers of Corporation Q and that Employee T's benefit accrued on that date will be $3,000,000. On April 1, 2021, Employee T receives a payment of $4,500,000, which is the entire benefit accrued under the plan.

(ii) *Conclusion*. Employee T is a covered employee for Corporation Q's 2021 taxable year. Before the Act's amendment to section 162(m)(3), an individual serving as a PFO was not considered a covered employee. Thus, Employee T is a covered employee solely as a result of the Act's amendment to section 162(m)(3). Even though Employee T was not eligible to participate in the nonqualified deferred compensation plan on November 2, 2017, Employee T was employed on November 2, 2017 and had the right to participate in the plan under a written binding contract as of that date. Because, as of November 2, 2017, the amount that is required to be paid pursuant to the written binding contract is $3,000,000, the Act's amendments to section 162(m) do not apply to $3,000,000 of the $4,500,000 payment made on April 1, 2021. Accordingly, $1,500,000 of the $4,500,000 payment (the difference between the $4,500,000 payment and the $3,000,000 grandfathered amount) is subject to the deduction limitation under section 162(m).

Example 10. (i) *Facts*. Corporation P executed a 5-year employment agreement with Employee S on January 1, 2017, providing for a salary of $1,800,000 per year to serve as Corporation P's PFO. The agreement constitutes a written binding contract under applicable law. In 2017 and 2018, Employee S receives the salary of $1,800,000 per year. In 2019, Corporation P increases Employee S's compensation with a supplemental payment of $40,000. On January 1, 2020, Corporation P increases Employee S's salary to $2,400,000.

(ii) *Conclusion: $40,000 Payment in 2019*. Employee S is a covered employee for Corporation P's 2018, 2019, and 2020 taxable years. Before the Act's amendment to section 162(m)(3), an individual serving as a PFO was not considered a covered employee. Thus, Employee S is a covered employee solely as a result of the Act's amendment to section 162(m)(3). Accordingly, the salary of $1,800,000 per year payable to Employee S under the employment agreement, which is a written binding contract under applicable law, is grandfathered unless the change in Employee S's compensation in either 2019 or 2020 is a material modification. The $40,000 supplemental payment does not constitute a material modification of the written binding contract because the $40,000 payment is less than or equal to a reasonable cost-of-living increase from 2017. However, the $40,000 supplemental payment is subject to the Act's amendments to section 162(m). Therefore, section 162(m) disallows Corporation P's deduction for the $40,000 supplemental payment, but does not disallow any portion of Corporation P's deduction for the $1,800,000 salary.

(iii) *Conclusion: Salary Increase to $2,400,000 in 2020*. The $560,000 increase in salary in 2020 is a material modification of the written binding contract because the additional compensation is paid on the basis of substantially the same elements or conditions as the compensation that is otherwise paid pursuant to the written binding contract and it is greater than a reasonable, annual cost-of-living increase. Because the written binding contract is materially modified as of January 1, 2020, all compensation paid to Employee S in 2020 and thereafter is subject to the Act's amendments to section 162(m). Therefore, section 162(m) disallows Corporation P's deduction for Employee S's compensation in excess of $1,000,000.

Example 11. (i) *Facts*. Assume the same facts as in *Example 10*, except that instead of an increase in salary, Employee S receives a restricted stock grant subject to Employee S's continued employment for the balance of the contract.

(ii) *Conclusion*. The restricted stock grant is not a material modification of the written binding contract because any additional compensation paid to Employee S under the grant is not paid on the basis of substantially the same elements and conditions as Employee S's salary because it is based both on the stock price and Employee S's continued service. However, compensation attributable to the restricted stock grant is subject to the Act's amendments to section 162(m). Therefore, section 162(m) disallows Corporation P's deduction for the restricted stock, but does not disallow any portion of Corporation P's deduction for the $1,800,000 salary.

IV. EFFECTIVE DATE

The Act's amendments to section 162(m) apply to taxable years beginning on or after January 1, 2018. The Treasury Department and the IRS anticipate that the guidance in this notice will be incorporated in future regulations that, with respect to the issues addressed in this notice, will apply to any taxable year ending on or after September 10, 2018. Any future guidance, including regulations, addressing the issues covered by this notice in a manner that would broaden the definition of "covered employee" as described under section III.A, or restrict the application of the definition of "written binding contract" as described in section III.B, will apply prospectively only.

V. REQUEST FOR COMMENTS

The Treasury Department and the IRS anticipate issuing further guidance on other aspects of section 162(m), including the Act's amendments to section 162(m). Accordingly, comments are requested on additional issues under section 162(m) that future guidance, including regulations, should address. Specifically, comments are requested on (1) the application of the definition of "publicly held corporation" to foreign private issuers, including the reference to issuers that are required to file reports under section 15(d) of the Securities Exchange Act of 1934, (2) the application of the definition of "covered employee" to an employee who was a covered employee of a predecessor of the publicly held corporation, (3) the application of section 162(m) to corporations immediately after they become publicly held either through an initial public offering or a similar business transaction, and (4) the application of the SEC executive compensation disclosure rules for determining the three most highly compensated executive officers for a taxable year that does not end on the same date as the last completed fiscal year.

Written comments may be submitted through November 9, 2018. Comments should include a reference to Notice 2018–68. Send submissions to CC:PA:LPD:PR (Notice 2018–68), Room 5203, Internal Revenue Service, 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 CC:PA:LPD:PR (Notice 2018–68), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the following e-mail address: Notice.comments@irscounsel.treas.gov. Please include "Notice 2018–68" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

VI. DRAFTING INFORMATION

The principal author of this notice is Ilya Enkishev of the Associate Chief Counsel (Tax Exempt and Government Entities), although other Treasury and IRS officials participated in its development. For further information on the provisions of this notice, contact Ilya Enkishev at (202) 317-5600 (not a toll-free number).

Rev. Proc. 2018–42

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 2017–41, 2017–29 I.R.B. 92, to extend the deadline for submitting on-cycle applications for opinion letters for pre-approved defined contribution plans for the third six-year remedial amendment cycle to December 31, 2018. Under Rev. Proc. 2017–41, this submission period is scheduled to expire on October 1, 2018.

SECTION 2. BACKGROUND

.01 Rev. Proc. 2016–37, 2016–29 I.R.B. 136, provides that every pre-approved plan has a regular, six-year remedial amendment cycle. Under Rev. Proc. 2016–37, the third six-year remedial amendment cycle for pre-approved defined contribution plans began on February 1, 2017, and ends on January 31, 2023. Rev. Proc. 2016–37 also provides that the 12-month on-cycle submission period for pre-approved defined contribution plans was scheduled to begin on August 1, 2017, and end on July 31, 2018.

.02 Rev. Proc. 2017–41 modified the pre-approved letter program by combining the master & prototype and volume submitter programs into a new Opinion Letter program. Under this program, providers of pre-approved plans may apply for new opinion letters once every six years. Rev. Proc. 2017–41 sets forth the procedures for obtaining opinion letters for qualified pre-approved plans submitted with respect to the third (and subsequent) six-year remedial amendment cycles. Rev. Proc. 2017–41 modified the on-cycle submission period for pre-approved defined contribution plan providers to submit applications for opinion letters for the third six-year remedial amendment cycle to begin on October 2, 2017, and end on October 1, 2018.

SECTION 3. MODIFICATION OF REV. PROC. 2017–41

This revenue procedure extends the October 1, 2018 submission deadline in Rev. Proc. 2017–41 to December 31, 2018. Accordingly, sections 1.02, 3.10, and 9.02 of Rev. Proc. 2017–41 are revised to replace October 1, 2018, with December 31, 2018.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2017–41 is modified.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective as of August 15, 2018.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in Rev. Proc. 2017–41 has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1674.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Kathleen Herrmann of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure or submissions under Rev. Proc. 2017–41, contact Employee Plans at (513) 975-6319 (not a toll-free number).

---

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

Rev. Proc. 2018–43

SECTION 1. PURPOSE

This revenue procedure provides the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through Exchanges for taxpayers to use in determining their maximum individual shared responsibility payment under § 5000A(c)(1)(B) of the Internal Revenue Code and § 1.5000A–4 of the Income Tax Regulations.

SECTION 2. BACKGROUND

.01 Section 5000A provides that if a taxpayer, or an individual for whom the taxpayer is liable, is without minimum essential coverage for one or more months in a taxable year, then the taxpayer is liable for the individual shared responsibility payment when filing his or her federal income tax return, unless an exemption applies. *See* § 5000A(a), (b)(1). In general, under § 5000A a taxpayer is liable for any individual who is a dependent, as defined in § 152, of the taxpayer. *See* §§ 5000A(b)(3)(A) and 1.5000A–1(c). Married individuals who file a joint return for a taxable year are jointly liable for any individual shared responsibility payment for a month included in the taxable year. *See* §§ 5000A(b)(3)(B) and 1.5000A–1(c)(3).

.02 For each taxable year, the individual shared responsibility payment is the lesser of (1) the sum of the monthly penalty amounts, or (2) the sum of the monthly national average bronze plan premiums for the shared responsibility family. *See* § 1.5000A–4(a). The monthly national average bronze plan premium means, for a month for which a shared responsibility payment is imposed, 1/12 of the annual national average premium for qualified health plans that (1) have a bronze level of coverage, (2) would provide coverage for the taxpayer's shared responsibility family members, and (3) are offered through Exchanges for plan years beginning in a calendar year with or within which the taxable year ends. *See* §§ 5000A(c)(1)(B) and 1.5000A–4(c). Shared responsibility family means, for a month in a taxable year, all nonexempt individuals for whom the taxpayer and the taxpayer's spouse, if the taxpayer is married and files a joint return with the spouse, are liable for the shared responsibility payment under § 5000A for that taxable year. *See* § 1.5000A–1(d)(17).

.03 Revenue Procedure 2014–46, 2014–12 C.B. 367, describes the methodology used to determine the monthly national average bronze plan premium and provides the premium amount for 2014. Revenue Procedure 2015–15, 2015–5 I.R.B. 564, provides the premium amount for 2015. Revenue Procedure 2016–43, 2016–36 I.R.B. 316, provides the premium amount for 2016. Revenue Procedure 2017–48, 2017–36 I.R.B. 229, provides the premium amount for 2017.

SECTION 3. MONTHLY NATIONAL AVERAGE BRONZE PLAN PREMIUM

.01 *Monthly National Average Bronze Plan Premium*. For purposes of § 5000A(c)(1)(B) and § 1.5000A–4, the monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through Exchanges is $283 per individual.

.02 *Maximum Monthly National Average Bronze Plan Premium*. For purposes of § 5000A(c)(1)(B) and § 1.5000A–4, the maximum monthly national average premium for qualified health plans that have a bronze level of coverage and are offered through Exchanges is $1,415 for a shared responsibility family with five or more members.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending after December 31, 2017.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Revenue Procedure 2017–48 is superseded.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is James Beatty of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Beatty at (202) 317-7006 (not a toll-free number).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletin 2018–27 through 2018–36

Announcements:

Notices:

Proposed Regulations:

Revenue Procedures:

Revenue Rulings:

Treasury Decisions:

[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–01 through 2018–26 is in Internal Revenue Bulletin 2018–26, dated June 27, 2018.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2018–27 through 2018–36

Revenue Procedures:

2015-27
Amplified by
Rev. Proc. 2018-39, 2018-34 I.R.B. *319*

2017-24
Amplified by
Rev. Proc. 2018-39, 2018-34 I.R.B. *319*

[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–01 through 2018–26 is in Internal Revenue Bulletin 2018–26, dated June 27, 2018.

Internal Revenue Service
Washington, DC 20224

Official Business
Penalty for Private Use, $300

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page (*www.irs.gov*) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.