from all unrelated trades or businesses less deductions. Section 512(a)(6) now requires UBTI ...

Sep. 26, 2018

The Internal Revenue Service (IRS) recently released Notice 2018-67 (Notice), providing tax-exempt organizations needed guidance on Internal Revenue Code Section 512(a)(6), the provision in the new Tax Cuts and Jobs Act requiring calculation of unrelated business taxable income (UBTI) separately for each unrelated trade or business. While the IRS still intends to issue proposed regulations

on this issue, the Notice provides guidelines to help exempt organizations compute

In enacting this change, Congress did not provide criteria for determining whether an exempt organization has more than one unrelated trade or business or how to identify them, but the Notice provides interim guidance that exempt organizations can rely on in reporting UBTI on their 2018 Form 990-Ts.

Under the Notice, when determining if an exempt organization has more than one unrelated trade or business, it may rely on a reasonable, good-faith interpretation of the law, including use of the North American Industry Classification System (NAICS) codes. For example, an organization's advertising activities and related services, reported under the same NAICS code, might be considered one unrelated trade or business activity, regardless of the source of the income.

Perhaps the most important part of the Notice pertains to reporting income from investment partnerships. 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 to include in UBTI its distributive share of gross partnership income (and directly connected partnership deductions) from the unrelated trade or business. Following comments from the nonprofit community on the administrative burden imposed by this section, the IRS intends to issue proposed regulations that would permit aggregation of gross income and directly connected deductions from such "investment activities."

Until regulations are issued, the Notice provides an **interim rule** allowing an organization to aggregate its UBTI from its interest in a single partnership with multiple trades or businesses, including trades or businesses conducted by lower-tier partnerships. This rule can be used if the directly-held partnership interest meets the requirements of either the de minimis test or the control test:

De minimis test – The partnership interest qualifies if the exempt organization holds no more than 2 percent of the profits interest and no more than 2 percent of the

capital interest. Percentage interests held by certain related organizations and

business, whether or not there is more than one trade or business conducted by the partnership or lower-tier partnerships. Thus, an exempt organization can treat each partnership interest acquired prior to August 21, 2018 as a single trade or business for purposes of computing UBTI.

The Notice addresses other issues, including the effect of Section 512(a)(7), which increases UBTI for certain qualified transportation fringe benefits and qualified parking. The Notice states that UBTI created from 512(a)(7) is not income derived from an unrelated trade or business, and thus any amount included in UBTI under Section 512(a)(7) is not subject to Section 512(a)(6).

Similarly, the Notice provides that income reported as unrelated business income, reported unrelated debt-financed income, reported specified payments from controlled entities, and reported certain insurance income, do not have a nexus to an unrelated trade or business. However, aggregating income included in UBTI under these provisions "may be appropriate in certain circumstances."

Finally, the Notice covers the use of net operating loss (NOL) carryforwards. These NOL carryforwards can be used against UBTI calculated under Section 512(a)(6). The organization first calculates UBTI for each separate trade or business, and then applies an NOL carryforward to those trades or businesses with UBTI. In effect, post-2017 NOLs will be calculated and taken before pre-2018 NOLs.

Notice 2018-67 is a good first step in providing exempt organizations some guidance on this one provision in the new law, but more guidance on tax changes for exempt organizations is still to come.

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