



Tax Cuts and Jobs Act – Modified Rules for UBTI

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FIFTH IN A SERIES

Tax exempt organizations and retirement plan trusts (with the exception of certain governmental trusts) are generally exempt from income tax under Internal Revenue Code (“Code”) Section 501(a). The Tax Cuts and Jobs Act (Public Law 115-97) passed by Congress at the close of 2017 modifies the rules governing the taxable income of exempt organizations and trusts—*i.e.*, “unrelated business taxable income” or “UBTI”—effective for tax years beginning after December 31, 2017.

This is the fifth in a series of articles by which the Spencer Fane LLP Employee Benefits Practice Team will explain many of the key changes the Act made in the employee benefits area.

PRIOR LAW

UBTI is the income of a tax exempt organization which results from a trade or business activity that is regularly carried on by the organization and not substantially related to the organization's exempt purposes. Certain types of income, including dividends, interest, royalties and certain rents do *not* constitute UBTI.

In the case of a retirement trust, investments in partnership entities which actively operate a trade or business may generate UBTI, necessitating the filing of IRS Form 990-T with respect to the partnership income attributable to the retirement trust.

Under the prior law, organizations and trusts were permitted to deduct expenses associated with unrelated trade or business activities. For example, tax exempt organizations carrying on more than one unrelated business activity could use deductions and losses from one activity to offset income from another unrelated business activity. Similarly, a retirement trust invested in multiple partnership entities could apply the losses from one investment to offset income from another.

KEY CHANGES

The Tax Cuts and Jobs Act modifies the UBTI rules by requiring exempt organizations and trusts to segregate each unrelated trade or business activity for purposes of determining net income, deductions and net operating losses (“NOLs”). An organization or trust's total UBTI will now be computed by adding together the net UBTI of each separate unrelated trade or business. However, for this purpose the net UBTI of each separate unrelated trade or business may not be less than zero. Thus, a net loss from one unrelated trade or business activity cannot be netted against others, instead generating an activity-specific NOL which may only be used to offset future income of that activity. Pre-2018 NOLs are grandfathered and not subject to the segregation rule.

The new law raises many questions which will hopefully be addressed in the near term in regulations. For example, retirement plans will need to know how to determine what constitutes a separate trade or business in the context of partnership investments generating UBTI.

GOVERNMENTAL TRUSTS NOT SUBJECT TO UBTI

Governmental trusts performing essential government functions, including governmental retirement plan trusts, are generally exempt from income tax under Code Section 115. The House version of the new tax law contained a provision which would have subjected Section 115 governmental trusts (*e.g.*, trusts holding the assets of governmental pension plans) to tax on UBTI. The Senate version of the bill did *not* include this House provision. The final bill adopted the Senate approach and, as result, Section 115 governmental trusts will *not* be subject to the UBTI

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rules. There remain unresolved issues for certain governmental and quasi-governmental trusts with regard to UBTI, which are not addressed under the final bill. However, the status quo continues for Section 115 trusts with respect to exemption from the UBTI rules.

PLANNING FOR NEW UBTI RULES

Tax exempt organizations and retirement trusts with more than one significant unrelated business activity should evaluate the impact of the new segregated accounting rules. The first step is to consult with accountants to identify planning and tax saving opportunities. Until the IRS issues regulations to clarify the new law, however, important questions cannot be fully answered. The Spencer Fane Employee Benefits Team will monitor further guidance in this area and is available to help employers evaluate these new rules.

View the other articles in the Tax Cuts and Jobs Act series [here](#).

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