



## Not-for-Profit Organizations Practice Group

### Monitoring and Advance Planning for Unrelated Business Taxable Income Are Now Critical

Syracuse, New York

August 2018

The Tax Cuts and Jobs Act added Section 512(a)(6) to the Internal Revenue Code. As a result, a Section 501(c)(3) organization (an exempt organization) with more than one unrelated trade or business activity is required to calculate unrelated business taxable income (UBTI) separately for each trade or business. Prior to the addition of Section 512(a)(6), an exempt organization which engaged in more than one unrelated trade or business determined UBTI on an aggregate basis, that is, all gross income from all unrelated trade or business activities less all of the allowable deductions for such activities. New Section 512(a)(6) increases the likelihood of positive UBTI for exempt organizations conducting multiple trades or businesses and makes monitoring these activities and planning for the tax consequences critical.

In the advance version of Notice 2018-67 (the Notice) released August 21, 2018, the IRS requests comments regarding the issues arising under Section 512(a)(6) and provides interim guidance that may be relied on prior to issuance of proposed regulations.

New Section 512(a)(6) provides 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." Section 512(a)(6) applies to taxable years beginning after December 31, 2017, but not to net operating losses arising before January 1, 2018, that are carried over to taxable years beginning on or after such date.

Congress left it to the IRS to flesh out many of the details including what activities constitute a separate trade or business. The Notice sets forth general interim rules for, among other things, determining whether an exempt organization engages in more than one trade or business and identifying separate trades or businesses.

Code Sections 511 through 514 govern determining what activities constitute an unrelated trade or business and calculating UBTI. The Notice contemplates using "a reasonable, good-faith interpretation" of these sections, considering all the facts and circumstances, for purposes of new Section 512(a)(6). To determine whether an exempt organization has more than one unrelated trade or business, the Notice states that "a reasonable, good-faith interpretation" includes using the North American Industry Classification System (NAICS) 6-digit codes and notes that the fragmentation principle may also be helpful. 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."



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For purposes of identifying separate trades or businesses, the Notice discourages use of a facts and circumstances analysis and provides that prior to proposed regulations, the IRS will consider the use of NAICS 6-digit codes to be "a reasonable, good-faith interpretation."

The Notice discusses the treatment of net operating losses (NOL) under Section 512(a)(6) and the allocation of deductions and income between exempt purposes and separate trade and business activities and provides guidance on applying Section 512(a)(6) when an exempt organization is a partner in a partnership that conducts a trade or business or has unrelated debt-financed income.

To download the Notice, click here: <https://www.irs.gov/pub/irs-drop/n-18-67.pdf>. Comments are due December 3, 2018.

Exempt organizations should closely monitor the activities, revenues and expenses of separate trades or businesses, especially at year end when income deferral and expense planning may be most significant. Contact the attorneys in our Tax Practice Area with questions on Section 512(a)(6) or the Notice and for assistance in preparing comments to submit to the IRS.

## Bousquet Holstein Not-for-Profit Organizations Practice Group

Our team of attorneys represents not-for-profit organizations in all aspects of their operations and management. The legal needs of our clients cover the spectrum of the firm's practice areas and as a result, attorneys in various practice areas of the firm have experience advising not-for-profit organizations. Our work on behalf of not-for-profit organizations includes compliance with federal and state exempt organization tax laws. If we can provide you with additional insight and information please contact:

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