On December 22, 2017, the Tax Cuts and Jobs Act (the Act) was signed into law, and it amended, among other things, the unrelated business taxable income (UBTI) provisions applicable to tax-exempt organizations effective for tax years beginning after December 31, 2017. The Act contains a requirement that each trade or business activity of a tax-exempt organization, including a tax-exempt social club, be separately computed in determining UBTI.

The Act: IRC Section 512(a)(6)

An exempt organization with more than one unrelated trade or business can no longer aggregate the income and deductions from all unrelated business activities in computing its UBTI. The Act added Internal Revenue Code (IRC) Section 512(a)(6) that requires exempt organizations with one or more unrelated trades or businesses to compute UBTI separately with respect to each unrelated trade or business, including for purposes of determining any net operating loss deduction.

IRC Section 512(a)(6) provides, in part, that in the case of any organization with more than one unrelated trade or business:

a) Unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business; and
b) The unrelated business taxable income of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business.

Simply stated, the Act requires tax-exempt organizations conducting more than one unrelated trade or business to calculate UBTI separately for each unrelated trade or business. This practice effectively prohibits using losses arising from one specific unrelated trade or business to offset income from another unrelated trade or business. A key unanswered question under the Act is which activities may be considered a singular unrelated activity for purposes of calculating UBTI? Regrettably, the Act does not stipulate what makes up a separate unrelated trade or business.

Pre-Act Law and the Club

To some extent, tax-exempt clubs, pre-Act, segregated investment income and nonmember income in determining their UBTI. For example, a social club operated a food and beverage concession for nonmembers, and it consistently sold food and beverages at prices insufficient to cover the cost of sales. Would the social club deduct from its net investment income losses incurred on sales of food and beverage to nonmembers? No, a tax-exempt social club’s sales of food and beverages to nonmembers, which were determined to not be profit motivated because its prices were insufficient to recover costs, could not, in determining its UBTI, reduce its net investment income by the losses from these nonmember sales.

The Act and the Club

While the nonmember losses, as a general matter, could not be deducted from investment income pursuant to Revenue Ruling 81-69, the computation of UBTI under the Act is in flux. As we previously noted, the Act requires exempt organizations conducting more than one unrelated trade or business to calculate UBTI separately for each unrelated trade or business, but the Act does not stipulate what makes up a separate unrelated trade or business.

- **Investments**—unrelated business income from investments, such as stocks, mutual funds, bonds, alternative investments and partnerships. Will the Internal Revenue Service (IRS) require that the unrelated business income of each category of investments to be separately computed?
- **Rental income**—unrelated business income from nonmember rental income. Will nonmember overnight room rental activities have to be separately considered from cell tower rental activities?
- **Nonmember revenues**—unrelated business income from nonmember greens fees and food and beverage activities. Will the IRS require that the unrelated business income, and the related tax, from nonmember golf activities to be separately computed from food and beverage activities?

These are interesting questions without definitive answers. How should clubs proceed? Clubs generally do a fine job with their record keeping with respect to revenues and expenses. We recommend that they continue doing so.

Treasury Regulations: New UBTI Inclusions

Treasury regulations are expected to be promulgated for purposes of providing guidance with respect to the new UBTI inclusions. That being said, the regulatory process typically does not occur at a rapid pace. It is imperative to remain vigilant with respect to monitoring IRS regulatory advisories.

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