This article presents general guidelines for Georgia nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

New Rules for UBIT: What You Need to Know About Siloing

Section 501(c)(3) tax-exempt organizations generally have to pay tax on income from a trade or business that is regularly carried on and that is not substantially related to the organization's exempt purpose (known as "unrelated business income tax" or UBIT[1]). Under the 2017 Tax Cuts and Jobs Act ("TCJA"), tax-exempt organizations have to calculate the UBIT owed differently. Before the TCJA, tax-exempt organizations that regularly conducted two or more unrelated trades or businesses were permitted to report combined net taxable income (gross income less aggregate deductions) from those activities, thereby reducing the amount of UBIT owed. Under the TCJA, tax-exempt organizations with multiple unrelated business activities can no longer offset income from one activity with losses from another activity.

This article is intended to ***very generally*** explain the changes under the TCJA, using a hypothetical charity. Charity A's purpose is to provide housing and educational opportunities to refugees from Central Africa, and to educate the public about the difficulties these refugees face. Charity A owns an apartment complex, which it uses to provide housing for refugees. Charity A also owns a property with a three-story office building and a parking lot and has a mortgage on the property. Charity A uses most of the office building for its nonprofit activities, but also runs a coffee shop in it. Charity A regularly produces a newsletter, posts on its social media accounts, and hosts a podcast to teach the public about its mission and work, and regularly sells commercial advertising spots in each. Charity A also provides paid public parking in its lot from Friday evening through Sunday for nearby restaurants.

Charity A is conducting three separate businesses that are unrelated to Charity A's mission:

1. Selling commercial advertising on its newsletter, social media accounts, and podcast;
2. Running the coffee shop; and
3. Providing paid public parking on weekends.

[1] For further background on UBIT, see the following articles: UBIT: Four Letters Your Nonprofit Needs to Know and UBIT: Is Income Generated by Your Training Program Taxable; and our webcast on UBIT here.

Because each of these businesses is unrelated to Charity A's mission (and for the purpose of this hypothetical, do not qualify for one of the IRS' exceptions, exclusions or modifications), they are subject to UBIT. This is true even if all the proceeds from these activities are put back into the organization to support its exempt activities.

Before the TCJA, a 501(c)(3) organization could combine the net income (revenue less expenses) from all of these unrelated businesses together. A nonprofit might have one successful unrelated business activity that generated net income and another unrelated business activity that consistently lost money. That organization might continue operating both businesses in order to take advantage of the tax benefits of offsetting the losses from the unsuccessful business against the income from the successful business. For example, if in a given year Charity A loses money by operating the coffee shop, but has net income from selling commercial advertising, Charity A could have used the losses from the coffee shop to offset the advertising income and thus reduce its total UBIT. But under the TCJA, income, losses, and expense deductions must now be tracked and reported **separately** for each of the 501(c)(3) organization's unrelated businesses — a process known as "siloing."

The first step in this new siloing process, determining which activities are considered separate businesses, can be difficult. The regulations issued by the IRS explain that nonprofit organizations should use North American Industry Classification System (NAICS) numbers[2] to help determine which activities are considered separate businesses. Specifically, nonprofit organizations should identify its separate businesses using the first two digits of the NAICS codes. Some nonprofit organizations may already be familiar with using NAICS numbers to separate their exempt purposes and activities from their unrelated business. Now, however, nonprofits must go one step further and separate each line of unrelated business. Returning to the example of Charity A, selling commercial advertising would likely be classified under the same NAICS number regardless of whether that advertising is in a newsletter, social media account, or podcast. Because those advertising activities all fall under the same NAICS classification number, Charity A can put them all together in one "silo," and track the expenses and income together. However, because the coffee shop and the parking lot fall under other NAICS numbers, Charity A would have to track and report the expenses and income for each of those activities separately – in other words, each gets its own "silo."

Note that any deductions must also be tracked and reported separately. If there are items that qualify for a deduction but are shared between unrelated trades or

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[2] https://www.census.gov/eos/www/naics/

businesses, or between an unrelated business and an exempt activity, the deduction must be allocated between the separate uses. For example, because Charity A uses the office building and parking lot for both nonprofit activities and unrelated business, any depreciation or expense deductions for the building or parking lot must be allocated between those separate uses. The IRS has not released guidance on that issue beyond its directions to allocate the deduction on a “reasonable basis,” so be sure to get help from a trusted tax professional when allocating any deductions for shared-use assets.

The TCJA also changed the way that Net Operating Losses (NOLs) are treated for unrelated businesses of 501(c)(3) organizations. NOLs, like income and deductions, are now subject to siloing and must be calculated and recorded separately for each unrelated business. However, the regulations clarify that pre-TCJA non-siloed NOLs (those acquired before 2018) may be deducted up to 100% from the combined unrelated business income and should be applied before later NOLs. Post-2017 NOLs may only be deducted from the specific unrelated business (silo) and only up to 80% of that silo’s unrelated business income.

Contact a tax professional for further advice about calculating UBIT for one or more unrelated businesses.

For further reading on this topic, see:

- https://www.govinfo.gov/content/pkg/FR-2020-04-24/pdf/2020-06604.pdf
- https://www.irs.gov/pub/irs-drop/n-18-67.pdf
- https://www.census.gov/eos/www/naics/2017NAICS/2017_NAICS_Manual.pdf
- https://www.pbpatl.org/wp-content/uploads/2011/12/ubit1.pdf
- https://www.pbpatl.org/wp-content/uploads/2013/06/UBIT-Is-Income-Generated-by-Your-Training-Program-Taxable.pdf