

One Minute Memo[®]



UBIT May Be In Your Future

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Overview

The proposed Tax Cuts and Jobs Act released by the House of Representatives on November 2, 2017 calls into question the position long taken by government pension plans that they are exempt from the unrelated business income tax rules (the “UBIT” rules).

Current Approach of Government Pension Plans

In 1977 the IRS released a brief statement in which it advised it was considering whether government pension plans were subject to tax on their income. Pending further review and guidance, the IRS stated that its position would be that government pension plans were not subject to tax on their income. In the intervening 40 years, the IRS has not provided any further guidance. As a result, government plans generally have taken, and continue to take, the position that they are not subject to the unrelated business taxable income (“UBIT”) rules.

Some government pension plans also take the position that they are exempt from tax pursuant to Section 115(1) of the Internal Revenue Code (the “Code”), which exempts from gross income any income derived from the “exercise of a governmental function.” Though an analysis of Code Section 115(1) is beyond the scope of this alert, we note that whether the operations of a government pension plan fit the criteria for tax exemption under Code Section 115(1) remains an open question.

Proposal

The Committee on Ways and Means, in its section-by-section summary of the proposed legislation, specifically notes that it is unclear whether public pension plans are subject to the UBIT rules. The proposed legislation resolves the apparent ambiguity by making clear that any entity exempt from taxation under Section 501(a) of the Internal Revenue Code (the “Code”) would, regardless of whether the entity claims an exemption from taxation under any other section of the Code, be subject to the UBIT rules. Government plans, as set out in Section 401(a) of the Code, are included in Section 501(a).

The Joint Committee on Taxation estimates that this provision will raise approximately \$1.1 billion dollars in additional revenue from 2018 - 2027.

Rapid Reactions

The current proposed legislation draws from the proposal put forth by Congressman David Camp in 2014. However, where the Camp proposal left open a possible avenue for government pension plans to continue to claim a UBIT exemption, the current proposed legislation does not.

Should the proposed legislation make its way through the House of Representatives and the Senate and ultimately be signed into law by the President it will add a layer of analysis to the investment underwriting process. For example, many government plans currently prefer not to invest through REITs (which are often used to “block” UBIT for non-government plan tax exempt investors). That may change if the proposed legislation as currently drafted becomes law. It is not clear if whether previous investments which were entered into by government pension plans on the assumption that UBIT was not a necessary consideration will be exempted from the new law. If they are not, government plans will need to work with their existing fund sponsors to explore setting up alternative investment vehicles or parallel funds to minimize the impact of the revised UBIT rules.

It is not time to panic. As noted above, it is unknown what the final legislation will look like or whether the current UBIT proposal will be included in the final legislation. It may be time, however, for government plans, internally and then with their fund sponsors, to explore options that could minimize the impact of the proposed legislation, should it become law.

We will continue to monitor the issues that are impactful to government pension plans and update you accordingly. In the interim, please do not hesitate to reach out to Robert Bodansky at rbodansky@seyfarth.com, Steven Richman at srichman@seyfarth.com, or Stanley Jutkowitz at sjutkowitz@seyfarth.com in Seyfarth Shaw’s [Institutional Investor Practice Group](#) if you have any questions regarding the proposed legislation or its potential impact on your government pension plan.

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