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UBTI Calculation Regs Reflect Public Input.

Guidance from the IRS and Treasury to help tax-exempt organizations calculate unrelated business taxable income if they have more than one unrelated trade or business adopts many suggestions offered in public comments.

The final regulations (T.D. 9933), released November 19 ahead of official publication in the Federal Register, address section 512(a)(6), a Tax Cuts and Jobs Act provision that requires exempt organizations with multiple unrelated trades or businesses — silos — to calculate UBTI separately for each one.

The final regs explain how an EO can determine if it has more than one unrelated trade or business and, if it does, how to calculate its UBTI.

“The IRS should be commended for its speedy efforts in issuing final guidance on 512(a)(6), along with their level of consideration given to the 17 comments submitted in response to the proposed regulations,” Meghan R. Biss of Caplin & Drysdale Chtd. told Tax Notes.

The preamble to the final regs discusses reducing the administrative burden on organizations and the IRS by adopting bright-line rules, Biss noted.

“In doing so, I believe that the IRS is taking into account how it will enforce these rules,” Biss said. “To me, the rejection of facts and circumstances is an indication that they want agents to avoid the enforcement difficulties posed in other EO areas that rely solely on a facts and circumstances test.”

NAICS Codes
The final regs retain the proposed regs’ (REG-106864-18) provision requiring an EO to identify each of its separate unrelated trades or businesses by using the first two digits of the North American Industry Classification System (NAICS) code that most accurately describes the unrelated trade or business.

The determination is based on the more specific NAICS code that describes the organization’s activity, and the descriptions in the current NAICS manual of trades or businesses using more than two digits of the NAICS codes are relevant in making that determination, according to the preamble.

In response to comments, the final rulemaking incorporates a NAICS rule for identifying particular industries and provides that when there are sales of goods both online and in shops, the separate unrelated trade or business is identified by the goods sold in shops if the same goods generally are sold online and in stores.

If an EO concludes that its trade or business activities would be most accurately described by different NAICS two-digit codes, the activities should be identified that way and treated as separate unrelated trades or businesses, according to the final regs.

Like the proposed rulemaking, the final regs say the NAICS two-digit code has to identify the separate unrelated trade or business in which the EO directly or indirectly engages. It may not

describe activities substantially related to accomplishing the organization's exempt purpose.

The final regs, in response to comments, eliminate the restriction on changing NAICS two-digit codes. An organization that changes the identification of a separate unrelated trade or business must report the modification in the tax year of the change in accordance with forms and instructions.

IRAs, Subpart F Income

The final regs adopt the proposed rulemaking's clarification that the definition of unrelated trade or business applies to IRAs.

Likewise, the proposed regs' clarification that inclusions of subpart F income and global intangible low-taxed income are treated the same way as dividends for purposes of determining UBTI is retained in the final rulemaking.

Net Operating Losses

An EO with more than one unrelated trade or business will determine the net operating loss deduction separately for each of its unrelated trades or businesses, according to the final regs. They also provide that reg. section 1.512(b)-1(e), which addresses the application of section 172 in the context of UBIT, applies separately for each such unrelated trade or business.

The final regs say an organization with losses in a tax year beginning before January 1, 2018, and in a tax year starting after December 31, 2017, will deduct its pre-2018 NOLs from total UBTI before deducting any post-2017 NOLs regarding a separate unrelated trade or business against the UBTI from such trade or business. The IRS and Treasury rejected a commentator's request to permit an EO to choose the order in which it uses pre-2018 and post-2017 NOLs based on its own facts and circumstances.

The final regs clarify that pre-2018 NOLs are taken against the total UBTI in a way that allows for maximum use of post-2017 NOLs, rather than pre-2018 NOLs, in a tax year.

"For example, the final regulations further clarify that an exempt organization may allocate all of its pre-2018 NOLs to one of its separate unrelated trades or businesses or it may allocate its pre-2018 NOLs ratably among its separate unrelated trades or businesses, whichever results in the greater utilization of the post-2017 NOLs in that taxable year," the preamble explains.

The final rulemaking also provides that after offsetting any gain from terminating, selling, exchanging, or otherwise disposing of a separate unrelated trade or business, any remaining NOL is suspended.

But the suspended NOLs may be used if the previous separate unrelated trade or business later resumes or if a new unrelated trade or business that is accurately identified using the same NAICS two-digit code as the previous separate unrelated trade or business begins or is acquired in a future tax year, according to the preamble.

In response to six commentators, the final regs provide that for purposes of section 512(a)(6), a separate unrelated trade or business that changes identification is treated as if the originally identified separate unrelated trade or business is terminated and a new separate unrelated trade or business begins.

Therefore, none of the NOLs from the previously identified separate unrelated trade or business will be carried over to the newly identified separate unrelated trade or business, the preamble explains.

The change in identification may apply to all or a part of the originally identified separate unrelated trade or business. If the change applies to the originally identified separate trade or business entirely, any NOLs attributable to that separate unrelated trade or business are suspended, the final regs say.

If the change in identification applies to the originally identified separate unrelated trade or business in part, the originally identified separate unrelated trade or business that remains unchanged keeps the entire NOLs attributable to it, including the part for which the identification is changing.

Investment Activities
Despite pleas from some commentators, the final regs, like the proposed version, treat an EO's investment activities that are subject to UBIT as a separate unrelated trade or business for purposes of section 512(a)(6).

Regarding specified payments from controlled entities, the IRS and Treasury adopted the language in the proposed regs without change, rejecting the suggestion that all specified payments be treated as one unrelated trade or business for purposes of section 512(a)(6).

Qualified Partnership Interest
The final regs rejected commentators' recommendations of alternative or additional methods for identifying a qualified partnership interest (QPI).

The rulemaking adopts the proposed regs' position that once an organization designates a partnership interest as a QPI, it can't subsequently identify the trades or businesses conducted by the partnership that are unrelated trades or businesses regarding the EO using NAICS two-digit codes unless and until the partnership interest stops being a QPI.

In response to a commentator, the final regulations clarify that if an organization whose interest must be considered when determining the EO's percentage interest for purposes of the first prong of the control test is a general partner in a partnership in which an EO holds an interest, that interest is not a QPI.

Regarding the first prong of the control test, the final regs keep the 20 percent capital interest threshold of the proposed regs. However, they make clear that the EO must satisfy the percentage interest requirement for its tax year with which or in which the partnership's tax year concludes.

TAX ANALYSTS

by FRED STOKELD

POSTED ON NOV. 20, 2020