UT LAW CLE Continuing Legal Education

Part Two: Higher Education Taxation Institute Summer Series

2:15 p.m. to 3:45 p.m.
Friday, August 7, 2020

Solving the Next Rubrik's Cube: A Panel Discussion of Best Practices on Reporting UBTI Activities in Silos on the Form 990-T and Managing Related Risks

Presenters:

John Barrett, Manager of Tax Services with the University of California System

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Moderator:

Ed Jennings, Director of Tax with the University of Michigan

Overview

- **Comparison of the IRS Notice and Proposed Treasury Regulations regarding Separating or "Siloing" Unrelated Business Taxable Income (UBTI) Activities**
- **Approaches to Separately Reporting UBTI Activities**
- **Challenges of Allocating Expenses**
- **Changes to Reporting Net Operating Losses (NOLs)**
- **Reporting and Computing Tax Credits**
- **Managing Tax Risks and Resources**
  - **Appendix I - Comments Submitted to the IRS by National Association of College and University Business Officers (NACUBO) on Safe Harbors for Allocation of Expenses by Colleges and Universities for Purposes of Determining Taxable Unrelated Business Income**
  - **Appendix II – Comments Submitted to the IRS by American Institute of Certified Professional Accountants (AICPA) on Recommendation for UBTI Cost Allocation Safe Harbor**

Comparison of the IRS Notice and Proposed Regulations

"The taxpayer: that's someone who works for the federal government, but doesn't have to take a civil service examination."– Ronald Reagan

- **What are the significant differences between the IRS pronouncements, Notice 2018-67 and the proposed regulations?**
  - **Use of NAICS codes?**
  - **Reporting an activity, such as golf course, into functions, such as cart rentals, food and concessions, recreation, etc.?**
  - **Reporting UBTI derived from unrelated debt financed rules under Section 514 or from specified payments received from controlled entities (imputed income) under Section 513(b)(13)?**
  - **Reporting an investment activity in a partnership?**
  - **Allocating Expenses to UBTI silos?**

As Background: Section 512(a)(6) on UBTI Silos

- **Prior Law –** Aggregate gross deductions from all unrelated trade or business activities could be used to offset aggregate gross income from all such unrelated trade or business activities, thereby reducing total UBTI.
- **Current Law** - The Tax Cuts and Jobs Act (TCJA) passed a provision, Internal Revenue Code (IRC) Section 512(a)(6), that requires an exempt organization subject to UBTI, with more than one unrelated trade or business activity, to calculate UBTI separately with respect to each trade or business.
  - **In essence, a tax loss from one unrelated trade or business activity may not be used to offset taxable income from another separate unrelated trade or business activity.**
  - **Net operating losses (NOLs) will be calculated separately for each trade or business prospectively.**
  - **This provision is effective for tax years beginning after December, 31 2017.**
- **Guidance – The IRS promulgated Notice 2018-67 and Proposed Regulations**

IRS Notice 2018-67 (August 2018)

- **Interim Criteria** – Exempt entities may rely on a reasonable, good-faith interpretation of UBTI tax law, Sections 511 through 514, by considering all the facts and circumstances, when determining whether they have more than one unrelated trade or business activity for purposes of Section 512(a)(6).
- **NAICS Codes** - A reasonable, good-faith interpretation includes using the North American Industry Classification System (NAICS) 6-digit Codes.
  - **This system groups together similar economic activities from the U.S., Canada and Mexico into defined industries that are identified using a 6-digit coding system.**
  - **The NAICS is used by federal agencies to collect, analyze, and publish statistical data related to the U.S. business economy. It provides over 1,000 6-digit codes.**
- **Request for Comments –** The IRS requested further comments on how best to segment or silo certain UBTI activities, including unrelated debt financed income (UDFI) under Section 514 and specified payments received from controlled entities (imputed income) under Section 513(b)(13).
- **Investments in Partnerships** – The notice provided specific rules to treat as qualified partnership investments (QPI) those investments made by endowments in limited partnerships or limited liability companies (LLC).

Proposed Regulations (April 2020)

- **NAICS Codes**
  - **Use of 2-digit codes (from more than 1,000 to 20 codes)**
    - **Once assigned a code it cannot be changed unless due to unintentional error**
    - **Code cannot describe the organization's exempt activities, such as "education services"**
  - **Unclear whether the fragmentation rule requires reporting by activity or by function**
- **UDFI and Imputed Income**
  - **Report all UDFI as QPI**
  - **Each controlled entity under Section 512(b)(13) is treated as a single separate trade or business regardless of whether it engages in more than one unrelated trade or business or makes more than one type of specific payment to the organization**
- **Partnership Investments**
  - **Look through rule under the de minimis test**
  - **Reduction on combining limited interests**
  - **Transition rule expires once the proposed regulations are finalized**

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