

Proposed Regulations on UBTI “Siloing” Rule

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Agenda

- Background on Section 512(a)(6) and Notice 2018-67
- Overview of Proposed Regulations
 - General Rules
 - Special Rules for Investment Activities
- Effective Date
- Other Topics
- Open Questions
- Appendix

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Section 512(a)(6)

- The Tax Cuts and Jobs Act enacted Section 512(a)(6), which requires tax-exempt organizations to compute UBTI separately for each unrelated trade or business (UTB) of the organization.
 - This has the effect of prohibiting an organization from deducting losses from one UTB against the income from a separate UTB.
 - The impact of the rule depends on how broad or narrow the scope is of a single UTB, but this was not addressed in the statute.
- Proposed Regulations were released in April 2020.
- The IRS had previously issued interim guidance in August 2018 (Notice 2018-67).
 - Organizations were permitted to rely on the Notice pending the release of the Proposed Regulations, and may continue to rely on the Notice for taxable years beginning before the Proposed Regulations are finalized.

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Proposed Regulations: Effective Date

- The Proposed Regulations take effect in the first taxable year after they are finalized.
- Prior to the effective date, an organization is permitted to rely on:
 - The Proposed Regulations, in their entirety;
 - Notice 2018-67;
 - A reasonable, good faith interpretation of Code Sections 511 through 514, considering all the facts and circumstances.

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Proposed Regulations: General Rules

- UTBs should be grouped into separate “silos” based on the 20 NAICS sectors identified by 2-digit codes (plus an “investment activities” silo discussed later).
 - NAICS = North American Industry Classification System
 - See list of sectors in the Appendix
- Each 2-digit code may only be used once and should group together all similar activities as a single silo. For example:
 - Multiple retail pharmacies would be grouped together under the single NAICS 2-digit code for “Retail Trade”
 - A golf course would be grouped together with unrelated rentals of performance or athletic space under the code for “Arts, Entertainment, and Recreation.”
- Cannot use the NAICS code that describes the organization’s exempt activities (“Educational Services”)
- An organization will assign a particular UTB to a NAICS sector starting in its first Form 990-T filed after the Proposed Regulations are finalized. Once assigned, it generally may not change that activity’s sector code absent an unintentional error.

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Fragmentation Principle

- Notice 2018-67 referred to the “fragmentation principle” in Section 513(c) and Reg. Section 1.513-1(b) for “helpful guidance” in identifying separate trades or businesses.
- Fragmentation principle remains relevant for separating related from unrelated aspects of a trade or business.
 - E.g., separating the sale of jewelry in an art museum gift shop (unrelated) and the sale of postcards replicating the art in the museum (related).
- It is not clear whether the IRS and Treasury view the fragmentation principle as relevant for identifying separate unrelated trades or business for Section 512(a)(6) purposes, though use of NAICS 2-digit codes may reduce need for fine distinctions.
 - The Proposed Regulations state that the special rule for investment activities “will not otherwise impact application of Section 512(c) and the fragmentation principle under Section 513(c).”

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