

Update on Final Regulations

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Final Regulations Under Section 512(a)(6) – UBTI Silo Rules

- Background
- NAICS 2-Digit Codes
- Investment Activities
 - QPIs
 - Other Activities
- Net Operating Losses
- Other Issues

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Final Regulations under Section 512(a)(6) - UBTI Silo Rules

- Section 512(a)(6) requires UBTI to be computed separately with respect to each unrelated trade or business, effective for tax years beginning after December 31, 2017
 - UBTI for each trade or business cannot be less than zero
 - Overall UBTI is sum of UBTI from individual trades or businesses, less specific deduction of \$1,000
 - **Effect:** Losses from one unrelated trade or business cannot be used to offset income from a different unrelated trade or business
- Final Regulations, released November 19, 2020, provide guidance on how activities should be grouped into these trade or business “silos”
 - Generally consistent with Proposed Regulations, with some taxpayer-friendly modifications

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General Rule - NAICS 2-Digit Codes

- Proposed Regulations required organizations to identify and group unrelated trades or businesses other than specifically defined “investment activities” using the North American Industry Classification System (“NAICS”)
 - Generally required organizations to separate activities into 20 NAICS sectors defined by two-digit codes
- Final Regulations generally retain use of NAICS two-digit codes
 - Clarify that determination of which NAICS two-digit code most accurately describes a trade or business activity is based on more specific six-digit code that best describes the activity, taking into account descriptions in NAICS manual
 - Provide broader ability to change NAICS two-digit codes
 - Proposed Regulations had permitted change only in certain specified circumstances
 - Final Regulations simply require that organization report change on Form 990-T in the taxable year in which it occurs
 - Open issue: How to treat one activity that arguably falls under multiple two-digit codes?

Investment Activities

- An organization’s “investment activities” are treated as one silo, separate from the organization’s other activities that are grouped using NAICS 2-digit codes
 - Investment activities, for these purposes, are limited to three types of activities expressly listed in the regulations:
 - Qualifying partnership interests (“QPIs”)
 - Debt-financed properties
 - Qualifying S corporation interests
 - Other activities, even if considered in the nature of investments, remain subject to the general silo rule and must generally be classified based on NAICS 2-digit codes
 - Special rules for non-qualifying S corporation interests and payments from controlled entities

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