

IRS Proposes Regulations on UBTI Siloing; Comments Due Soon

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On April 24, 2020, the IRS issued proposed regulations on how tax-exempt organizations are required to calculate their unrelated business taxable income (“UBTI”). [1] Comments are due June 23, 2020—and the government has said that it intends to issue final regulations by October. [2] This doesn’t leave much time for organizations grappling with COVID-19 to identify problems with the proposed regulations and respond to the IRS.

This Alert gives an overview of the notice of proposed rulemaking (“NPRM”), which comes two years after the Tax Cuts and Jobs Act required organizations to separately compute their UBTI for each “trade or business” and prohibited using losses from one trade or business to offset gains in another. Our next Alert will cover specific issues in more detail, with particular emphasis on the treatment of investment income.

The IRS issued initial guidance on implementation of the TCJA “siloing” requirements in 2018. [3] The proposed regulations modify that guidance in several ways and provide information on areas where the IRS was previously silent. At a high level, the proposed regulations include:

- a single simplified method for identifying most separate trades or businesses that use 2-digit North American Industry Classification System (NAICS) Codes;
- a single trade or business category for UBTI that arises from specific investment activities, which includes qualifying partnership interests, qualifying S corporation interests, and debt-financed properties. Qualifying partnership interests and qualifying S corporation interests are those that meet either a de minimis test or a control test;
- guidance on the treatment of specified payments from controlled entities under section 512(b)(13);
- guidance on the treatment of insurance income from controlled foreign corporations under 512(b)(17) and clarification that subpart F income (including Global Intangible Low-Taxed Income) is treated as a dividend for purposes of section 512(b)(1);
- guidance on the treatment of non-qualifying S corporation interests;
- guidance on the treatment of UBTI for Social Clubs, VEBAs, and Supplemental Unemployment Benefits Trusts;
- clarification on the application of the charitable contribution deduction;
- guidance on the proper ordering of net operating losses (NOLs); and
- retention of the prior system of calculating UBTI for purposes of the public support test.

The IRS requests comments on all of those areas, but highlights the need for comments on:

- allocating between exempt and non-exempt activities and between multiple trades or businesses. The IRS states that the reasonable basis standard will apply but clarifies that the unadjusted gross-to-gross method is not a reasonable allocation method;

- whether an ordering rule is necessary to clarify how the special rule in section 170(d)(1)(B) operates when a tax-exempt organization has NOL carryovers in more than one unrelated trade or business; and
- the burden of different calculations of UBTI for purposes of public support versus the payment of taxes and filing of the Form 990-T.

For more information on this Alert or more general information on UBTI reporting requirements, please contact a member of Caplin & Drysdale's Exempt Organizations team.

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[1] Unrelated Business Taxable Income Separately Computed for Each Trade or Business, 85 Fed. Reg. 23172 (proposed April 24, 2020).

[2] "Treasury is 'fairly confident' it will finalize all major Tax Cuts and Jobs Act guidance by its October 1 [2020] deadline." Annagabriella Colón, Treasury Likely to Meet 2020 TCJA Guidance Deadline, 166 TAX NOTES FEDERAL 1340 (Feb. 24, 2020).

[3] Notice 2018-67. We discussed the 2018 guidance here.

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