

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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subject: Application of section 512(a)(6) to post-2017 net operating losses carried back to pre-2018 years

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

(1) Whether an organization subject to § 512(a)(6) that incurs an NOL from one of its separate unrelated trades or businesses in a taxable year beginning after December 31, 2017 (post-2017 year) may carry back and deduct that NOL against aggregate unrelated business taxable income (UBTI) for a taxable year beginning before January 1, 2018 (pre-2018 year).

(2) Whether an organization subject to § 512(a)(6) that incurs an NOL in a post-2017 year from one of its separate unrelated trades or businesses that is carried back under § 172(b) to pre-2018 years may deduct against aggregate UBTI for a post-2017 year any of the remaining NOL carried to the post-2017 year. That is, whether the “siloeing” requirement of § 512(a)(6) applies to the deduction of an NOL in post-2017 years if the NOL arose in a post-2017 year and was carried back to a pre-2018 year before the remaining NOL is carried to the post-2017 year.

CONCLUSIONS

(1) Yes, an organization subject to § 512(a)(6) that incurs an NOL from one of its separate unrelated trades or businesses in a post-2017 year may carry back and deduct that NOL against aggregate UBTI for a pre-2018 year.

(2) No, an organization subject to § 512(a)(6) that incurs an NOL in a post-2017 year from one of its separate unrelated trades or businesses that is carried back under § 172(b) to pre-2018 years may not deduct against aggregate UBTI for a post-2017 year any of that NOL carried to the post-2017 year. The siloing requirement of § 512(a)(6) applies to the deduction in post-2017 years of all NOLs that arise in post-2017 years. An NOL arising in a post-2017 year is subject to § 512(a)(6) regardless of whether the NOL was first carried back to a pre-2018 year.

LAW

Section 172 of the Code was amended by § 2303 of the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat. 281 (CARES Act). As amended by the CARES Act, § 172(a)(1) generally allows in the case of a taxable year beginning before January 1, 2021, a deduction for the taxable year in an amount equal to the aggregate of the NOL carryovers to such year, plus the NOL carrybacks to such year.

A “net operating loss” is defined in § 172(c) as the excess of deductions allowed by chapter 1 of the Code over gross income, as modified by § 172(d). One of these modifications, under § 172(d)(1), provides that no NOL deduction is allowed in computing an NOL.

Section 2303(b)(1) of the CARES Act added § 172(b)(1)(D)(i)(I), which provides that any NOL arising in taxable years beginning after December 31, 2017, and before January 1, 2021, shall be an NOL carryback to each of the five taxable years preceding the taxable year of such loss. Section 172(b)(2) provides, in part, that the entire amount of the NOL for any loss year shall be carried to the earliest taxable year to which such loss may be carried.

Section 172(b)(2) further provides that the portion of the NOL which shall be carried to each of the succeeding taxable years shall be the excess, if any, of the NOL over the sum of the modified taxable income for each of the prior taxable years to which such loss may be carried.

Some, but not all, of the modifications described in § 172(d) apply in determining the modified taxable income for purposes of § 172(b)(2). Specifically, an NOL deduction is allowed in determining modified taxable income. However, § 172(b)(2)(A) provides that this NOL deduction is determined without regard to the NOL for the loss year or for any taxable year thereafter. Additionally, § 172(b)(2)(B) provides that

modified taxable income for any such prior taxable year may not be considered to be less than zero.

Section 512(a)(6)(A) was added to the Code by § 13702(a) of Public Law 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 512(a)(6)(A) provides, in part, that the UBTI for any tax-exempt organization with more than one unrelated trade or business shall be computed separately with respect to each such trade or business, including for purposes of determining any NOL deduction (referred to as “siloining”). Thus, an NOL deduction allowed to a separate unrelated trade or business of a tax-exempt organization must be attributable to NOLs generated by taking into account only the income and deductions of that separate unrelated trade or business.

Section 13702(b)(1) of the TCJA provides that § 512(a)(6) is effective for taxable years beginning after December 31, 2017. Section 13702(b)(2) of the TCJA provides, in part, that if any NOL arising in a pre-2018 year is carried over to a post-2017 year, § 512(a)(6)(A) shall not apply to such NOL.

ANALYSIS

Issue 1: Section 172(b)(1)(D)(i)(I) provides that an NOL arising in a taxable year beginning in 2018, 2019, or 2020 is carried back to each of 5 taxable years preceding the year in which the NOL arose. Accordingly, some or all of the taxable years in this 5-year carryback period will be pre-2018 years. The siloining requirements under § 512(a)(6) are effective only for post-2017 years. For taxable years beginning prior to this effective date, the siloining requirements do not apply and the UBTI of a tax-exempt organization with more than one unrelated trade or business is determined on an aggregate basis, including for purposes of determining any NOL deduction. Consequently, any NOL arising in a post-2017 year that is carried back to a pre-2018 year is applied against the aggregate UBTI of the organization for the pre-2018 year.

Issue 2: Although an NOL is carried to and deducted in taxable years other than the year in which it arose, its association with the specific year in which it arose does not change and it remains separate from NOLs arising in other years. This is essential to the statutory system under § 172 by which NOLs are carried to a specified period of years and absorbed in the order in which they arose. For example, deductions of NOLs can never generate an NOL because NOL deductions are excluded when determining whether or not an NOL arises in a taxable year. Similarly, NOL carrybacks and carryovers to a year are not increased by the amount of any NOL in that year, by operation of § 172(b)(2)(B). As a result of these provisions, the NOLs that arise in one taxable year do not mix or blend with NOLs that arise in other years.

This separation is integral to the statutory scheme, so that, for instance, an NOL that arises in 2018 and is carried back to 2013 does not become subject to the 20-year limitation on carryovers that applies to NOLs arising in 2013. The ordering rules in § 172(b)(2)(A) that require taxpayers to use NOLs in the order in which they arose exist

because taxpayers must keep track of which NOLs they are deducting in a particular year. If NOL carrybacks and carryovers to a year blended together, then no ordering rule would be necessary. Separation of NOLs by the year in which they arose is consistent with the approach taken in the § 172 regulations, such as §1.172-6, which demonstrates the calculation of the amount of NOL that can be carried back or carried over to each of a series of years by considering the NOL that arose in each loss year sequentially and not by determining a single aggregated NOL amount for each year of deduction.

As a result, an NOL that arises in a post-2017 year and is carried back to a pre-2018 year cannot be considered as having arisen in the pre-2018 year even if a portion of the NOL from the post-2017 year is absorbed in the pre-2018 year. NOLs are tax attributes that arise in specific taxable years and are allowed as deductions in other years. The treatment of an NOL depends on the year in which it arose and not only on the year or years to which it is carried (for instance, the § 172(a)(2)(B)(ii) limitation on the deductibility of NOLs applies only to deductions in taxable years beginning after 2020 and only to NOLs arising in post-2017 years).

Because an NOL arising in a post-2017 year is always treated as arising in that year, even if it is carried back and used in a pre-2018 year, it remains subject to the § 512(a)(6) siloing requirements when carried to a post-2017 year.

Example:

X is an organization subject to tax under § 511(a)(1), with 2 separate unrelated trades or businesses (UB1 and UB2). X's income and loss for UB1 and UB2 for each of 2016-2019 is as follows:

2016 (first year of existence):

	<u>UBTI</u>	<u>(NOL)</u>
UB1:	--	(1,000)
UB2:	--	--

2017:

	<u>UBTI</u>	<u>(NOL)</u>
UB1:	5,000	--
UB2:	5,000	--

2018:

	<u>UBTI</u>	<u>(NOL)</u>
UB1:	--	(15,000)
UB2:	--	--

2019:

	<u>UBTI</u>	<u>(NOL)</u>
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UB1: 5,000 --
 UB2: 5,000 --

On the original return for 2017, X is entitled to deduct the full amount of the 2016 NOL of \$1,000 and has total UBTI for 2017 of \$9,000. In 2018, X is entitled to carry the \$15,000 NOL back to 2017. Because § 512(a)(6) does not apply in 2017, that NOL can be used against the aggregate income from both UB1 and UB2. Therefore, X may amend its 2017 return to show no UBTI and carry over the remaining \$6,000 of the 2018 NOL into 2019. When determining its taxes for 2019, X may only use the 2018 NOL carryover to reduce the UBTI from UB1, because the siloing requirement applies. Therefore, although the 2018 NOL carryover to 2019 is \$6,000, X may only use that amount as a deduction against its \$5,000 of UBTI from UB1. The 2018 NOL may not be used against the \$5,000 of UBTI from UB2 and the remaining unused \$1,000 of the 2018 NOL is carried to 2020 to be used against UBTI from UB1.

Summary table:

	2016	2017	2018	2019
UB1 Income (Loss)	(\$1,000)	\$5,000	(\$15,000)	\$5,000
UB2 Income (Loss)	-	\$5,000	-	\$5,000
Pre-NOL Income (Loss)	(\$1,000)	\$10,000	(\$15,000)	\$10,000
UB1 NOL Deduction	-	-	-	\$5,000
UB2 NOL Deduction	-	-	-	-
Total NOL Deduction	-	\$10,000	-	\$5,000
Post-NOL Income (Loss)	(\$1,000)	-	(\$15,000)	\$5,000
2016 NOL Carried Over	\$1,000	-	-	-
2016 NOL Deducted	-	\$1,000	-	-
2018 NOL Carried Over	\$15,000	\$6,000	\$6,000	\$1,000
2018 NOL Deducted	-	\$9,000	-	\$5,000

Please call James Beatty at (202) 317-4613, or William Jackson at 202-317-4731, if you have any questions.