Determining Trade or Business for purposes of IRC § 512(a)(6)
Overview Flow Chart
Prop. Treas. Reg. § 1.512(a)-6
(for organizations other than 501(c)(7), (9) or (17))

Start Here

Is the UBTI derived as specified payments under 512(b)(13)?

Yes
Determine how many controlled entities require reporting. (1)

No

Is the UBTI for certain captive insurance payments? 512(b)(17)

Yes
Separate T or B reported on Form 990-T and Schedules M

No

Is the UBTI from investment activities, including debt-financed income?

Yes
Review the Investment Activities Flow Chart

No

Is the business activity a direct T or B

Yes
Use the 2-digit NAICS codes to identify the business (2)

No

Notes

(1) Specified payments received from a controlled entity can be grouped together as one T or B. If the filing organization receives specified payments from more than one controlled entity, then each controlled entity will be considered a separate T or B. See Prop Reg 1.512(a)-6(d) for more information.

(2) 2-digit NAICS code represents the UBTI activity and not the related activities. Each code should be reported once on the Form 990-T.

Key

UBTI – Unrelated Business Taxable Income
NAICS - North American Industry Classification System
T or B - Trade or Business
QPI – Qualifying Partnership Interests
Is the investment a qualifying partnership interest?

Start

Is the investment a qualifying S corporation interest? (1)

Yes

Investment Activities (Grouped together as one trade or business under 512(a)(6))

No

Is the UBTI generated from debt-financed properties? 512(b)(4) (2)

Yes

Not Considered an Investment Activity – may be a separate T or B under 512(a)(6)

No

Is the investment a qualifying partnership interest?

Yes

Is the investment a qualifying S corporation interest? (1)

No

Not Considered an Investment Activity – may be a separate T or B under 512(a)(6)

Notes

(1) – The qualifying S corporation interest rules follow the QPI rules. If the S corp. is not a QPI it will be considered one separate trade or business activity on the 990-T.

(2) – There still may be certain rentals of property that should be considered a separate T or B and not grouped with other investment activities. Such as:

- >50% personal property rental
- Lodging rentals where services are rendered
- Rentals that are already considered UBTI because property is taken into account for computing gross income – 1.514(b)-1(b)(2)(i)
Qualifying Partnership Interests Flow Chart
Prop. Treas. Reg. § 1.512(a)-6
QPI does not apply to 501(c)(7) Social Clubs

Start

Is the Org a general partner?

Control Test
Does the Organization control the P'ship?

Yes

Control Test
Does the organization (combined with related interests) have a capital interest < 20%?

Yes

May be considered a Qualifying Partnership Interest see the Investment Activities Flow Chart

No

De minimis Test
Does the Org own < 2% interest in the p'ship? (capital and profits interest)

Yes

No

Control Test
Does the Organization control the P'ship?

Yes

No (applies for the indirect interests that do not meet the look-through rule)

Not a QPI and need to identify T or B directly-held by the p'ship and any indirectly-held p'ships

No Control Test
Does the organization (combined with related interests) have a capital interest < 20%?

Yes

No

Look-through Rule
Are there indirect interests where the de minimis test is met?

Yes

Yes (applies only for the indirect interests which meet the look-through rule)

Review the Transition Rule Flow Chart if the Look-through Rule was not used on the investment

No

Review the Exclusive List of Investment Activities Flow Chart

Once designated a QPI must remain a QPI unless the investment no longer meets the QPI requirements

See QPI Footnotes for additional explanations
Separate UBTI rules apply to organizations subject to 512(a)(3), which applies to social clubs (501(c)(7)); VEBAs (509(c)(9)); and SUBs (501(c)(17)). The QPI flow chart provided covers most other organizations, which are subject to the UBTI rules under 512(a)(1).

The proposed regulations provide for an exclusive list investments which may be grouped together as one trade or business activity for purposes of 512(a)(6), and qualifying partnership investments is part of exclusive list. Please note many of the qualifying partnership interest rules also apply to S Corporations. Please see the regulations for additional information. See the Exclusive List of Investments Flow Chart.

De minimis Test: If the organization owns no more than a 2% capital interest AND no more than 2 percent profits interest. See how to calculate the percentages below.

Control Test:
To meet the control test the organization (along with related interests) holds no more than 20% capital interest and does not control the partnership. See how to calculate the percentages below.

Related Interests: To determine the percentage owned, combine interests owned by supporting organizations (509(a)(3)) and controlled entities (512(b)(13)(D)).

Control: It is based on facts and circumstances, per Prop Reg, 1.512(a)-6(c)(4)(iii) if:
1) The organization, by itself, may require the partnership to perform, or may prevent the partnership from performing, any act that significantly affects the operations of the partnership;
2) Any of the organization’s officers, directors, trustees, or employees have rights to participate in the management of the partnership at any time;
3) Any of the organization’s officers, directors, trustees, or employees have rights to conduct the partnership’s business at any time; or
4) The organization, by itself, has the power to appoint or remove any of the partnership’s officers or employees or a majority of directors.

Calculation of Percentage Interests: The organization can rely on the Schedule K-1 (Form 1065), Line J. In the case of partnership held for less than a year, use the beginning balances of the ownership period.

De Minimis Test:
Average of the beginning and ending profits interests

And

Average of the beginning and ending capital interests

Control Test:
Average of the beginning and ending capital interests
**Transition Rule for Certain Partnerships Flow Chart**

**Prop. Treas. Reg. § 1.512(a)-6(c)(7)**

Does not apply to social clubs under 501(c)(7)

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**Notes**

* See the Exclusive List of Investment Activities and Qualifying Partnership Interests Flow Charts before using this flow chart. If the Look-through Rule is used on the investment then the Transition Rule does not apply.

** The transition rules apply even if the organization's percentage interest changes before the transition period ends.

The organization may rely on the transition rule until the first day of the organization's tax year beginning after the final regulations are issued.