identifies the U.S. agent of the foreign principal party in interest authorized to act as exporter for export licensing purposes. One writing may cover multiple transactions between the same principals.

(2) *Power of Attorney or Other Written Authorization.* The foreign principal party in interest must designate an agent in the United States for a ''Foreign Principal Party Controlled Export Transaction.'' The U.S. agent must obtain a power of attorney or other written authorization from the foreign principal party in interest before it may act on its behalf or apply for a license. Upon request, the foreign principal party in interest must provide the U.S. principal party in interest with a copy of the power of attorney or other written authorization.

(3) Information Sharing Requirements. (i) The U.S. principal party in interest, upon request, must provide the foreign principal party in interest and its forwarding or other agent with the correct Export Control Classification Number (ECCN), or with sufficient technical information to determine classification. In addition, the U.S. principal party in interest must provide the foreign principal party in interest or the foreign principal's agent any information that it knows may affect the determination of license requirements or export authorization.

(ii) The foreign principal party in interest must authorize the U.S. principal party in interest to obtain from the foreign principal party in interest's U.S. agent the following information, and direct its U.S. agent to provide such information to the U.S. principal party in interest, upon request:

(A) Date of export;
(B) Port of export;
(C) Country of ultimate destination;
(D) Destination port;
(E) Method of transportation;
(F) Specific carrier identification; and
(G) Export authorization (e.g., license number, license exemption, or NLR designation).

PART 772—[AMENDED]

■ 8. The authority citation for part 772 continues to read as follows:

Authority: 50 U.S.C. app. 2401 *et seq.;* 50 U.S.C. 1701 *et seq.;* E.O. 13222, 66 FR 44025, 3 CFR, 2001 Comp., p. 783; Notice of August 08, 2013, 78 FR 49107 (August 12, 2013).

■ 9. Section 772 is amended by:
■ a. Adding the definition for ''Foreign Principal Party Controlled Export Transaction'' in alphabetical order, as set forth below;
■ b. Revising the definition for ''Forwarding agent'', as set forth below; and
■ c. Removing the definition of ''Routed export transaction.''

§ 772.1 Definitions of terms as used in the Export Administration Regulations (EAR).

* * * * *

Foreign Principal Party Controlled Export Transaction. A transaction meeting the requirements of § 758.3(b), where the foreign principal party in interest assumes responsibility for determining licensing requirements and obtaining license authority through its U.S. agent. The assumption of responsibility for determining licensing requirements and obtaining license authority is only authorized when the foreign principal party in interest is responsible for the movement of the items out of the United States.

* * * * *

Forwarding agent. The person in the United States who is authorized by a principal party in interest to perform the services required to facilitate the export of the items from the United States. This may include air couriers or carriers. In Foreign Principal Party Controlled Export Transactions, the forwarding agent and the exporter may be the same for compliance purposes under the EAR.

* * * * *

Dated: January 15, 2014.

Kevin J. Wolf,
Assistant Secretary for Export Administration.

[FR Doc. 2014–01176 Filed 2–5–14; 8:45 am]
BILLING CODE 3510–33–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–143874–10]

RIN 1545–BJ92

Calculation of UBTI for Certain Exempt Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking.

SUMMARY: This document contains a new proposed regulation providing guidance on how certain organizations that provide employee benefits must calculate unrelated business taxable income (UBTI). This document also withdraws the notice of proposed rulemaking relating to UBTI that was published on February 4, 1986.

DATES: The notice of proposed rulemaking that was published on February 4, 1986, at 51 FR 4391 is withdrawn as of February 6, 2014. Written or electronic comments and request for a public hearing must be received by May 7, 2014.

ADDRESSES: Send Submissions to: CC:PA:LPD:PR (REG–143874–10), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–143874–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–143874–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulation, Dara Alderman or Janet Laufer at (202) 317–5500 (not a toll-free number); concerning submissions of comments and/or to request a hearing, Oluwafunmilayo (Fumni) Taylor at (202) 317–6901 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed Income Tax Regulations (26 CFR part 1) under section 512(a) of the Code. Organizations that are otherwise exempt from tax under section 501(a) are subject to tax on their unrelated business taxable income (UBTI) under section 511(a). Section 512(a) of the Code generally defines UBTI of exempt organizations and provides special rules for calculating UBTI for organizations described in section 501(c)(7) (social and recreational clubs), voluntary employees' beneficiary associations described in section 501(c)(9) (VEBAs), supplemental unemployment benefit trusts described in section 501(c)(17) (SUBs), and group legal services organizations described in section 501(c)(20) (GLSOs).

Section 512(a)(1) provides a general rule that UBTI is the gross income from any unrelated trade or business regularly carried on by the organization, less certain deductions. Under section 512(a)(3)(A), in the case of social and recreational clubs, VEBAs, SUBs, and GLSOs, UBTI is defined as gross income, less directly connected expenses, but excluding ''exempt function income.''

Exempt function income is defined in section 512(a)(3)(B) as gross income from two sources. The first type of exempt function income is amounts paid by members as consideration for providing the members or their dependents or guests with goods, facilities, or services in furtherance of the organization's exempt purposes. The second type of exempt function income is all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by the organization computed as if the organization were subject to section 512(a)(1)) that is set aside: (1) For a charitable purpose specified in section 170(c)(4); (2) in the case of a VEBA, SUB, or GLSO, to provide for the payment of life, sick, accident, or other benefits; or (3) for reasonable costs of administration directly connected with a purpose described in (1) or (2).

Section 512(a)(3)(E) generally limits the amount that a VEBA, SUB, or GLSO may set aside as exempt function income to an amount that does not result in an amount of total assets in the VEBA, SUB, or GLSO at the end of the taxable year that exceeds the section 419A account limit for the taxable year. For this purpose, however, the account limit does not take into account any reserve under section 419A(c)(2)(A) for post-retirement medical benefits.

Section 512(a)(3)(E) was added to the Code under the Tax Reform Act of 1984, Public Law 98–369 (98 Stat. 598 (1984)). Congress enacted section 512(a)(3)(E) to limit the extent to which a VEBA, SUB, or GLSO's income is exempt from tax, noting that ''[p]resent law does not specifically limit the amount of income that can be set aside'' by a VEBA, SUB, or GLSO on a tax-free basis. H.R. Rep. No. 98–432, pt. 2, at 1275.

To implement section 512(a)(3)(E), § 1.512(a)–5T was published in the **Federal Register** as TD 8073 on February 4,1986 (51 FR 4312), with an immediate effective date. A cross-referencing Notice of Proposed Rulemaking (the 1986 Proposed Regulation) was issued contemporaneously with the temporary regulation. Written comments were received on the 1986 Proposed Regulation, and a public hearing was held on June 26, 1986. The 1986 Proposed Regulation is hereby withdrawn and replaced by the new proposed regulation that is published in this document. Section 1.512(a)–5T will continue to apply until it is removed by a final rule published in the **Federal Register**. This new proposed regulation contains some changes to improve clarity and respond to comments received on the 1986 Proposed Regulation, but otherwise generally has the same effect as the 1986 Proposed Regulation and § 1.512(a)–5T.

Explanation of Provisions

Covered Entity

This new proposed regulation uses the uniform term ''Covered Entity'' to describe VEBAs and SUBs subject to the UBTI computation rules of section 512(a)(3).[1] For taxable years beginning after June 30, 1992, GLSOs are no longer exempt as section 501(c)(20) organizations. *See* section 120(e). Therefore, a GLSO is no longer a Covered Entity. Effective July 1, 1992, a GLSO could, if it otherwise qualified, request a ruling or determination modifying the basis for its exemption from section 501(c)(20) to section 501(c)(9).

Limitation on Amounts Set Aside for Exempt Purposes

The 1986 Proposed Regulation and § 1.512(a)–5T provide that under section 512(a)(3)(E)(i), a Covered Entity's UBTI is generally the lesser of two amounts: (1) The investment income of the Covered Entity for the taxable year (excluding member contributions), or (2) the excess of the total amount set aside as of the close of the taxable year (including member contributions and excluding certain long-term assets) over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year. In the view of the Treasury Department and the IRS, this means that UBTI is calculated based on the extent to which the assets of a Covered Entity at the end of the year exceed the section 512 limitation, regardless of whether income was allocated to payment of benefits during the course of the year.

In *CNG Transmission Mgmt. VEBA* v. *U.S.,* 588 F.3d 1376 (Fed. Cir. 2009), *aff'g,* 84 Fed. Cl. 327 (2008), the Federal Circuit Court of Appeals decided in favor of the IRS on this issue. The Court said that the ''language of section 512(a)(3)(E) is clear and unambiguous,'' and that a VEBA ''may not avoid the limitation on exempt function income in [section] 512(a)(3)(E)(i) merely by allocating investment income toward the payment of welfare benefits during the course of the tax year.'' *CNG,* 558 F.3d at 1379, 1377–78; *accord Northrop Corp. Employee Insurance Benefit Plans Master Trust* v. *U.S.,* 99 Fed. Cl. 1 (2011), *aff'd,* 467 Fed. Appx. 886 (Fed. Cir. April 10, 2012), *cert. denied,* (Dec. 3, 2012).

Notwithstanding the view of the Treasury Department and the IRS and support for that view in the foregoing cases, one court has applied a different interpretation. In *Sherwin-Williams Co. Employee Health Plan Trust* v. *Comm'r,* 330 F.3d 449 (6th Cir. 2003), *rev'g,* 115 T.C. 440 (2000), the Sixth Circuit Court of Appeals held that investment income that the taxpayer VEBA earmarked and claimed was spent before year-end on reasonable costs of administration was not subject to the section 512(a)(3)(E) limit on exempt function income.[2] The Treasury Department and the IRS believe that the decision in *Sherwin-Williams* is contrary to the statute, the legislative history of section 512(a)(3)(E), § 1.512(a)–5T, and the 1986 Proposed Regulation, and have determined that it is appropriate to issue this proposed regulation clarifying the proper way to make the calculation.[3] If the final regulation follows the approach taken in this proposed regulation, the IRS will no longer recognize the precedential effect of *Sherwin-Williams* in the Sixth Circuit.

This new proposed regulation retains the formula set forth in the 1986 Proposed Regulation and § 1.512(a)–5T but modifies and clarifies the description and adds examples. This new proposed regulation specifically states that any investment income a Covered Entity earns during the taxable year is subject to unrelated business income tax (UBIT) to the extent the Covered Entity's year-end assets exceed the account limit, and clarifies that this rule applies regardless of how that income is used.

To further improve clarity, this new proposed regulation slightly modifies language from the prior version of Q&A–3, separates it into a new Q&A–2 and –3, and adds examples.

This new proposed regulation also reflects the rule under section

[1] While section 501(c)(7) organizations are also subject to the UBTI computation rules of section 512(a)(3), this proposed regulation addresses only computations for VEBAs and SUBs.

[2] As noted by the Federal Circuit in *CNG, Sherwin-Williams* can be viewed as distinguishable on its facts because the government there agreed to a stipulation that the investment income at issue had been spent on administrative costs, and in *CNG* there was not an equivalent stipulation. The Treasury Department and the IRS believe that the stipulation in *Sherwin-Williams* is not a distinction that should have affected the outcome. Specifically, the Treasury Department and the IRS believe that regardless of whether investment income is earmarked for (or otherwise traceable to) the payment of program benefits and administrative expenses during the year, the formula set forth in the 1986 Proposed Regulation and § 1.512(a)–5T, as well as the new proposed regulation, operates the same way.

[3] The IRS's interpretation is set forth in its non-acquiescence to the *Sherwin-Williams* decision (AOD 2005–02, 2005–35 I.R.B. 422). In AOD 2005–02, the IRS recognized the precedential effect of the decision to cases appealable to the Sixth Circuit and indicated that it would follow *Sherwin-Williams* with respect to cases within that circuit if the opinion cannot be meaningfully distinguished.

512(a)(3)(B) that the UBTI of a Covered Entity includes UBTI derived by the Covered Entity from any unrelated trade or business (as defined in section 513) regularly carried on by it, computed as if the organization were subject to section 512(a)(1).

In addition, this new proposed regulation reflects the special rule under section 512(a)(3)(E)(iii). Accordingly, a Covered Entity is not subject to the limitation under section 512(a)(3)(E) if substantially all of the contributions to the Covered Entity are made by employers who were tax exempt throughout the five-year taxable period ending with the taxable year in which the contributions are made.

Special Rules Relating to Sections 419A(f)(5) and 419A(f)(6)

Some commenters on the 1986 Proposed Regulation requested that the regulations explicitly provide that the special account limits under section 419A(f)(5) for collectively bargained plans be used in determining the set aside limits under section 512. The 1986 Proposed Regulation contained a rule that references § 1.419A–2T for special rules relating to collectively bargained welfare benefit funds. The Treasury Department and the IRS are actively working on regulations under section 419A(f)(5) relating to collectively-bargained welfare benefit funds and believe it is appropriate to address issues related to collectively bargained welfare benefit funds in that project.

A number of commenters suggested that a VEBA that is part of a 10 or more employer plan described in section 419A(f)(6) should be exempted from the UBTI rules under section 512. However, after the 1986 Proposed Regulation and § 1.512(a)–5T were published, the Technical Corrections to the Tax Reform Act of 1984, which was part of the Tax Reform Act of 1986, Public Law 99–514, added language to section 512(a)(3)(E)(i) that specifically subjects 10 or more employer plans to the set aside limit described in that section . *See* section 1851(a)(10)(A) of Public Law 99–514. Consistent with this change in the law, this new proposed regulation provides that a Covered Entity that is part of a 10 or more employer plan is subject to the set aside limit, and that the account limit is determined as if the plan is not subject to the exception under section 419A(f)(6).

Treatment of Existing Reserves

A number of concerns were raised by commenters relating to the rules in the 1986 Proposed Regulation regarding existing reserves. For example, one commentator stated that the requirement that an employer must charge all post-retirement claims paid on or after July 18, 1984 against any existing reserve as of July 18, 1984 (and earnings on existing reserves) is burdensome. However, this treatment of existing reserves is required under section 512(a)(3)(E)(ii)(III). Thus, this new proposed regulation retains the rules regarding existing reserves in the 1986 Proposed Regulation and adds a clarification to the example.

Proposed Effective Date

This regulation is proposed to apply to taxable years ending on or after the date of publication of the final regulation.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before this proposed regulation is adopted as a final regulation, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of this regulation are Dara Alderman and Janet Laufer, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in the development of this regulation.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to be read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.512(a)–5 is added to read as follows:

§ 1.512(a)–5 Questions and answers relating to the unrelated business taxable income of organizations described in paragraphs (9) or (17) of section 501(c).

Q–1. What does section 512(a)(3) provide with respect to organizations described in paragraphs (9) or (17) of section 501(c)?

A–1. (a) In general, section 512(a)(3) provides rules for determining the unrelated business income tax of voluntary employees' beneficiary associations (VEBAs) and supplemental unemployment benefit trusts (SUBs). Under section 512(a)(3)(A), a Covered Entity's ''unrelated business taxable income'' means all income except exempt function income. Under section 512(a)(3)(B), exempt function income includes income that is set aside for exempt purposes, as described in Q&A–2 of this section, subject to certain limits, as described in Q&A–3 of this section.

(b) For purposes of this section, a ''Covered Entity'' means a VEBA or a SUB.

Q–2. What is exempt function income?

A–2. (a) Under section 512(a)(3)(B), the exempt function income of a Covered Entity for a taxable year means the sum of—

(1) amounts referred to in the first sentence of section 512(a)(3)(B) that are paid by members of the Covered Entity and employer contributions to the Covered Entity (collectively ''member contributions''); and

(2) other income of the Covered Entity (including earnings on member contributions) that is set aside for—

(i) a purpose specified in section 170(c)(4) and reasonable costs of administration directly connected with such purpose, or

(ii) subject to the limitation of section 512(a)(3)(E) (as described in Q&A–3 of this section), the payment of life, sick, accident, or other benefits and reasonable costs of administration directly connected with such purpose.

(b) The other income described in paragraph (a)(2) of this Q&A–2 does not include the gross income derived from any unrelated trade or business (as defined in section 513) regularly carried on by the Covered Entity, computed as if the organization were subject to section 512(a)(1).

Q–3. What are the limits on the amount that may be set aside?

A–3. (a) Pursuant to section 512(a)(3)(E)(i), and except as provided in paragraph (b) of this Q&A–3, the amount of investment income (as defined in paragraph (c)(1) of this Q&A–3) set aside by a Covered Entity as of the close of a taxable year of such Covered Entity to provide for the payment of life, sick, accident, or other benefits (and administrative costs associated with the provision of such benefits) is not taken into account for purposes of determining the amount of that income that constitutes ''exempt function income'' to the extent that the total amount of the assets of the Covered Entity at the end of the taxable year to provide for the payment of life, sick, accident, or other benefits (and related administrative costs) exceeds the applicable account limit for such taxable year of the Covered Entity (as described in paragraph (d) of this section). Accordingly, any investment income a Covered Entity earns during the taxable year is subject to unrelated business income tax to the extent the Covered Entity's year-end assets exceed the applicable account limit. This rule applies regardless of whether the Covered Entity spends or retains (or is deemed to spend or deemed to retain) that investment income during the course of the year. Thus, in addition to the unrelated business taxable income derived by a Covered Entity from any unrelated trade or business (as defined in section 513) regularly carried on by it, computed as if the organization were subject to section 512(a)(1), the unrelated business taxable income of a Covered Entity for a taxable year of such an organization includes the lesser of—

(1) the investment income of the Covered Entity for the taxable year, or

(2) the excess of the total amount of the assets of the Covered Entity (excluding amounts set aside for a purpose described in section 170(c)(4)) as of the close of the taxable year over the applicable account limit for the taxable year.

(b) In accordance with section 512(a)(3)(E)(iii), a Covered Entity is not subject to the limits described in this Q&A–3 if substantially all of the contributions to the Covered Entity are made by employers who were tax exempt throughout the five year taxable period ending with the taxable year in which the contributions are made.

(c) For purposes of this section, a Covered Entity's ''investment income''—

(1) means all income except—

(i) member contributions described in paragraph (a)(1) of Q&A–2 of this section;

(ii) income set aside as described in paragraph (a)(2)(i) of Q&A–2 of this section; or

(iii) income from any unrelated trade or business described in paragraph (b) of Q&A–2 of this section; and

(2) includes gain realized by the Covered Entity on the sale or disposition of any asset during such year (other than gain on the sale or disposition of assets of an unrelated trade or business described in paragraph (b) of Q&A–2 of this section). The gain realized by a Covered Entity on the sale or disposition of an asset is equal to the amount realized by the organization over the basis of such asset in the hands of the organization reduced by any qualified direct costs attributable to such asset (under paragraphs (b), (c), and (d) of Q&A–6 of § 1.419A–1T).

(d) In calculating the total amount of the assets of a Covered Entity as of the close of the taxable year, certain assets with useful lives extending substantially beyond the end of the taxable year (for example, buildings, and licenses) are not to be taken into account to the extent they are used in the provision of life, sick, accident, or other benefits. By contrast, cash and securities (and other similar investments) held by a Covered Entity are taken into account in calculating the total amount of the assets of a Covered Entity as of the close of the taxable year because they are used to pay welfare benefits, rather than merely used in the provision of such benefits.

(e) The determination of the applicable account limit for purposes of this Q&A–3 is made under the rules of sections 419A(c) and 419A(f)(7), except that a reserve for post-retirement medical benefits under section 419A(c)(2)(A) is not to be taken into account. See § 1.419A–2T for special rules relating to collectively bargained welfare benefit funds.

(f) The limits of this Q&A–3 apply to a Covered Entity that is part of a 10 or more employer plan, as defined in section 419A(f)(6). For this purpose, the account limit is determined as if the plan is not subject to the exception under section 419A(f)(6).

(g) *Examples.* The following examples illustrate the calculation of a VEBA's UBTI:

Example 1 (a) Employer *X* establishes a VEBA as of January 1, 2013, through which it provides health benefits to active employees. The plan year is the calendar year. The VEBA has no employee contributions or member dues, receives no income from an unrelated trade or business regularly carried on by the VEBA, and has no income set aside for a purpose specified in section 170(c)(4). The VEBA's investment income in 2013 is $1,000. As of December 31, 2013, the applicable account limit under section 512(a)(3)(E)(i) is $5,000 and the total amount of assets is $7,000.

(b) The UBTI for 2013 is $1,000. This is because the UBTI is the lesser of (1) the investment income for the year ($1,000) and (2) the excess of the VEBA assets over the account limit at the end of the year ($7,000 over $5,000, or $2,000).

Example 2 (a) The facts are the same as in *Example 1,* except that the VEBA's applicable account limit under section 512(a)(3)(E)(i) as of December 31, 2013, is $6,500.

(b) The UBTI for 2013 is $500. This is because the UBTI for 2013 is the lesser of (1) the investment income for the year ($1,000) and (2) the excess of the VEBA assets over the account limit at the end of the year ($7,000 over $6,500, or $500).

Example 3 (a) Employer *Y* contributes to a VEBA through which *Y* provides health benefits to active and retired employees. The plan year is the calendar year. At the end of 2012, there was no carryover of excess contributions within the meaning of section 419(d), the balance in the VEBA was $25,000, the Incurred but Unpaid (IBU) claims reserve was $6,000, the reserve for post-retirement medical benefits (PRMB) (computed in accordance with section 419A(c)(2)) was $19,000, and there were no existing reserves within the meaning of section 512(a)(3)(E)(ii). During 2013, the VEBA received $70,000 in employer contributions and $5,000 in investment income, paid $72,000 in benefit payments and $7,000 in administrative expenses, and received no income from an unrelated trade or business regularly carried on by the VEBA. All the 2013 benefit payments are with respect to active employees and the IBU claims reserve (that is, the account limit under section 419A(c)(1)) at the end of 2013 was $7,200. The reserve for PRMB at the end of 2013 was $20,000. All amounts designated as ''administrative expenses'' are expenses incurred in connection with the administration of the employee health benefits. ''Investment income'' is net of administrative costs incurred in the production of the investment income (for example, investment management and/or brokerage fees). Only employers contributed to the VEBA (that is, there were no employee contributions or member dues/fees). The VEBA did not set aside any income for the a purpose specified in section 170(c)(4).

(b) The total amount of assets of the VEBA at the end of 2013 is $21,000 (that is, $25,000 beginning of year balance + $70,000 contributions + $5,000 investment income − ($72,000 in benefit payments + $7,000 in administrative expenses)).

(c) The applicable account limit under section 512(a)(3)(E)(i) (that is, the account limit under section 419A(c), excluding the reserve for post retirement medical benefits) is the IBU claims reserve ($7,200).

(d) The total amount of assets of the VEBA as of the close of the year ($21,000) exceeds the applicable account limit ($7,200) by $13,800.

(e) The unrelated business taxable income is $5,000 (that is, the lesser of investment income ($5,000) and the excess of the amount of assets of the VEBA as of the close of the taxable year over the applicable account limit ($13,800)).

Example 4 (a) The facts are the same as in *Example 3* except that the 2012 year-end balance was $15,000.

(b) The total amount of assets in the VEBA at the end of 2013 is $11,000 (that is, $15,000 beginning of year balance + $70,000 contributions + $5,000 investment income − ($72,000 in benefit payments + $7,000 in administrative expenses)).

(c) The applicable account limit under section 512(a)(3)(E)(i) remains $7,200.

(d) The total amount of assets of the VEBA as of the close of the year ($11,000) exceeds the applicable account limit ($7,200) by $3,800.

(e) The unrelated business taxable income is $3,800 (that is, the lesser of investment income ($5,000) and the excess of the total amount of assets of the VEBA at the close of the taxable year over the applicable account limit ($3,800)).

Q–4. What is the effective date of the amendments to section 512(a)(3) and what transition rules apply to ''existing reserves for post-retirement medical or life insurance benefits''?

A–4. (a) The amendments to section 512(a)(3), made by the Tax Reform Act of 1984, apply to income earned by a Covered Entity after December 31, 1985, in the taxable years of such an organization ending after such date.

(b) Section 512(a)(3)(E)(ii)(I) provides that income that is attributable to ''existing reserves for post-retirement medical or life insurance benefits'' will not be treated as unrelated business taxable income. This includes income that is either directly or indirectly attributable to existing reserves. An ''existing reserve for post-retirement medical or life insurance benefits'' (as defined in section 512(a)(3)(E)(ii)(II)) is the total amount of assets actually set aside by a Covered Entity on July 18, 1984 (calculated in the manner set forth in Q&A–3 of this section, and adjusted under paragraph (c) of Q&A–11 of § 1.419–1T), reduced by employer contributions to the fund on or before such date to the extent such contributions are not deductible for the taxable year of the employer containing July 18, 1984, and for any prior taxable year of the employer, for purposes of providing such post-retirement benefits. For purposes of the preceding sentence only, an amount that was not actually set aside on July 18, 1984, will be treated as having been actually set aside on such date if—

(1) such amount was incurred by the employer (without regard to section 461(h)) as of the close of the last taxable year of the Covered Entity ending before July 18, 1984, and

(2) such amount was actually contributed to the Covered Entity within 8½ months following the close of such taxable year.

(c) In addition, section 512(a)(3)(E)(ii)(I) applies to existing reserves for such post-retirement benefits only to the extent that such ''existing reserves'' do not exceed the amount that could be accumulated under the principles set forth in Revenue Rulings 69–382, 1969–2 CB 28; 69–478, 1969–2 CB 29; and 73–599, 1973–2 CB 40. Thus, amounts attributable to any such excess ''existing reserves'' are not within this transition rule even though they were actually set aside on July 18, 1984. See § 601.601(d)(2)(ii)(b).

(d) All post-retirement medical or life insurance benefits (or other benefits to the extent paid with amounts set aside to provide post-retirement medical or life insurance benefits) provided after July 18, 1984 (whether or not the employer has maintained a reserve or fund for such benefits) are to be charged, first, against the ''existing reserves'' within this transition rule (including amounts attributable to ''existing reserves'' within this transition rule) for post-retirement medical benefits or for post-retirement life insurance benefits (as the case may be) and, second, against all other amounts. For this purpose, the qualified direct cost of an asset with a useful life extending substantially beyond the end of the taxable year (as determined under Q&A–6 of § 1.419–1T) will be treated as a benefit provided and thus charged against the ''existing reserve'' based on the extent to which such asset is used in the provision of post-retirement medical benefits or post-retirement life insurance benefits (as the case may be). All plans of an employer providing post-retirement medical benefits are to be treated as one plan for purposes of section 512(a)(3)(E)(ii)(III), and all plans of an employer providing post-retirement life insurance benefits are to be treated as one plan for purposes of section 512(a)(3)(E)(ii)(III).

(e) In calculating the unrelated business taxable income of a Covered Entity for a taxable year of such organization, the total income of the Covered Entity for the taxable year is reduced by the income attributable to ''existing reserves'' within the transition rule before such income is compared to the excess of the total amount of the assets of the Covered Entity as of the close of the taxable year over the applicable account limit for the taxable year.

(f) The following example illustrates the calculation of a VEBA's UBTI:

Example. Assume that the total income of a VEBA for a taxable year is $1,000, and that the excess of the total amount of the assets of the VEBA as of the close of the taxable year over the applicable account limit is $600. Assume also that of the $1,000 of total income, $540 is attributable to ''existing reserves'' within the transition rule of section 512(a)(3)(E)(ii)(I). The unrelated business taxable income of this VEBA for the taxable year is equal to the lesser of the following two amounts: (1) The total income of the VEBA for the taxable year, reduced by the extent to which such income is attributable to ''existing reserves'' within the meaning of the transition rule ($1,000 − $540 = $460); or (2) the excess of the total amount of the assets of the VEBA as of the close of the taxable year over the applicable account limit ($600). Thus, the unrelated business income of this VEBA for the taxable year is $460.

Q–5. What is the effective/applicability date of this section?

A–5. Except as otherwise provided in this paragraph, this section is applicable to taxable years ending on or after the date of publication of the final regulation. For rules that apply to earlier periods, see 26 CFR 1.512(a)–5T (revised as of April 1, 2013).

John M. Dalrymple,

Deputy Commissioner for Services and Enforcement.

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DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 317

[DOD–2008–OS–0068]

RIN 0790–AI31

Defense Contract Audit Agency (DCAA) Privacy Act Program

AGENCY: Department of Defense.

ACTION: Proposed rule.

SUMMARY: The Department of Defense (DoD) is proposing to amend the Defense Contract Audit Agency (DCAA) Privacy Act Program Regulation. Specifically, an exemption section is being added to include an exemption for