requirement. To date, family office CPOs claiming an exemption from registration has been required to provide notice to the CFTC of their claim for exemption. The current no-action relief imposes a notice requirement,[12] as did the previous regulatory exemption that was relied upon by family office CPOs prior to its repeal in 2012.[13] Neither of these notice requirements placed any significant burdens or costs upon family office CPOs.[14]

The Proposal would have subjected persons claiming an exemption from CPO registration to the same notice requirements that apply to other types of CPOs claiming an exemption from registration under Regulation 4.13. Under Regulation 4.13, a person claiming any of the enumerated exemptions from CPO registration is required to provide his or her name, address, telephone number, fax number, and email address, and the name of the pool for which it is claiming the exemption.[15] In the Proposal the Commission estimated that the notice filing would cost approximately $28.50 per pool annually.[16]

The estimated $28.50 annual cost of filing a notice of claim of exemption is trivial compared to the hundreds of millions of dollars managed by the average family office CPO. All other types of CPOs claiming an exemption under Regulation 4.13, such as operators of single pools without compensation, or operators of small pools with less than $400,000 in capital, are required to file the same notice of a claim of exemption. There is no rational justification for exempting large family office pools with hundreds of millions of dollars, or in many cases billions of dollars, under management from the minimal notice requirements that apply to other, less wealthy persons claiming exemptions from CPO registration.

The CFTC's interest in commodity pool operators is not limited to the protection of investors in the pool. The Commission has a significant interest in how the activities of these pool operators may affect the commodity markets. Congress has declared in section 4l of the Commodity Exchange Act (CEA) that the activities of commodity trading advisors and commodity pool operators are affected with a national public interest in that, among other things their operations are directed toward and cause the purchase and sale of commodities for future delivery and the foregoing transactions occur in such volume as to affect substantially transactions on contract markets.[17] The Commission has a significant interest in knowing the identity of the persons that operate these pools, including those that are exempt from registration. This significant interest is manifested in the Commission's requirement that all other exempt CPOs provide the Commission with annual notices claiming or affirming their exemption from registration. The Commission's interest in the activities of large, multimillion dollar family pool CPOs is certainly no less than the Commission's interest in the activities of smaller CPOs, all of which are required to provide annual notice when they claim an exemption from registration.

The Commission eliminates the notice requirement largely on the basis that this will harmonize the Commission's regulations with those of the SEC. Harmonization for harmonization's sake is not a rational basis for agency action. The question for the CFTC is not whether the SEC has determined whether a notice requirement is appropriate, but rather whether the CFTC would benefit from a notice requirement under the CFTC's system of regulations. To the extent that the Commission believes it has no regulatory interest in the operation of commodity pools beyond the protection of investors in the pool, such a belief is manifestly wrong and inconsistent with Congress's finding in CEA section 4l. The Commission has a significant regulatory interest in knowing the identity of CPOs that may be ''a disruptive force in the market-place.'' [18] The Commission's mission would be better served by harmonizing the family pool CPO exemption process with its own regulations for exempt CPOs rather than the SEC's regulations.

Disqualification of Disqualified Persons

The Proposal would have prohibited any person who was subject to a statutory disqualification from registration from claiming an exemption from registration. The logic underlying this provision is simple: a person who is disqualified from operating a commodity pool in a registered capacity should also be disqualified from operating a pool in an unregistered capacity. Disqualified persons should be disqualified. In the Proposal the Commission stated:

> The Commission is concerned that it poses undue risk from a customer protection standpoint for its regulations in their current form to permit statutorily disqualified persons or entities to legally operate exempt commodity pools, especially when those same persons would not be permitted to register with the Commission. The Commission preliminarily believes that preserving the prohibition on statutory disqualifications from Advisory 18–96 and applying it to exemptions under § 4.13 would provide a substantial customer protection benefit by prohibiting statutorily disqualified persons from operating and soliciting participants for investment in exempt commodity pools.[19]

The National Futures Association (NFA) submitted a comment letter ''fully support[ing]'' the disqualification of disqualified persons. NFA stated:

> [T]he Commission aptly states in the **Federal Register** release that the proposed prohibition would provide a substantial customer protection benefit. In particular, the proposed change addresses a significant regulatory gap in the Commission's exemption framework and will certainly strengthen customer protection by ensuring that a person who may be prohibited from registering as a CPO is not able to operate an exempt fund outside of the Commission's and NFA's regulatory oversight.[20]

In today's final rule the Commission states that commenters raised a number of issues regarding the statutory disqualification proposal that require further consideration. I agree that the Commission should address these comments. But it should have done so prior to granting today's exemptions from registration. Customer protection should be our first priority, and not deferred indefinitely. The Commission should have addressed these comments and finalized the disqualification rule prior to granting today's exemption for family offices. Customer protection should not take a back seat to exemptions from regulations for billionaires.

The approval of this rule without any checks and balances on exempt family office CPOs will increase risks to our markets and market participants. I therefore dissent.

[FR Doc. 2019–26162 Filed 12–9–19; 8:45 am]

BILLING CODE 6351–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9886]

RIN 1545–BJ92

Calculation of UBTI for Certain Exempt Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation and removal of temporary regulation.

SUMMARY: This document contains a final regulation providing guidance on how certain organizations that provide employee benefits must calculate unrelated business taxable income (UBTI).

DATES:

Effective Date: This regulation is effective December 10, 2019.

Applicability Date: This regulation applies to taxable years beginning on or after December 10, 2019. For rules that apply to earlier periods, see § 1.512(a)–

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[12] CFTC Letter No. 12–37, at 2–3 (Nov. 29, 2012), available at: *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/12-37.pdf.*

[13] 17 CFR 4.13(b) (2011).

[14] Under the current no-action relief, a person claiming the exemption must provide the claimant's name, business address, and telephone number, state the capacity (*i.e.,* CPO) and name of the pool for which the claim is being filed, and be electronically signed by the CPO. CFTC Letter No. 12–37, at 2–3.

[15] 17 CFR 4.13(b)(1) (2019).

[16] Proposal, at 52923. Based on the notices filed under the CFTC No Action Letter 12–37, the Commission estimated that approximately 200 CPOs would be affected, with an average of 3 pools each that would be subject to the notice requirement. *Id.*

[17] 7 U.S.C. 6l.

[18] *See supra* note 10.

[19] Proposal, 83 FR 52906.

[20] Letter from Carol Wooding, Vice President, General Counsel and Secretary, National Futures Association, to Christopher J. Kirkpatrick, Secretary of the Commission, Re: RIN 3038–AE76: Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors (Dec. 17, 2018).

5T as contained in 26 CFR part 1, revised April 1, 2019.

FOR FURTHER INFORMATION CONTACT: Jennifer Solomon or Janet Laufer at (202) 317–5500 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final 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), and supplemental unemployment benefit trusts described in section 501(c)(17) (SUBs).

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, and SUBs, 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 or SUB, 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).

As described in greater detail below, section 512(a)(3)(E) generally limits the amount that a VEBA or SUB may set aside as exempt function income to an amount that does not result in an amount of total assets in the VEBA or SUB at the end of the taxable year that exceeds the section 419A account limit for the taxable year. As specified in section 512(a)(3)(E)(i), for this purpose, 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's or SUB'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 or SUB 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 was withdrawn and replaced by a new proposed regulation (the 2014 proposed regulation) that was published in the **Federal Register** on February 6, 2014 (79 FR 7110). The Treasury Department and the IRS received two comments on the 2014 proposed regulation. No public hearing was held.

The Treasury Department and the IRS have considered the comments received in response to the 2014 proposed regulation. This final regulation adopts the provisions of the 2014 proposed regulation with no modifications other than the following changes: (1) A change in the applicability date to taxable years beginning on or after the date of publication of this final regulation; (2) the addition of a clause modifying the definition of covered entity to include certain corporations described in section 501(c)(2), as provided in section 512(a)(3)(C); (3) the addition of a clause which refers to the provision in section 512(a)(3)(D) addressing nonrecognition of gain in the case of sales of certain property; and (4) updates to the examples, formatting changes, and other minor changes in wording, which are nonsubstantive. The modifications to the definition of covered entity and the addition of the clause addressing nonrecognition of gain are described under the heading ''Summary of Comments and Explanation of Provisions.'' The temporary regulation is removed.

Summary of Comments and Explanation of Provisions

Covered Entity

Consistent with the 2014 proposed regulation, this final 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, group legal services organizations (GLSOs) are no longer exempt as section 501(c)(20) organizations.[2] *See* section 120(e). Therefore, a GLSO is no longer a Covered Entity.

The 2014 proposed regulation did not reflect the provision of section 512(a)(3)(C), which provides that section 512(a)(3)(A) applies to a corporation described in section 501(c)(2), the income of which is payable to an organization described in section 501(c)(7), (9), or (17), as if the corporation were the organization to which the income is payable. For this purpose, the corporation is treated as having exempt function income for a taxable year only if it files a consolidated return with the organization described in section 501(c)(7), (9), or (17). In this final regulation, a clause has been added to clarify that the term ''Covered Entity'' includes a corporation described in section 501(c)(2) to the extent provided in section 512(a)(3)(C).

Nonrecognition of Gain

The 2014 proposed regulation did not reflect the provision of section 512(a)(3)(D) regarding nonrecognition of gain with respect to the sale of certain property. In this final regulation, a clause has been added to refer to that provision. Section 512(a)(3)(D) provides that, if property used directly in the performance of the exempt function of a Covered Entity is sold by the Covered Entity, and other property is purchased and used by the Covered Entity directly in the performance of its exempt function within a four-year period beginning one year before the date of the sale, and ending three years after the date of sale, gain (if any) from the sale is recognized only to the extent that the sales price of the old property exceeds the Covered Entity's cost of purchasing the other property.

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

[2] The preamble of the 2014 proposed regulation referred to GLSOs. However, on December 19, 2014, the Tax Increase Prevention Act of 2014, Public Law 113–295 (128 Stat. 4010) repealed sections 120 and 501(c)(20) regarding GLSOs as ''deadwood'' provisions.

Limitation on Amounts Set Aside for Exempt Purposes

Section 512(a)(3)(E)(i) limits the amount of investment income a Covered Entity may treat as nontaxable exempt function income in any given year to the extent such income ''result[s] in'' a year-end account balance ''in excess of'' the modified section 419A account limit. An account overage can be considered the result of, or essentially caused by, investment income only by considering all investment income earned during the year. Thus, in order to give an appropriate meaning to the term ''result in'', the total amount of investment income earned during the year should be considered when calculating whether an excess exists at the end of the year.

Certain taxpayers have taken a contrary position and asserted that investment income may be set aside and used separately before the end of a taxable year for current benefit payments and related administrative costs (collectively, ''benefit expenditures'') and thereby avoid the limit imposed by section 512(a)(3)(E)(i) on exempt function income. 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 VEBA earmarked and claimed was spent before year-end on reasonable costs of administration was not subject to the section 512(a)(3)(E)(i) limit on exempt function income. In contrast, 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 rejected this argument. The Court stated that the ''language of section 512(a)(3)(E) is clear and unambiguous,'' and upheld the Court of Federal Claims' conclusion 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).

The Treasury Department and the IRS have concluded 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 and 2014 proposed regulations, and have determined that it is appropriate to issue this final regulation clarifying the proper calculation method.[3] Specifically, the Treasury Department and the IRS disagree with the Sixth Circuit's conclusion that investment income may be set aside and used separately before the end of a taxable year to pay the reasonable costs of administering health care benefits and thereby avoid the limit imposed by section 512(a)(3)(E)(i) on exempt function income.[4]

The fungible nature of money means that there is necessarily a connection between investment income that a Covered Entity earns during the year and the total amount of funds in the entity at year-end, even if the Covered Entity purports to apply all of that income to benefit expenditures. For example, a VEBA with a beginning balance of $1,000, investment income of $100, benefit expenditures of $3,000, and employer contributions of $3,000, will have a year-end balance of $1,100. This will be true regardless of whether the VEBA allocates the investment income to the benefit expenditures. Assume that the VEBA's year-end account limit under section 512(a)(3)(E)(i) is $1,010, so that there is an account overage of $90. Absent $90 of the investment income, the VEBA would have had a year-end account balance of $1,010 and no account overage. Thus, $90 of the investment income in the example ''result[s] in'' a year-end account balance ''in excess of'' the VEBA's year-end account limit and may not be set aside and excluded as exempt function income.

The analysis that all investment income earned during a year should be considered in determining whether there is an account overage is consistent with the Joint Committee on Taxation's report with respect to the legislation that enacted section 512(a)(3)(E). This report indicated that investment income is subject to UBTI in ''an amount equal to the lesser of the income of the fund or the amount by which the assets in the fund exceed a specific limit on amounts set aside for exempt purposes.'' *See* Staff of the Joint Comm. on Taxation, 98th Cong., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984,* at 790 (Comm. Print 1984) (JCS–41–84). Accordingly, the Treasury Department and the IRS continue to interpret section 512(a)(3)(E)(i) to mean that whether a VEBA or SUB allocated its investment income (rather than other funds) to current year expenditures is irrelevant to the application of the set aside limitation.

As discussed above, the statutory provisions are not dependent upon a determination as to whether particular sources of income were used for benefit expenditures in any particular year. Rather, the ''result in'' language of section 512(a)(3)(E)(i) means that amounts set aside for benefit expenditures are treated as exempt function income only to the extent the total amount set aside for such purposes as of the end of the year is equal to or less than ''the account limit determined under section 419A . . . for the taxable year (not taking into account any reserve described in section 419A(c)(2)(A) for post-retirement medical benefits).'' Accordingly, the final regulations reflect this rule, and, for taxable years to which these regulations apply, the IRS will apply this final regulation to cases arising in the Sixth Circuit.

This final regulation retains the formula, description, and examples set forth in the 2014 proposed regulation. The 2014 proposed regulation retained the formula set forth in the 1986 proposed regulation and § 1.512(a)–5T, but modified and clarified the description and added examples. Thus, consistent with the 2014 proposed regulation, this final 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.

The IRS received two comments on the 2014 proposed regulation. One of the commenters asked that the proposed regulation be withdrawn on the basis that it is inconsistent with the statute, while the other commenter indicated his view that the position taken in the proposed regulation is a fair interpretation of the statute. With respect to the request that the 2014 proposed regulation be withdrawn, the Treasury Department and the IRS have concluded that the position in the 2014 proposed regulation, and adopted in this final regulation, is not only consistent with the statute, but is correct

[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 the decision in *Sherwin-Williams* with respect to cases within that circuit if the opinion could not be meaningfully distinguished.

[4] Notably, the Sixth Circuit opinion in *Sherwin-Williams* concluded that section 512(a)(3)(E)(i) supported the interpretation adopted by the court, not that the interpretation was based on the unambiguous terms of the statute or even the best reading of the statute. The Sixth Circuit also erroneously considered the 1986 temporary regulation as consistent with that interpretation.

for the reasons set forth in this preamble.

Both of the commenters expressed concern over the proposed applicability date in the 2014 proposed regulation because of its potential impact on VEBAs within the Sixth Circuit's jurisdiction. The 2014 proposed regulation proposes that it will apply to taxable years ending on or after the date of publication of the final regulation. One commenter argued that the proposed applicability date would be unfair to VEBAs that are within the Sixth Circuit's jurisdiction because these VEBAs and their sponsors have been operating in good faith under a tax regime that a federal court of appeals held is the law. The commenter suggested that if the 2014 proposed regulation were finalized as proposed, the regulation should apply only with respect to taxable years beginning six months after the date the final regulation is published in the **Federal Register**, at least for VEBAs within the Sixth Circuit's jurisdiction.

The other commenter stated that VEBAs that account for investment income in the manner approved by the Sixth Circuit have been operating in good faith and in accordance with a reasonable interpretation of the relevant Code provisions. The commenter expressed concern that if the regulation were finalized in the manner in which it was proposed, the investment income of those VEBAs would be retroactively taxed. The commenter therefore requested that the proposed applicability date be changed in the final regulation to the first taxable year beginning on or after the date of publication of the final regulation.

Taking into account these comments, the Treasury Department and the IRS have decided to modify the applicability date, so that this final regulation applies to taxable years beginning on or after the date of publication of the final regulation (and so for VEBAs within the Sixth Circuit's jurisdiction, the position reflected in AOD 2005–02 would apply through the end of the VEBA's taxable year in which the final regulation is issued).

Effective/Applicability Date

This regulation is effective on December 10, 2019. The regulation applies to taxable years beginning on or after December 10, 2019. For rules that apply to earlier periods, see § 1.512(a)–5T as contained in 26 CFR part 1, revised April 1, 2019.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Because this 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, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of this regulation are Jennifer Solomon and Janet Laufer, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). 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.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805, unless otherwise noted.

*   *   *   *   *

■ **Par. 2.** Section 1.512(a)–55 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).

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

(2) *A–1.* (i) 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'' (UBTI) 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 paragraph (b) of this section, subject to certain limits, as described in paragraph (c) of this section.

(ii) For purposes of this section, a ''Covered Entity'' means a VEBA or a SUB, and, to the extent provided in section 512(a)(3)(C), a corporation described in section 501(c)(2).

(b)(1) *Q–2.* What is exempt function income?

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

(A) 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'');

(B) Other income of the Covered Entity (including earnings on member contributions) that is set aside for a purpose specified in section 170(c)(4) and reasonable costs of administration directly connected with such purpose; and

(C) Other income of the Covered Entity (including earnings on member contributions) that, subject to the limitation of section 512(a)(3)(E) (as described in paragraph (c) of this section), is set aside for the payment of life, sick, accident, or other benefits and reasonable costs of administration directly connected with such purpose.

(ii) The other income described in paragraphs (b)(2)(i)(B) and (C) of this section 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).

(c)(1) *Q–3.* What are the limits on the amount that may be set aside?

(2) *A–3.* (i) Pursuant to section 512(a)(3)(E)(i), and except as provided in paragraph (c)(2)(ii) of this section, the amount of investment income (as defined in paragraph (c)(2)(iii) of this section) 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 set aside 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 (c)(2)(iv) 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. The rule in this paragraph (c)(2) 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—

(A) The investment income of the Covered Entity for the taxable year; and

(B) The excess (if any) of—

(*1*) 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

(*2*) The applicable account limit for the taxable year.

(ii) In accordance with section 512(a)(3)(E)(iii), a Covered Entity is not subject to the limits described in this paragraph (c) 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.

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

(A) Means all income except—

(*1*) Member contributions described in paragraph (b)(2)(i)(A) of this section;

(*2*) Income set aside as described in paragraph (b)(2)(i)(B) of this section; or

(*3*) Income from any unrelated trade or business described in paragraph (b)(2)(ii) of this section; and

(B) 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)(2)(ii) of this section), except to the extent provided in section 512(a)(3)(D).

(C) For purposes of paragraph (c)(2)(iii)(B) 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).

(iv) 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 may be used to pay welfare benefits, rather than merely used in the provision of such benefits.

(v) The determination of the applicable account limit for purposes of this paragraph (c) 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.

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

(vii) The following examples illustrate the calculation of a VEBA's UBTI.

(A) *Example 1.* (*1*) Employer *X* establishes a VEBA as of January 1, 2015, 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 2020 is $1,000. As of December 31, 2020, the applicable account limit under section 512(a)(3)(E)(i) is $5,000 and the total amount of assets of the VEBA is $7,000.

(*2*) The VEBA's UBTI for 2020 is $1,000. This is because the UBTI is the lesser of the investment income for the year ($1,000) and the excess of the VEBA assets over the account limit at the end of the year ($7,000 over $5,000, or $2,000).

(B) *Example 2.* (*1*) The facts are the same as in the example in paragraph (c)(2)(vii)(A) of this section (*Example 1*), except that the VEBA's applicable account limit under section 512(a)(3)(E)(i) as of December 31, 2020, is $6,500.

(*2*) The VEBA's UBTI for 2020 is $500. This is because the UBTI for 2020 is the lesser of the investment income for the year ($1,000) and the excess of the VEBA assets over the account limit at the end of the year ($7,000 over $6,500, or $500).

(C) *Example 3.* (*1*) 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 2020, 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 2021, the VEBA receives $70,000 in employer contributions and $5,000 in investment income, pays $72,000 in benefit payments and $7,000 in administrative expenses, and receives no income from an unrelated trade or business regularly carried on by the VEBA. All the 2021 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 2021 was $7,200. The reserve for PRMB at the end of 2021 is $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 does not set aside any income for the purpose specified in section 170(c)(4).

(*2*) The total amount of assets of the VEBA at the end of 2021 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)).

(*3*) 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).

(*4*) 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.

(*5*) The unrelated business taxable income of the VEBA 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)).

(D) *Example 4.* (*1*) The facts are the same as in the example in paragraph (c)(2)(vii)(C) of this section (*Example 3*) except that the 2020 year-end balance was $15,000.

(*2*) The total amount of assets in the VEBA at the end of 2021 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)).

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

(*4*) 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.

(*5*) The VEBA's 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)).

(d)(1) *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''?

(2) *A–4.* (i) 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.

(ii) 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 paragraph (c) 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 including 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 the amount was—

(A) 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

(B) Actually contributed to the Covered Entity within 8 ½ months following the close of such taxable year.

(iii) 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 the transition rule of section 512(a)(3)(E)(ii)(I) even though they were actually set aside on July 18, 1984. See § 601.601(d)(2)(ii)(*b*) of this chapter.

(iv) 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 the transition rule of section 512(a)(3)(E)(ii)(I) (including amounts attributable to ''existing reserves'' within the transition rule of section 512(a)(3)(E)(ii)(I) for post-retirement medical benefits or for post-retirement life insurance benefits (as the case may be)) and, second, against all other amounts. For purposes of this paragraph (d)(2)(iv), 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).

(v) 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 of section 512(a)(3)(E)(ii)(I) 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.

(vi) The following example illustrates the calculation of UBTI for a VEBA that has existing reserves.

(A) *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 $460, determined as 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 of section 512(a)(3)(E)(ii)(I) ($1,000 − $540 = $460); and

(*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).

(B) [Reserved]

(e)(1) *Q–5.* What is the applicability date of this section?

(2) *A–5.* Except as otherwise provided in this paragraph (e)(2), this section is applicable to taxable years beginning on or after December 10, 2019. For rules that apply to earlier periods, see § 1.512(a)–5T, as contained in 26 CFR part 1, revised April 1, 2019.

§ 1.512(a)–5T [Removed]

■ **Par. 3.** Section 1.512(a)–5T is removed.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: November 19, 2019.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Parts 100 and 165

[Docket Number USCG–2019–0908]

RIN 1625–AA08

Special Local Regulation; Temporary Change for Recurring Marine Event in the Seventh Coast Guard District

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is temporarily changing the enforcement period of a special local regulation for a recurring marine event in the Seventh Coast Guard District and adding a temporary safety zone for this event. These regulations apply to the St. Croix Christmas Boat Parade and Fireworks Display in the vicinity of Protestant Cay in St. Croix, USVI, which will take place this year on December 14, 2019. The temporary special local regulation and temporary safety zone is needed to protect personnel, vessels, and the marine environment from the boat parade and fireworks display. Entry of vessels or persons into this regulated area is prohibited unless specifically authorized by the Captain of the Port San Juan.

DATES: This rule is effective on December 14, 2019, from 4 p.m. until 11 p.m.