§ 1.512(a)–5T

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basis of recognized mortality or morbid-
bidity tables and assumed rates of in-
terest under an actuarially acceptable
method would not be unreasonable
even though such accumulations are
quite large and the time between the
receipt by the organization of such
amounts and the date of payment of
the benefits is quite long. For example,
an accumulation of income for 20 years
or longer which is determined to be
reasonable necessary to pay life insur-
ance benefits to members, their depen-
dents or designated beneficiaries,
generally would not be an unreasonable
accumulation. Income which has been
set aside may be invested, pending the
action contemplated by the set aside,
without being regarded as having been
used for other purposes.

[T.D. 7498, 41 FR 44393, Oct. 8, 1976]

§ 1.512(a)–5T Questions and answers

relating to the unrelated business

taxable income of organizations de-
scribed in paragraphs (9), (17) or
(20) of Section 501(c) (temporary).

Q–1: What does section 512(a)(3), as amend-
ed by the Tax Reform Act of 1984 (Act), pro-
vide with respect to organizations described
in paragraphs (9), (17) or (20) of section
501(c)?

A–1: In general, section 512(a)(3), as amend-
ed by section 511 of the Act, extends the
rules for determining the unrelated business
income tax of voluntary employees’ bene-
ficiary associations (VEBAs) to supple-
mental unemployment compensation benefit
trusts (SUBs) and group legal service organi-
zations (GLSOS). The section also restricts
the amount of income that may be set aside
by such organizations for exempt purposes.

Q–2: What is the effective date of the amendments to section 512(a)(3)?

A–2: The amendments to section 512(a)(3) will apply to income earned by VEBAs, SUBs or GLSOS after December 31, 1985, in the tax-
able years of such organizations ending after
such date. For purposes of applying section
512(a)(3) to the first taxable year of such an
organization ending after December 31, 1985,
the income of the Veba, SUB or GLSO
earned after December 31, 1985, will be deter-
mmed by allocating the total income earned
for such taxable year on the basis of the cal-
endar year 1985 and 1986 months in such tax-
able year. However, if a Veba, SUB or GLSO
is part of a plan that is maintained pursuant
to one or more collective bargaining agree-
ments (a) between employee representatives
and one or more employers, and (b) which are
in effect on July 1, 1986 (or ratified on or
before that date), the amendments do not
apply to income earned in a taxable year of
a Veba, SUB or GLSO beginning before the
termination of the last of the collective barg-
aining agreements pursuant to which the
plan is maintained (determined with re-
gard to any extension of the contract agreed
to after July 1, 1985). For purposes of the pre-
ceding sentence, any plan amendment made
pursuant to a collective bargaining agree-
manship relating to the plan which amends the
plan solely to conform to any requirement
added under section 511 of the Tax Reform
Act 1984 (i.e., requirements under section 419,
419A, 512(a)(3)(E), and 4976) shall not be treat-
ed as a termination of such collective bar-
gaining agreements.

Q–3: What amount of income may a Veba,
SUB or GLSO set aside for exempt purposes?

A–3: (a) Pursuant to section 512(a)(3)(E)(1),
the amounts set aside in a Veba, SUB, or
GLSO (including a Veba, SUB, or GLSO
that is part of a 10 or more employer plan, as
defined in section 419A(f)(6)(B)) as of the
close of any taxable year of such Veba, SUB,
or GLSO to provide for the payment of life,
sick, accident, or other benefits may not be
taken into account for purposes of deter-
mining exempt function income to the extent
that such amounts exceed the qualified asset
account limit, determined under sections
419A(c) and 419A(f)(7), for such taxable year
of the Veba, SUB, or GLSO. In calculating
the qualified asset account limit for this pur-
purpose, a reserve for post-retirement medical
benefits under section 419A(c)(2)(A) is not to
be taken into account.

(b) The exempt function income of a
VEBa, SUB, or GLSO for a taxable year of
such an organization, under section
512(a)(3)(B), includes: (1) Certain amounts
paid by members of the Veba, SUB, or
GLSO within the meaning of the first sen-
tence of section 512(a)(3)(B) (member contribu-
tions); and (2) other income of the Veba,
SUB, or GLSO (including earnings on mem-
ber contributions) that is set aside for the
payment of life, sick, accident, or other ben-
efits to the extent that the total amount set
aside in the Veba, SUB or GLSO as of the
close of the taxable year for any purpose (in-
cluding member contributions and other in-
come set aside in the Veba, SUB, or GLSO
as of the close of the year) does not exceed
the qualified asset account limit for such
taxable year of the organization. For pur-
poses of section 512(a)(3)(B), member contribu-
tions include both employee contribu-
tions and employer contributions to the
VEBa, SUB, or GLSO. In calculating the
total amount set aside in a Veba, SUB, or
GLSO as of the close of a taxable year, cer-
tain assets with useful lives extending sub-
stantially beyond the end of the taxable year
(e.g., buildings, and licenses) are not to be
taken into account to the extent they are
used in the provision of life, sick, accident,
Internal Revenue Service, Treasury

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or other benefits. For example, cash and securities (and similar investments) held by a VEBA, SUB or GLSO are not disregarded in calculating the total amount set aside for this purpose, even if they are used to pay welfare benefits, rather than merely used in the provision of such benefits. Accordingly, the unrelated business taxable income of a VEBA, SUB, or GLSO for the taxable year (excluding member contributions); or, the excess of the total amount set aside as of the close of the taxable year (including member contributions, and excluding certain assets with a useful life extending substantially beyond the end of the taxable year to the extent they are used in the provision of welfare benefits) over the qualified asset account limit (calculated without regard to the otherwise permitted reserve for post-retirement medical benefits) for the taxable year. See §1.419–2T for special rules relating to collectively bargained welfare benefit funds.

(c) The income of a VEBA, SUB, or GLSO for any taxable year includes gain realized by the organization on the sale or disposition of any asset during such year. The gain realized by a VEBA, SUB, or GLSO 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 §1.419–1T).

Q–4: What transition rules apply to existing reserves for post-retirement medical or life insurance benefits?

A–4: (a) Section 512(a)(3)(E)(i)(I) provides that income that is either directly or indirectly attributable to existing reserves for post-retirement medical or life insurance benefits will not be treated as unrelated business taxable income. An existing reserve for post-retirement medical or life insurance benefits (as defined in section 512(a)(3)(E)(i)(II)) is the total amount of assets actually set aside in a VEBA, SUB, or GLSO on July 18, 1984 (calculated in the manner set forth in Q&A–3 of the regulation, 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 VEBA, SUB, or GLSO ending before July 18, 1984, and (2) such amount was actually contributed to the VEBA, SUB, or GLSO within 8½ months following the close of such taxable year.

(b) In addition, section 512(a)(3)(E)(i)(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 C.B. 28; 69–478, 1969–2 C.B. 29; and 73–599, 1973–2 C.B. 40. Thus, amounts attributable to such excess existing reserves are not within this transition rule even though they were actually set aside on July 18, 1984.

(c) 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)(i)(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)(i)(III).

(d) In calculating the unrelated business taxable income of a VEBA, SUB, or GLSO for a taxable year of such organization, the total income of the VEBA, SUB, or GLSO 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 set aside as of the close of the taxable year over the qualified asset account limit for the taxable year. Thus, for 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 VEBA set aside as of the close of the taxable year over the applicable qualified asset account limit is $600. Assume also that of the $1,000 of total income, $300 is attributable to existing reserves within the transition rule of section 512(a)(3)(E)(i)(I). The unrelated business 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 ($1,000), reduced to the extent that such income is attributable to existing reserves within the transition rule ($500); or (2) the excess of the total amount set aside as of the close of the taxable year over the applicable qualified asset account limit ($600). Thus, the unrelated business income of this VEBA for the taxable year is $500.

§ 1.512(b)–1 Modifications.

Whether a particular item of income falls within any of the modifications provided in section 512(b) shall be determined by all the facts and circumstances of each case. For example, if a payment termed rent by the parties is in fact a return of profits by a person operating the property for the benefit of the tax-exempt organization or is a share of the profits retained by such organization as a partner or joint venturer, such payment is not within the modification for rents. The modifications provided in section 512(b) are as follows:

(a) Certain Investment Income—(1) In general. Dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), annuities, income from notional principal contracts (as defined in Treasury Regulations 26 CFR 1.863–7 or regulations issued under section 446), other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner, and all deductions directly connected with any of the foregoing items of income shall be excluded in computing unrelated business taxable income.

(2) Limitations. The exclusions under paragraph (a)(1) of this section do not apply to income derived from and deductions in connection with debt-financed property (as defined in section 514(b)). Moreover, the exclusions under paragraph (a)(1) of this section do not apply to gains or losses from the sale, exchange, or other disposition of any property, or to gains or losses from the lapse or termination of options to buy or sell securities. For rules regarding the treatment of these gains and losses, see section 512(b)(5) and §1.512(b)–1(d). Furthermore, the exclusions under paragraph (a)(1) of this section do not apply to interest and annuities derived from and deductions in connection with controlled organizations. For rules regarding the treatment of such amounts, see section 512(b)(13) and §1.512(b)–1(l).


§ 1.512(b)–1 Modifications.

(b) Royalties. Royalties, including overriding royalties, and all deductions directly connected with such income shall be excluded in computing unrelated business taxable income. However, for taxable years beginning after December 31, 1969, certain royalties from and certain deductions in connection with either, debt-financed property (as defined in section 514(b)) or controlled organizations (as defined in paragraph (l) of this section) shall be included in computing unrelated business taxable income. Mineral royalties shall be excluded whether measured by production or by gross or taxable income from the mineral property. However, where an organization owns a working interest in a mineral property,