* * * * *

Issued in Washington, DC, on April 29, 2024.

Frank Lias,

Manager, Rules and Regulations Group.

[FR Doc. 2024–09562 Filed 5–14–24; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–133850–13]

RIN 1545–BN93

Interest Capitalization Requirements for Improvements to Designated Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would remove the associated property rule and similar rules from the existing regulations on the interest capitalization requirements for improvements to designated property. In addition, this document contains proposed regulations that would modify the definition of ''improvement'' for purposes of applying those existing regulations. Lastly, this document contains proposed regulations that would modify other rules in those existing regulations in light of the proposed removal of the associated property rule. The proposed regulations would affect taxpayers making improvements to real or tangible personal property that constitute the production of designated property.

DATES: Written or electronic comments and requests for a public hearing must be received by July 15, 2024.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG–133850–13) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG–133850–13), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Livia Piccolo of the Office of Associate Chief Counsel (Income Tax and Accounting), at (202) 317–7007; concerning submissions of comments or a public hearing, Vivian Hayes, (202) 317–6901 (not toll-free numbers) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Background

This document proposes amendments to § 1.263A–11(e)(1)(ii) and (iii) of the Income Tax Regulations (26 CFR part 1) to remove the ''associated property rule'' and similar rules from the interest capitalization requirements for improvements that constitute the production of property under section 263A(f) of the Internal Revenue Code (Code). In addition, this document proposes amendments to § 1.263A–11(f) to clarify that § 1.263A–11(f) applies only to property purchased and further produced before it is placed in service. Finally, this document proposes to amend § 1.263A–8(d)(3) to update the definition of ''improvement'' so that it is consistent with the definition of ''improvement'', including the exceptions, safe harbors, and elections provided under § 1.263(a)–3.

Sections 263A(a) and (b) of the Code generally require the capitalization of direct and indirect costs of real or tangible personal property produced by the taxpayer. Under section 263A(g)(1) and § 1.263A–8(d)(3), the term ''produce'' includes ''improve.''

Section 263A(f) contains rules for capitalizing interest with respect to certain property produced by the taxpayer and for determining the amount of interest required to be capitalized. In general, section 263A(f)(1) limits capitalization to interest that is paid or incurred during the production period and that is allocable to real property or certain tangible personal property produced by the taxpayer, referred to as ''designated property'' in the section 263A regulations. *See* § 1.263A–8(b)(1). Under section 263A(f)(2)(A), in determining the amount of interest required to be capitalized to any property, (i) interest on any indebtedness directly attributable to production expenditures with respect to the property is assigned to the property, and (ii) interest on any other indebtedness is assigned to the property to the extent that the taxpayer's interest cost could have been reduced if production expenditures not attributable to indebtedness described in clause (i) had not been incurred (avoided cost method).

Section 1.263A–8(a) provides that taxpayers must use the avoided cost method described in § 1.263A–9 in determining the amount of interest required to be capitalized with respect to the production of designated property. Section 1.263A–9(a)(1) explains that, under the avoided cost method, any interest that the taxpayer theoretically would have avoided if accumulated production expenditures (as defined in § 1.263A–11) (APEs) had been used to repay or reduce the taxpayer's outstanding debt must be capitalized. Under § 1.263A–11(a), APEs generally mean the cumulative amount of direct and indirect costs described in section 263A(a) that are required to be capitalized with respect to a unit of property.

Section 1.263A–9(c) provides that, to the extent a taxpayer's APEs exceed traced debt (that is, debt that is allocated to APEs with respect to the unit of property), the general formula for determining the amount of interest that must be capitalized is the average excess expenditures multiplied by the weighted average interest rate on the debt during the time the production occurs. A larger base of production expenditures leads to more interest capitalized.

Section 1.263A–11(e)(1)(i) provides that, if an improvement constitutes the production of designated property under § 1.263A–8(d)(3), APEs with respect to the improvement consist of all direct and indirect costs required to be capitalized with respect to the improvement. In the case of an improvement to a unit of real property qualifying as the production of designated property under § 1.263A–8(d)(3), § 1.263A–11(e)(1)(ii) provides that APEs include an allocable portion of the cost of land, and for any measurement period, the adjusted basis of any existing structure, common feature, or other property that is not placed in service, or must be temporarily withdrawn from service to complete the improvement (associated property) during any part of the measurement period if the associated property directly benefits the property being improved, the associated property directly benefits from the improvement, or the improvement was incurred by reason of the associated property (associated property rule). In the case of an improvement to a unit of tangible personal property qualifying as the production of designated property under § 1.263A–8(d)(3), § 1.263A–

11(e)(1)(iii) provides that APEs include the adjusted basis of the asset being improved if that asset either is not placed in service or must be temporarily withdrawn from service to complete the improvement.

Section 1.263A–12(a) explains that under § 1.263A–9, a taxpayer must capitalize interest for computation periods that include the production period of a unit of designated property. In the case of property produced for self-use, § 1.263A–12(d)(1) generally provides that the production period for a unit of property ends on the date that the unit is placed in service and all production activities reasonably expected to be undertaken are completed.

In *Dominion Resources, Inc.* v. *United States,* 681 F.3d 1313 (Fed. Cir. 2012), the Federal Circuit invalidated the associated property rule of § 1.263A–11(e)(1)(ii)(B) for property temporarily withdrawn from service. The court concluded that the regulation was not a reasonable interpretation of the avoided cost rule in section 263A(f)(2)(A)(ii) and that it violated the *State Farm* requirement that the Treasury Department and the IRS provide a reasoned explanation for adopting a regulation. *See Motor Vehicles Mfrs. Ass'n of the United States, Inc.* v. *State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983).

The taxpayer in *Dominion Resources* was a public utility that replaced coal burners in two of its electric generating plants. This action required the taxpayer to temporarily withdraw the two electric generating plants from service. During that time, Dominion incurred interest on debt unrelated to the improvements. Dominion deducted some of that interest, and the IRS disagreed with the taxpayer's computations. The IRS argued that pursuant to § 1.263A–11(e)(1)(ii)(B), the taxpayer's APEs should include the cost of the improvements (that is, the amount spent to replace the coal burners), as well as the adjusted basis of the property temporarily withdrawn from service to complete the improvement (that is, the electric generating plants).

The taxpayer and the IRS ultimately reached a settlement agreement, pursuant to which Dominion deducted 50 percent and capitalized 50 percent of the disputed amount. The taxpayer subsequently filed a claim for refund, asserting that the entire amount was deductible. The taxpayer challenged the validity of § 1.263A–11(e)(1)(ii)(B) as applied to its improvements. In *Dominion Resources, Inc.* v. *United States,* 97 Fed. Cl. 239 (Fed. Cl. 2011), the United States Court of Federal Claims upheld the validity of the associated property rule and denied the taxpayer's claim for refund.

On appeal, the United States Court of Appeals for the Federal Circuit (Federal Circuit) reversed the lower court decision and invalidated the associated property rule of § 1.263A–11(e)(1)(ii)(B) for property temporarily withdrawn from service. The Federal Circuit explained that the regulation ''unreasonably links'' the interest capitalized when a taxpayer makes an improvement to the adjusted basis of the property temporarily withdrawn from service to complete the improvement. The court reasoned that to implement the avoided cost principle, the interest to be capitalized is the amount that could have been avoided if funds had not been expended for the improvement. However, the adjusted basis of the temporarily withdrawn property does not represent an ''avoided'' amount. The court found that ''[a] property owner does not expend funds in an amount equal to the adjusted basis [of the temporarily withdrawn property] when making the improvement. Instead, she expends funds in an amount equal to the cost of the improvement itself.'' *Dominion Resources,* 681 F.3d at 1318; *see also* S. Rep. No. 99–313, at 144 (1986) (interest to be capitalized is the amount ''that could have been avoided if funds had not been expended for construction.''); H.R. Rep. No. 99–426, at 628 (1985) (same). Thus, the court concluded that the regulation contradicts the avoided cost rule.

Section 1.263A–8(d)(3) provides that any improvement to property described in § 1.263(a)–1(b) constitutes the production of property. Final regulations under sections 162 and 263(a) of the Code (TD 9636) were published in the **Federal Register** (78 FR 57686) on September 19, 2013. The final regulations clarified the definition of ''improvement'' and moved the definition to § 1.263(a)–3. Section 1.263(a)–3 did not change the meaning of the term ''improvement'' but synthesized applicable case law and prior administrative rules into a framework to ease determinations of whether a cost must be capitalized as an improvement cost or deducted as a repair and maintenance expense. These final regulations also clarified that a cost capitalized as an improvement cost can include only the cost of activities performed after the property is placed in service. *See* § 1.263(a)–3(d).

Explanation of Provisions

The Treasury Department and the IRS have considered the Federal Circuit's opinion in *Dominion Resources* and agree with its rationale. Under this rationale, treating the adjusted basis of any associated property that is temporarily withdrawn from service to complete the improvement as a component of APEs contradicts the avoided cost rule because the adjusted basis of the temporarily withdrawn property does not represent an ''avoided'' amount. Accordingly, these proposed regulations would remove the associated property rule at § 1.263A–11(e)(1)(ii)(B) (for improvements to real property) and § 1.263A–11(e)(1)(iii) (for improvements to tangible personal property) for property temporarily withdrawn from service. For similar reasons, these proposed regulations would remove the rule at § 1.263A–11(e)(1)(ii)(A) (APEs with respect to an improvement to real property includes an allocable portion of the cost of land).

In *Dominion Resources,* the challenge to § 1.263A–11(e)(1)(ii)(B) applied only to improvements to property ''temporarily withdrawn from service'' and not to improvements to property that is ''not placed in service.'' However, the Treasury Department and the IRS have determined that the associated property rule at §§ 1.263A–11(e)(1)(ii)(B) and 1.263A–11(e)(1)(iii) for improvements to property ''not placed in service'' also should be removed because under § 1.263(a)–3(d), the definition of ''improvement'' is limited to amounts paid for activities performed *after* the property is placed in service. Amounts paid for activities performed prior to the date that property is placed in service are characterized as acquisition or production costs (rather than improvement costs) and are generally capitalized under § 1.263(a)–2 and section 263A. *See* §§ 1.263(a)–2(d) and (c)(1). In addition, the APE rules in § 1.263A–11(f) already address a situation in which a taxpayer incurs production costs with respect to property that has not been placed in service. Accordingly, these proposed regulations would remove the associated property rule at §§ 1.263A–11(e)(1)(ii)(B) and 1.263A–11(e)(1)(iii) for improvements to property not placed in service.

Because these proposed regulations would remove the associated property rule at § 1.263A–11(e)(1)(ii)(B), the de minimis rule of § 1.263A–11(e)(2) would be irrelevant. Accordingly, these proposed regulations also would remove this de minimis rule.

As a result of the proposed amendments to § 1.263(a)–11(e) to remove from APEs the adjusted basis of associated real property, the adjusted

basis of associated tangible personal property, and an allocable portion of the cost of the land when the taxpayer makes an improvement, a taxpayer would be required to include in APEs only the direct and indirect costs of the improvement itself.

The proposed regulations would not change the substance of the rules in § 1.263A–11(f) concerning interest capitalized with respect to property purchased and further produced before it is placed in service. Section 1.263A–11(f) provides that if a taxpayer purchases a unit of property for further production, the taxpayer's APEs include the full purchase price of the property plus additional direct and indirect costs incurred by the taxpayer.

The Treasury Department and the IRS considered whether the rules in § 1.263A–11(f) should be modified to exclude the purchase price of such property from the taxpayer's APEs in light of the holding in *Dominion Resources.* That is, the Treasury Department and the IRS considered whether the rationale of *Dominion Resources* should apply to situations in which a taxpayer purchases property for further production prior to placing the property in service. As noted previously in the Background and this Explanation of Provisions, the holding in *Dominion Resources* was limited to improvements to property ''temporarily withdrawn from service'' and did not address situations in which a taxpayer purchases property for further production prior to placing the property in service. Further, unlike the cost of property that is temporarily withdrawn from service to be improved, the cost of property purchased for further production prior to being placed in service represents an ''avoided'' amount under avoided cost principles because the cost of such property is a component cost of the original production activity. In contrast, the cost of property that is temporarily withdrawn from service to be improved is not a component cost of the subsequent production activity. Accordingly, these proposed regulations would retain the substantive rules in § 1.263A–11(f). However, these proposed regulations would modify § 1.263A–11(f) to clarify that § 1.263A–11(f) applies only to situations in which property is purchased and further produced before the property is placed in service.

The Treasury Department and the IRS recognize that the proposed amendments to remove from APEs the adjusted basis of associated real property, the adjusted basis of associated tangible personal property, and an allocable portion of the cost of the land when the taxpayer makes an improvement may increase the potential for abuse. For example, a taxpayer may attempt to treat property produced for self-use as having been placed in service (even though the placed-in-service requirements have not yet been met) and then attempt to characterize subsequent production activities as an improvement, thereby improperly excluding relevant costs from APEs. Section 1.263A–12(d)(1) provides that in the case of property produced for self-use, the production period for a unit of property does not end until the taxpayer places the property in service and all production activities reasonably expected to be undertaken are completed. The proposed regulations contain a cross-reference to § 1.263A–12(d)(1) to emphasize that taxpayers must comply with the rules of that section when determining whether the production period has ended and therefore whether the taxpayer's production activities constitute an improvement.

The final regulations under sections 162 and 263(a), published in 2013, clarify the definition of ''improvement'' and change the specific citations for the definition. Specifically, § 1.263(a)–3 now governs the definition of ''improvement'' for purposes of section 263(a). In addition, § 1.263(a)–3 includes certain exceptions, safe harbors, and elections that may be applied in determining whether certain amounts must be treated as improvement costs. The treatment afforded by the application of § 1.263(a)–3, including these exceptions, safe harbors, and elections, should also apply in determining whether costs must be treated as improvements for the computation of APEs for section 263A interest capitalization purposes. Accordingly, these proposed regulations would amend § 1.263A–8(d)(3) to update the definition of ''improvement'' so that it is consistent with the definition of ''improvement'', including the exceptions, safe harbors, and elections provided under § 1.263(a)–3. Note, however, the de minimis safe harbor election, as provided by § 1.263(a)–1(f), is not an election under § 1.263(a)–3 and generally does not apply to amounts paid for tangible property subject to section 263A if these amounts comprise the direct or allocable indirect costs of other property produced by the taxpayer. *See* § 1.263(a)–1(f)(3)(v). Accordingly, the de minimis safe harbor election under § 1.263(a)–1(f) generally would not apply in determining whether amounts should be included in the computation of APEs for interest capitalization under section 263A.

Proposed Applicability Dates

These regulations are proposed to apply to taxable years beginning after the date that final regulations are published in the **Federal Register**. However, taxpayers may choose to apply these proposed regulations for taxable years beginning after May 15, 2024 and on or before the date that final regulations are published in the **Federal Register**.

Special Analyses

I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

1. Collections of Information

These proposed regulations do not impose additional recordkeeping or reporting burden related to section 263A for taxpayers. A change in a taxpayer's treatment of interest to a method consistent with §§ 1.263A–8(d)(3) and 1.263A–11(e) and (f), as applicable, is a change in method of accounting to which sections 446 and 481 apply. Taxpayers change methods of accounting by filing Form 3115 (OMB 1545–2070). For purposes of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) (PRA), the reporting burden associated with Form 3115 will be reflected in the PRA submission for OMB 1545–2070, so no estimate is provided here.

2. Burden Estimates

These regulations impose 0 hours and $0 of additional recordkeeping or reporting burden related to section 263A for taxpayers. Taxpayers who change their accounting method based on the revised requirements do so by filing Form 3115 (OMB 1545–2070). For purposes of the PRA, the reporting burden associated with Form 3115 will be reflected in the PRA submission for OMB 1545–2070, so no estimate is provided here.

Because businesses with gross receipts of up to $25 million (as adjusted for inflation pursuant to sections 263A(i) and 446(c)) are exempted from the requirement to capitalize costs, including interest, under section 263A, businesses with

gross receipts in excess of $25 million (as adjusted for inflation) are impacted by these proposed regulations. Approximately 30,000 taxpayers with gross receipts in excess of $25 million (as adjusted for inflation) reported that they were subject to section 263A during the past five years. This number is based upon the number of taxpayers who reported that they were subject to section 263A on Forms 1120, 1125–A, and 4562.

It is estimated that no more than 1 percent of these businesses will make improvements to real or tangible personal property that constitute the production of designated property for which a change in accounting method will be made in any one year. Therefore, it is estimated that approximately 300 taxpayers may be impacted by the changes in these proposed regulations.

III. Regulatory Flexibility Act

Small business taxpayers, those with gross receipts of up to $ 25 million (as adjusted for inflation), are exempted from the requirement to capitalize costs, including interest, under section 263A. Therefore, very few, if any, small business taxpayers will be affected by these proposed regulations. It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Treasury Department and the IRS invite comments about the potential impacts of this proposed rule on small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel of the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million (updated annually for inflation). This proposed rule does not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS, as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments will be made available at *https://www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Livia Piccolo of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 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 * * *

* * * * *

§ 1.263A–0 [Amended]

■ **Par. 2.** Section 1.263A–0 is amended by removing the entries for § 1.263A–11(e)(1) and (2).

■ **Par. 3.** Section 1.263A–8 is amended by revising paragraph (d)(3)(i) to read as follows:

§ 1.263A–8 Requirement to capitalize interest.

* * * * *

(d) * * *

(3) *Improvements to existing property*—(i) *In general.* Any improvement to property owned by the taxpayer that is treated as an improvement under § 1.263(a)–3 constitutes the production of property. Generally, any improvement to designated property constitutes the production of designated property. An improvement is not treated as the production of designated property, however, if the de minimis exception described in paragraph (b)(4) of this section applies to the improvement. Paragraph (d)(3)(iii) of this section provides an exception for certain improvements to tangible personal property. In addition, improvements to designated property under this paragraph (d)(3)(i) do not include repairs and maintenance described in § 1.162–4(a).

* * * * *

■ **Par. 4.** Section 1.263A–11 is amended by revising paragraphs (e) and (f) to read as follows:

§ 1.263A–11 Accumulated production expenditures.

* * * * *

(e) *Improvements.* If an improvement constitutes the production of designated property under § 1.263A–8(d)(3), accumulated production expenditures with respect to the improvement consist of all direct and indirect costs required to be capitalized with respect to the improvement. *See* § 1.263A–12(d)(1) to determine when the production period for a unit of property has ended.

(f) *Mid-production purchases.* If a taxpayer purchases a unit of property for further production before the purchased unit of property is placed in service, the taxpayer's accumulated production expenditures include the full purchase price of the purchased unit of property plus all the additional direct and indirect production costs incurred by the taxpayer that are required to be capitalized with respect to the purchased unit of property.

* * * * *

■ **Par. 5.** Section 1.263A–15 is amended by adding paragraph (a)(6) to read as follows:

§ 1.263A–15 Effective dates, transitional rules, and anti-abuse rule.

(a) * * *

(6) Sections 1.263A–8(d)(3) and 1.263A–11(e) and (f) apply to taxable years beginning after [DATE OF PUBLICATION OF FINAL RULE]. A change in a taxpayer's treatment of interest to a method consistent with §§ 1.263A–8(d)(3) and 1.263A–11(e) and (f), as applicable, is a change in method of accounting to which sections 446 and 481 apply.

* * * * *

Douglas W. O'Donnell,

Deputy Commissioner.

[FR Doc. 2024–10579 Filed 5–14–24; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 310

[Docket ID: DoD–2024–OS–0049]

RIN 0790–AL30

Privacy Act of 1974; Implementation

AGENCY: Office of the Secretary of Defense (OSD), Department of Defense (DoD).

ACTION: Proposed rule.

SUMMARY: The Department of Defense (Department or DoD) is giving concurrent notice of a new Department-wide system of records pursuant to the Privacy Act of 1974 for the DoD–0020, ''Military Human Resource Records'' system of records and this proposed rulemaking. In this proposed rulemaking, the Department proposes to exempt portions of this system of records from certain provisions of the Privacy Act because of national security requirements, and to prevent the undermining of evaluation materials used to determine potential for promotion.

DATES: Send comments on or before July 15, 2024.

ADDRESSES: You may submit comments, identified by docket number and title, by any of the following methods.

* *Federal eRulemaking Portal: https://www.regulations.gov.* Follow the instructions for submitting comments.

* *Mail:* Department of Defense, Office of the Assistant to the Secretary of Defense for Privacy, Civil Liberties, and Transparency, Regulatory Directorate, 4800 Mark Center Drive, Attn: Mailbox 24, Suite 08D09, Alexandria, VA 22350–1700.

Instructions: All submissions received must include the agency name and docket number or Regulatory Information Number for this **Federal Register** document. The general policy for comments and other submissions from members of the public is to make these submissions available for public viewing on the internet at *https://www.regulations.gov* as they are received without change, including any personal identifiers or contact information.

FOR FURTHER INFORMATION CONTACT: Ms. Rahwa Keleta, (703) 571–0070, *OSD.DPCLTD@mail.mil.*

SUPPLEMENTARY INFORMATION:

I. Background

In accordance with the Privacy Act of 1974, the DoD is establishing a new DoD-wide system of records titled ''Military Human Resource Records,'' DoD–0020. This system of records describes DoD's collection, use, and maintenance of records about members of the armed forces, including active duty, reserve, and guard personnel. Records support Department requirements and individual Service members' careers, through the collection and management of personnel and employment data. This information includes individual's pay and compensation, education, assignment history, rank and promotion determinations, separation and retirement actions, and career milestones.

II. Privacy Act Exemption

The Privacy Act allows Federal agencies to exempt eligible records in a system of records from certain provisions of the Act, including those that provide individuals with a right to request access to and amendment of their own records. If an agency intends to exempt a particular system of records, it must first go through the rulemaking process pursuant to 5 U.S.C. 553(b)(1)–(3), (c), and (e). This proposed rule explains why an exemption is being claimed for this system of records and invites public comment, which DoD will consider before the issuance of a final rule implementing the exemption.

The DoD proposes to modify 32 CFR part 310 to add a new Privacy Act exemption rule for the DoD–0020, Military Human Resource Records system of records. The DoD proposes this exemption because some of its military personnel records may contain classified national security information and disclosure of those records to an individual may cause damage to national security. The Privacy Act, pursuant to 5 U.S.C. 552a(k)(1), authorizes agencies to claim an exemption for systems of records that contain information properly classified pursuant to executive order. The DoD is proposing to claim an exemption from the access and amendment requirements and certain disclosure accounting requirements of the Privacy Act, pursuant to 5 U.S.C. 552a(k)(1), to prevent disclosure of any information properly classified pursuant to executive order, as implemented by DoD Instruction 5200.01 and DoD Manual 5200.01, Volumes 1 and 3.

In addition, the DoD proposes an exemption for this system of records because the records may contain evaluation material, including from other systems of records, that is used to determine potential for promotion in the armed services within the scope of 5 U.S.C. 552a(k)(7). In some cases, such records may contain information pertaining to the identity of a source who furnished information to the Government under an express promise that the source's identity would be held in confidence (or prior to the effective date of the Privacy Act, under an implied promise). The DoD therefore is proposing to claim an exemption from several provisions of the Privacy Act, including various access, amendment, disclosure of accounting, and certain record-keeping and notice requirements, to prevent disclosure of any information that would compromise the identity of confidential sources who might not have otherwise provided information to assist the Government.

Records in this system of records are only exempt from the Privacy Act to the extent the purposes underlying the exemption pertain to the record. A notice of a new system of records for DoD–0020, ''Military Human Resource Records,'' is also published in this issue of the **Federal Register**.

Regulatory Analysis

Executive Order 12866, ''Regulatory Planning and Review'' and Executive Order 13563, ''Improving Regulation and Regulatory Review''

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563