Federal Register

Wednesday,
January 10, 2001

Part IV

Department of the Treasury

Internal Revenue Service

26 CFR Parts 53, 301 and 602

Excise Taxes on Excess Benefit Transactions; Final Rule and Proposed Rule

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 53, 301, and 602

[TD 8920]

RIN 1545–AY64

Excise Taxes on Excess Benefit Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the excise taxes on excess benefit transactions under section 4958 of the Internal Revenue Code, as well as certain amendments and additions to existing Income Tax Regulations affected by section 4958. Section 4958 was enacted in section 1311 of the Taxpayer Bill of Rights 2. Section 4958 imposes excise taxes on transactions that provide excess economic benefits to disqualified persons of public charities and social welfare organizations (referred to as applicable tax-exempt organizations). Disqualified persons who benefit from an excess benefit transaction with an applicable tax-exempt organization are liable for a tax of 25 percent of the excess benefit. Such persons are also liable for a tax of 200 percent of the excess benefit if the excess benefit is not corrected by a certain date. Additionally, organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause, are liable for a tax of 10 percent of the excess benefit. The tax for which participating organization managers are liable cannot exceed $10,000 for any one excess benefit transaction.

DATES: *Effective Date:* These regulations are effective January 10, 2001.

Applicability Date: These regulations apply as of January 10, 2001 and will cease to apply January 9, 2004.

FOR FURTHER INFORMATION CONTACT: Phyllis D. Haney, (202) 622–4290 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these temporary regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1623, in conjunction with the notice of proposed rulemaking published August 4, 1998, 63 FR 41486, REG–246256–96, Failure by Certain Charitable Organizations to Meet Certain Qualification Requirements; Taxes on Excess Benefit Transactions.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books and records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 4958 was added to the Code by the Taxpayer Bill of Rights 2, Public Law 104–168 (110 Stat. 1452), enacted July 30, 1996. The section 4958 excise taxes generally apply to excess benefit transactions occurring on or after September 14, 1995. The IRS notified the general public of the new section 4958 excise taxes in Notice 96–46 (1996–2 C.B. 112), which also solicited comments on the new law.

On August 4, 1998, a notice of proposed rulemaking (REG–246256–96) clarifying certain definitions and rules contained in section 4958 was published in the **Federal Register** (63 FR 41486). The IRS received numerous written comments responding to this notice, including a comment from the public on the collections of information estimates contained therein.

That commentator expressed concern that the purchase of independent compensation surveys is required to certify the reasonableness of certain outside and personnel contracts; and that the proposed regulations place a burden on governing bodies of applicable tax-exempt organizations, increasing the personal risk of members of those governing bodies. The collections of information in the proposed regulations are voluntary on the part of the governing bodies of applicable tax-exempt organizations. Although the collections of information allow the organization to rely on a presumption that a transaction is reasonable or at fair market value, the failure to obtain the collections of information in no way implies that a transaction is unreasonable.

Further, as discussed under Explanation of Provisions of this preamble (under the heading *Rebuttable presumption that a transaction is not an excess benefit transaction*), the IRS and the Treasury Department believe that any applicable tax-exempt organization may compile its own comparability data rather than obtain an independent survey to satisfy the requirement to obtain appropriate data as to comparability. Therefore, although the comment on Paperwork Reduction Act requirements was considered in the new estimates of the annual burden per recordkeeper and per respondent, these temporary regulations continue to conclude that the estimated annual burden per recordkeeper varies from 3 hours to 308 hours, depending on individual circumstances, with an estimated weighted average of 6 hours, 3 minutes.

A public hearing was held on March 16 and 17, 1999. After consideration of all the comments, the proposed regulations under section 4958 were revised as follows. The major areas of the comments and revisions are discussed below.

Explanation of Provisions

Additional Taxes on Disqualified Person

A disqualified person benefitting from an excess benefit transaction must correct the excess benefit within the taxable period to avoid liability for the 200-percent tax under section 4958(b). The taxable period is defined by section 4958 as the period beginning on the date the transaction occurred and ending on the earlier of the date of mailing a notice of deficiency, or the date on which the 25-percent tax is assessed.

A commentator questioned whether the disqualified person would receive any notice that the IRS was examining a possible excess benefit transaction before either of the events ending the taxable period occur. In fact, a disqualified person would be notified if an examination of that person were opened pursuant to an examination of an applicable tax-exempt organization. The IRS has an obligation under Internal Revenue Code (Code) section 7602(c) to notify taxpayers at the beginning of the examination and collection process that the IRS might contact third parties (such as the organization) about the taxpayer's tax liabilities. Additionally, the IRS follows the procedure of issuing a ''first letter of proposed deficiency'' allowing the taxpayer an opportunity for administrative review in the IRS Office of Appeals. This first letter is issued 30 days before the notice of deficiency is issued. Consequently, a disqualified person would be aware of any examination of a potential excess benefit transaction before the end of the taxable period.

Although it is also IRS practice to issue a single notice of deficiency for both the 25-percent and 200-percent section 4958 taxes for which the disqualified person is liable, the abatement rules under section 4961 provide that the 200-percent tax under section 4958(b) is not to be assessed (and if assessed, is to be abated) if the excess benefit is corrected within 90 days after the mailing of the notice of deficiency for that tax.

Correction

Section 4958(f)(6) defines *correction* as ''undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.'' The proposed regulations provide a short, general description of correction, referring to the statutory language. The proposed regulations define correction as repaying an amount of money equal to the excess benefit, plus ''any additional amount needed to compensate the organization for the loss of the use of the money or other property'' from the date of the excess benefit transaction to the date the excess benefit is corrected. The proposed regulations further allow correction ''in certain circumstances'' by permitting the disqualified person to return property to the organization and ''taking any additional steps necessary to make the organization whole.'' Where there is an ongoing contract for services, the proposed regulations provide that the parties need not terminate the contract in order to correct, but the contract ''may need to be modified'' to avoid future excess benefit transactions.

The IRS received numerous comments and requests for additional guidance relating to correction as defined in the proposed regulations. A number of commentators requested that final regulations state explicitly that correction requires a disqualified person to pay interest on the excess benefit amount, and to specify the rate of interest.

The temporary regulations state that the disqualified person must pay the applicable tax-exempt organization a correction amount in order to correct an excess benefit transaction and prevent imposition of the 200-percent tax. The correction amount equals the sum of the excess benefit and interest on the excess benefit. The amount of the interest charge is determined by multiplying the excess benefit by an interest rate, compounded annually, for the period from the date the excess benefit transaction occurred to the date of correction. The interest rate used for this purpose must be a rate that equals or exceeds the applicable Federal rate (AFR), compounded annually, for the month in which the transaction occurred. The period from the date the excess benefit transaction occurred to the date of correction is used to determine whether the appropriate AFR is the Federal short-term rate, the Federal mid-term rate, or the Federal long-term rate.

Commentators requested that an applicable tax-exempt organization have discretion to determine the appropriate form of correction; for example, payment of money, return of property, or some combination. Alternatively, one commentator requested an explicit rule that monetary payment is always sufficient and that a buy-back or return of property is not required. Another requested clarification that rescission could constitute an appropriate form of correction.

The temporary regulations provide, in general, that a disqualified person corrects an excess benefit only by making a payment in cash or cash equivalents to the applicable tax-exempt organization equal to the correction amount. The disqualified person may, however, with the agreement of the applicable tax-exempt organization, make a payment by returning specific property previously transferred in the excess benefit transaction. In the latter case, the amount of the payment equals the lesser of the fair market value of the property determined on the date the property is returned to the organization, or the fair market value of the property on the date the excess benefit transaction occurred.

Under the temporary regulations, if the payment made by returning the property is less than the correction amount, the disqualified person must make an additional cash payment to the organization of the difference. Conversely, if the payment made by returning the property exceeds the correction amount, the organization may make a cash payment to the disqualified person of the difference. The disqualified person who engaged in the excess benefit transaction with the applicable tax-exempt organization may not participate in the applicable tax-exempt organization's decision whether to accept as a correction payment the return of specific property previously transferred in the excess benefit transaction. An organization may always refuse the return of that property as payment, and require instead that the disqualified person make a payment in cash (or cash equivalents) of the full correction amount.

The temporary regulations provide a special rule relating to the correction of an excess benefit transaction resulting from the vesting of benefits provided under a nonqualified deferred compensation plan. To the extent that such benefits have not been distributed to the disqualified person, the disqualified person may correct the portion of the excess benefit attributable to such undistributed deferred compensation by relinquishing any right to receive such benefits (including any earnings thereon).

The temporary regulations provide five new examples that illustrate acceptable forms of correction. The temporary regulations also clarify that, if the disqualified person makes a payment of less than the full correction amount, the 200-percent tax is imposed only on the unpaid portion of the correction amount.

Another commentator suggested that where an organization failed to establish its intent to treat an economic benefit as consideration for the performance of services, amending an information return, rather than requiring the disqualified person to repay the benefit, should be sufficient to correct the excess benefit transaction, assuming that the total amount of compensation was reasonable. In this regard, the proposed regulations specifically allow the reporting of an economic benefit by an organization on an original or amended Federal tax information return to establish that a benefit was intended as compensation. The proposed regulations and these temporary regulations permit an organization to establish its intent by amending an information return at any time prior to when the IRS commences an examination. Additionally, the temporary regulations explicitly allow the disqualified person to amend the person's Federal tax return to report a benefit as income at any time prior to when the IRS commences an examination of the disqualified person or the applicable tax-exempt organization for the taxable year in which the transaction occurs.

In addition, under the proposed regulations and these temporary regulations, if an organization can show reasonable cause (using existing standards under section 6724) for failing to report an economic benefit as compensation as required under the Code or regulations, then the organization will be treated as clearly indicating its intent to provide an economic benefit as compensation for services. The section 6724 standards include acting in a responsible manner before and after the failure to report occurred, along with either significant mitigating factors or events beyond the organization's control.

Where the applicable tax-exempt organization provides taxable benefits to a disqualified person, section 4958(c)(1) requires a clear indication that the organization intended to provide the benefits as consideration for the performance of services. Where there is no such clear indication, the value of those benefits generally is an excess benefit, regardless of any claim of reasonableness of the total compensation package. In this case, the regular correction rules apply.

The temporary regulations provide that failure of the organization or the disqualified person to report nontaxable economic benefits (or otherwise document a clear intent) does not result automatically in an excess benefit transaction. This rule is consistent with the legislative history. (H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 57, note 8). These nontaxable benefits must still be taken into account (unless specifically excluded elsewhere in the regulations) when determining whether the total amount of compensation paid to a disqualified person is reasonable. Therefore, only to the extent that total compensation exceeds what is reasonable could a section 4958 excise tax be imposed and correction be required with respect to nontaxable economic benefits.

The temporary regulations provide additional guidance regarding correction where an applicable tax-exempt organization has ceased to exist or is no longer tax-exempt under section 501(a) as an organization described in section 501(c)(3) or (4). The temporary regulations make clear that a disqualified person must correct the excess benefit transaction in either event. In the case of section 501(c)(3) organizations, the disqualified person must pay the correction amount to another organization described in section 501(c)(3) in accordance with the dissolution clause of the applicable tax-exempt organization involved in the excess benefit transaction, provided the other organization is not related to the disqualified person. In the case of section 501(c)(4) organizations, the disqualified person must pay the correction amount to the successor section 501(c)(4) organization or, if there is no tax-exempt successor, to any section 501(c)(3) or section 501(c)(4) organization not related to the disqualified person.

Several commentators requested clarification that a disqualified person is allowed to deduct the payment of a correction amount as a business expense. The issue is beyond the scope of these regulations. The provisions of Subtitle A of the Code govern the deductibility of any part of a correction payment.

Tax Paid by Organization Managers: Reliance on Advice of Counsel

The proposed regulations provide a safe harbor under which a manager's participation in a transaction will ordinarily not be subject to tax under section 4958(a)(2), even though the transaction is subsequently held to be an excess benefit transaction, if the manager fully discloses the factual situation to legal counsel, then relies on the advice of such counsel expressed in a reasoned written legal opinion that a transaction is not an excess benefit transaction. This safe harbor parallels the rules for foundation manager taxes contained in the regulations under section 4941 (taxes on self-dealing) and section 4945 (taxes on taxable expenditures).

A number of commentators suggested that the final regulations expand the advice-of-counsel safe harbor to allow reliance on the advice of other professionals. Specifically mentioned were section 7525 practitioners (Federally authorized tax practitioners), professional tax advisors, and compensation consultants and appraisers with respect to valuation issues. Commentators likewise suggested that parallel revisions should be made to the section 4941 and 4945 regulations.

The temporary regulations expand the safe harbor contained in the proposed regulations. The temporary regulations provide that an organization manager's participation in an excess benefit transaction will ordinarily not be considered knowing to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. For this purpose, appropriate professionals are legal counsel (including in-house counsel), certified public accountants or accounting firms with expertise regarding the relevant tax law matters, and independent valuation experts who meet specified requirements. The requirements for appropriate valuation experts are modeled after the section 170 regulations that define *qualified appraisers* for charitable deduction purposes. Under the section 4958 temporary regulations, the valuation experts must hold themselves out to the public as appraisers or compensation consultants; perform the relevant valuations on a regular basis; be qualified to make valuations of the type of property or services being valued; and include in the written opinion a certification that they meet the preceding requirements. This section 4958 regulations project did not undertake any revisions to the advice-of-counsel safe harbor or the definition of *knowing* in the section 4941 and 4945 regulations.

The temporary regulations contain an additional safe harbor, providing that an organization manager's participation in a transaction will ordinarily not be considered knowing if the manager relies on the fact that the requirements giving rise to the rebuttable presumption of reasonableness are satisfied with respect to the transaction (for the requirements, see discussion under the heading *Rebuttable presumption that a transaction is not an excess benefit transaction* of this preamble).

Date of Occurrence

Section 4958 does not specify when an excess benefit transaction occurs. The proposed regulations provide that an excess benefit transaction occurs on the date on which the disqualified person receives the economic benefit from the applicable tax-exempt organization for Federal income tax purposes. The proposed regulations also provide that a transaction consisting of the payment of deferred compensation occurs on the date the deferred compensation is earned and vested. Several comments were received requesting additional guidance about the timing of an excess benefit transaction. Specifically, one commentator requested clarification in the case of multiple payments.

The temporary regulations continue to provide as a general rule that an excess benefit transaction occurs on the date the disqualified person receives the economic benefit for Federal income tax purposes. The temporary regulations contain additional rules for a series of compensation payments or other payments arising pursuant to a single contractual arrangement provided to a disqualified person over the course of the disqualified person's taxable year (or part of a taxable year). In such a case, any excess benefit transaction with respect to these aggregate payments is deemed to occur on the last day of the taxable year (or, if the payments continue for part of the year, the date of the last payment in the series).

The temporary regulations also contain special rules for deferred, contingent, and certain noncash compensation. The temporary regulations state that in the case of benefits provided pursuant to a qualified pension, profit-sharing, or stock bonus plan, the transaction occurs on the date the benefit is vested. In the case of a transfer of property that is subject to a substantial risk of forfeiture, or in the case of rights to future compensation or property (including benefits under a nonqualified deferred compensation plan), the transaction occurs on the date the property, or the rights to future compensation or property, is not subject to a substantial risk of forfeiture. However, where the disqualified person elects to include an amount in gross income in the taxable year of transfer pursuant to section 83(b), the general rule applies, such that the transaction occurs on the date the disqualified person receives the economic benefit from the applicable tax-exempt organization for Federal income tax purposes. Any excess benefit transaction with respect to benefits under a deferred compensation plan which vest during any taxable year of the disqualified person is deemed to occur on the last day of the disqualified person's taxable year.

The temporary regulations continue to reference the relevant Code sections for statute of limitations rules as they apply to section 4958 excise taxes. Generally, the statute of limitations for section 4958 taxes begins with the filing of the applicable tax-exempt organization's return for the year in which the excess benefit transaction occurred. If the organization discloses an item on its return or on an attached schedule or statement in a manner sufficient to apprise the IRS of the existence and nature of an excess benefit transaction, the three-year limitation on assessment and collection applies. If the transaction is not so disclosed, a six-year limitation on assessment and collection applies, unless an exception listed in section 6501(c) applies.

Definition of Applicable Tax-Exempt Organization

Section 4958(e) defines an *applicable tax-exempt organization* as ''any organization which (without regard to any excess benefit) would be described in paragraph (3) or (4) of section 501(c) and exempt from tax under section 501(a) * * *'' (except private foundations). An applicable tax-exempt organization also includes any organization that was described in section 501(c)(3) or (4) and exempt from tax under section 501(a) at any time during a five-year period ending on the date of an excess benefit transaction (the *lookback period*).

The temporary regulations revise the section defining applicable tax-exempt organizations to clarify that an organization is not described in section 501(c)(3) or (4) for purposes of section 4958 during any period covered by a final determination or adjudication that the organization is not exempt from tax under section 501(a) as an organization described in section 501(c)(3) or (4), so long as that determination or adjudication is not based upon participation in inurement or one or more excess benefit transactions.

A number of commentators requested that the final regulations clarify the status of section 115 governmental entities that voluntarily applied for a determination of their section 501(c)(3) status. Others requested that those governmental entities that applied for section 501(c)(3) exemption before the enactment of section 4958 be exempt from section 4958. In response to these comments, the temporary regulations provide that any governmental entity that is exempt from (or not subject to) taxation without regard to section 501(a) is not an applicable tax-exempt organization for purposes of section 4958.

Definition of Disqualified Person

Section 4958(f)(1) defines a disqualified person with respect to any transaction as ''any person who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organization * * *'' (and several other categories of related persons). The proposed regulations list the statutory categories of related persons (*i.e.*, certain family members and 35-percent controlled entities) that are treated as disqualified persons for section 4958 purposes. The proposed regulations also list several categories of persons who are treated as disqualified persons by virtue of the functions they perform for, or the interests they hold in, the organization. The proposed regulations further provide that other persons may be treated as disqualified persons depending on all relevant facts and circumstances and list some of the factors to be considered.

Some commentators questioned certain categories of persons who are deemed to have substantial influence under the proposed regulations (*e.g.*, presidents, chief executive officers, treasurers), arguing that these *per se* categories conflict with a statement in the legislative history that ''[a] person having the title of 'officer, director, or trustee' does not automatically have the status of a disqualified person.'' These commentators requested that final regulations adopt an alternative approach of listing these categories as facts and circumstances tending to show that a person has substantial influence over the affairs of an organization. In response to these comments, the temporary regulations clarify that the per se categories of persons who are in a position to exercise substantial influence for section 4958 purposes are defined by reference to the actual powers and responsibilities held by the person and not merely by the person's title or formal position. Thus, for example, it is possible that a person with the mere title of ''president'' could be treated as not having substantial influence if it is demonstrated that the person, in fact, does not have ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization.

A number of commentators objected to a provision in the proposed regulations under which a person who has or shares authority to sign drafts or to authorize electronic transfer of the organization's funds is treated as a treasurer or chief financial officer who is in a position to exercise substantial influence over the affairs of the organization. Other commentators requested that the final regulations recognize that a person who may authorize transfer of only minimal amounts of the organization's funds should not be treated as a disqualified person solely by reason of that authority.

The temporary regulations clarify that a person who has the powers and responsibilities of a treasurer or chief financial officer is in a position to exercise substantial influence, provided that the person has ultimate responsibility for managing the finances of the organization. As requested by commentators, the temporary regulations delete the provision from the proposed regulations that refers to having, or sharing, authority to sign drafts or to authorize electronic transfer of funds.

The IRS and the Treasury Department considered, but declined to adopt at present, a special rule with respect to so-called ''donor advised funds'' maintained by an applicable tax-exempt organization. Unlike other segments of an applicable tax-exempt organization, such as an operating department (or division) of the organization, a donor advised fund consists of a segregated fund maintained for the specific purpose of allowing certain persons to provide ongoing advice regarding the organization's use of amounts contributed by a particular donor (or donors). Although these persons cannot properly have legal control over the segregated fund, they nonetheless are in a position to exercise substantial influence over the amount, timing, or recipients of distributions from the fund. Accordingly, the IRS and the Treasury Department request comments regarding potential issues raised by applying the fair market value standard of section 4958 to distributions from a donor advised fund to (or for the use of) the donor or advisor.

The proposed regulations deem certain persons not to have substantial influence, including any applicable tax-exempt organization described in section 501(c)(3) (*i.e.,* public charities subject to section 4958). Various commentators requested that section 501(c)(4) applicable tax-exempt organizations, section 115 governmental entities, corporations or associations organized as non-profits under the laws of any State, or entities 100-percent controlled by and for the benefit of section 501(c)(3) applicable tax-exempt organizations, be deemed not to exercise substantial influence over the affairs of applicable tax-exempt organizations.

The temporary regulations provide that any organization described in section 501(c)(3) and exempt from tax under section 501(a) (including a private foundation), is not a disqualified person. The temporary regulations do not specifically exclude from disqualified person status section 115 and section 501(c)(4) organizations generally, as requested in comments. However, the temporary regulations state that an organization described in section 501(c)(4) is deemed not to have substantial influence with respect to another applicable tax-exempt organization described in section 501(c)(4). Additionally, the temporary regulations provide that the transfer of economic benefits to a government entity for exclusively public purposes is disregarded for purposes of section 4958.

A number of comments were received on the section of the proposed regulations providing that facts and circumstances govern in all cases where disqualified person status is not explicitly described. Commentators variously requested revision or deletion of the statement that a person with managerial control over a discrete segment of an organization could be in a position to exercise substantial influence over the affairs of the entire organization. Instead of considering this factor in an overall evaluation of the facts and circumstances, the temporary regulations provide that the fact that a ''person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization'' is a separate factor tending to show substantial influence. The IRS and the Treasury Department believe that, in some circumstances, a person managing a discrete segment or activity of an organization is, in fact, in a position to exercise substantial influence over the organization as a whole.

With respect to the factor that a person is a *substantial contributor* within the meaning of section 507(d)(2), requests were made to define a *substantial contributor* as a person contributing more than two percent of the organization's total support; to use a higher threshold, such as the greater of $50,000 or 10 percent of total contributions received; to limit the treatment of substantial contributor status as a factor to a reasonable time (*e.g.*, four years); and to tie substantial contributor status to persons required to be disclosed as such on Form 990 or Schedule A of that form. Additionally, a request was made to specify how the five-year lookback period applies to substantial contributors.

The temporary regulations continue to include as a factor tending to show substantial influence the fact that a person is a substantial contributor, generally as defined in section 507(d)(2)(A). However, the temporary regulations clarify that, to determine whether a person is a substantial contributor for section 4958 purposes, only contributions received by the organization during its current taxable year and the four preceding taxable years are taken into account.

With respect to the factor that a person's compensation is based on revenues derived from activities of the organization that the person controls, a number of commentators requested that a determination of disqualified person status not be based solely on this factor. Several commentators specifically requested clarification of this factor with respect to physicians in particular, and others requested that the factor be deleted altogether. Other commentators requested that the factor be narrowed to situations where the person's compensation is based on revenues from activities that provide over half of the organization's annual revenue, or that the factor be modified to apply only if a person's compensation is based to a significant extent on revenues derived from activities of the organization that the person controls. In response to these comments, the temporary regulations modify the factor to require that the person's compensation is primarily based on revenues derived from activities of the organization that the person controls.

A number of commentators argued that it is inappropriate to include all persons with managerial authority, or persons serving as key advisors to a person with managerial authority, as potential disqualified persons. Additional comments on this issue requested that the final regulations clarify the meaning of *managerial authority* or delete that factor from the regulations. Others suggested that the term *key advisor* be limited to those with real, substantial authority, or deleted altogether and replaced by a standard that a person can have managerial authority by virtue of his or her actual impact on the organization's affairs without regard to title or position. In response to these comments, the temporary regulations delete as a factor tending to show substantial influence the fact that a person serves as a key advisor to a manager. Moreover, with respect to managerial authority, the temporary regulations list revised factors tending to show substantial influence, including whether: (1) The person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees; and (2) the person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole.

With respect to factors tending to show that a person does not have substantial influence, one commentator requested that the fact that the person has had no prior involvement or relationship with the organization be added as a factor. Another commentator requested that the independent contractor factor be modified so that all ''outside, independent professionals performing services on a strictly fee-for-service arrangement'' are presumed not to be disqualified persons. Other commentators requested that additional factors tending to show no substantial influence be added for employees. In this regard, suggested factors included that the person reports to a disqualified person, does not participate in major policy or financial decisions affecting the organization as a whole, or holds a position three or more levels below the governing body. In response to these comments, the temporary regulations provide as a factor tending to show no substantial influence the fact that a person is an independent contractor (such as an attorney, accountant, or investment manager or advisor) whose sole relationship to the organization is providing professional advice, but who does not have decision-making authority, with respect to transactions from which the independent contractor will not economically benefit either directly or indirectly (aside from customary fees received for the professional advice rendered). In addition, the temporary regulations add as factors tending to show no substantial influence the fact that the direct supervisor of the individual is not a disqualified person, and that the person does not participate in any management decisions affecting the organization as a whole or a substantial, discrete segment or activity of the organization. The temporary regulations also address the issue of persons with no prior involvement with the organization by providing a special exception for initial contracts (see the discussion under the heading *Initial Contract Exception* in this preamble).

Definition of Excess Benefit Transaction

Section 4958(c)(1) defines the phrase *excess benefit transaction* as ''any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit.'' The excess benefit is the amount by which the value of the economic benefits provided to (or for the use of) the disqualified person exceeds the value of the consideration received. The proposed regulations further define certain terms in the statutory definition of *excess benefit transaction* and delineate specific items that either are disregarded or must be taken into account in determining the value of a compensation package. The proposed regulations also prescribe standards for determining fair market value for section 4958 purposes. In response to comments received on these topics, the temporary regulations make numerous changes to the provisions of the proposed regulations that define the phrase *excess benefit transaction* (as summarized under the next six topic headings).

The IRS and the Treasury Department considered whether embezzled amounts should be viewed as provided by the organization for section 4958 purposes. In this regard, the IRS and the Treasury Department believe that any economic benefit received by a disqualified person (who by definition has substantial influence) from the assets of the organization is provided by the organization even if the transfer of the benefit was not authorized under the regular procedures of the organization.

Economic Benefit Provided Directly or Indirectly

Section 4958(c)(1)(A) provides that an excess benefit transaction may arise when economic benefits are provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person. In this regard, the proposed regulations provide that ''[a] benefit may be provided indirectly through the use of one or more entities controlled by or affiliated with the applicable tax-exempt organization. For example, if an applicable tax-exempt organization causes its taxable subsidiary to pay excessive compensation to, or engage in a transaction at other than fair market value with, a disqualified person of the parent organization, the payment of the compensation or the transfer of property is an excess benefit transaction.'' This example is based on similar language contained in the legislative history to section 4958 (See H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 56, note 3).

A number of commentators requested further clarification of the definition of *indirect excess benefit transactions.* Some commentators requested that the final regulations clarify that any compensation disqualified persons receive from unrelated third parties through the acquiescence of the employing applicable tax-exempt organization not be considered in determining reasonable compensation. Another commentator suggested that, as a general rule, an excess benefit may be found to be provided indirectly through an entity controlled by an applicable tax-exempt organization only when the funds or other benefits at issue can clearly be traced to the parent organization. Additionally, a request was received to specify that payment by a subsidiary of excessive compensation does not, by itself, justify the conclusion that the parent organization caused the subsidiary to engage in an excess benefit transaction. Other requests were made to clarify that services received by the applicable tax-exempt organization may include services provided by the disqualified person to one or more other entities controlled by or affiliated with the organization.

Commentators also suggested several clarifications to the phrase ''controlled by or affiliated with'' for purposes of determining whether an indirect excess benefit transaction has occurred. One commentator suggested that control or affiliation must exist at the time the benefit is authorized or approved, rather than when the benefit is received by the disqualified person. Others suggested that the definition of ''controlled by or affiliated with'' follow more closely the definition of control under the section 4941 self-dealing regulations or under section 512(b)(13) (including constructive ownership rules contained in section 318). Another commentator suggested defining the term *affiliated* to mean that organizations share a majority of governing body members or principal officers. Other commentators requested that the final regulations state that approval of a benefit by a board independent of the applicable tax-exempt organization would prevent finding that the organization indirectly provided an excess benefit to a disqualified person. Commentators also requested that the final regulations include examples demonstrating that the mere existence of a relationship between two entities, including a control relationship, is insufficient to justify a conclusion that a benefit has been indirectly provided to a disqualified person unless a purposeful avoidance of section 4958 by conducting a transaction indirectly is shown.

In response to these comments, the temporary regulations clarify that an applicable tax-exempt organization may provide an economic benefit indirectly to a disqualified person either through a controlled entity or through an intermediary. In this regard, the temporary regulations parallel the section 4941 self-dealing regulations, except that the temporary regulations generally adopt the section 512(b)(13) standard for control. (The section 512(b)(13) standard for control considers only the tax-exempt organization's interest in the controlled entity, or the tax-exempt organization's control of a nonstock corporation's directors or trustees. In contrast, the section 4941 regulations' definition of control also considers interests held individually by the directors or trustees of the foundation). The temporary regulations provide that all consideration and benefits exchanged between a disqualified person and an applicable tax-exempt organization, and all entities the organization controls, are taken into account to determine whether there has been an excess benefit transaction.

The temporary regulations provide that an applicable tax-exempt organization provides an economic benefit indirectly through an intermediary when: (1) An applicable tax-exempt organization provides an economic benefit to a third party (the intermediary); (2) the intermediary provides economic benefits to a disqualified person of the applicable tax-exempt organization; and (3) either (a) there is evidence of an oral or written agreement or understanding that the intermediary will transfer property to a disqualified person; or (b) the intermediary lacks a significant business purpose or exempt purpose of its own for engaging in such a transfer. The temporary regulations also include four new examples illustrating different fact patterns under which economic benefits are provided indirectly to a disqualified person through a controlled entity or through an intermediary.

Initial Contract Exception

The proposed regulations do not provide any special rules for transactions conducted pursuant to the first contract that a previously unrelated person enters into with the applicable tax-exempt organization. Several comments received during the regular comment period requested that a person having no prior relationship with an organization not be considered a disqualified person with respect to the first contractual arrangement with the organization.

After the close of the written comment period for the proposed regulations (November 2, 1998), but before the public hearing (March 16 and 17, 1999), the United States Court of Appeals for the Seventh Circuit issued its decision in *United Cancer Council, Inc.* v. *Commissioner of Internal Revenue,* 165 F.3d 1173 (7th Cir. 1999), *rev'ing and remanding* 109 T.C. 326 (1997). In this case, the Seventh Circuit reversed the Tax Court's finding that a contract between a charity and a previously unrelated fundraising company resulted in private inurement in violation of the charity's tax-exempt status. The Seventh Circuit remanded the case back to the Tax Court to address the question whether the fundraising contract resulted in private benefit in violation of section 501(c)(3).

In *United Cancer Council,* the Seventh Circuit concluded that prohibited inurement under section 501(c)(3) cannot result from a contractual relationship negotiated at arm's length with a party having no prior relationship with the organization, regardless of the relative bargaining strength of the parties or resultant control over the tax-exempt organization created by the terms of the contract. The transactions at issue in *United Cancer Council* were conducted prior to the effective date of section 4958. Consequently, *United Cancer Council* involved interpretations of the general requirements for tax-exempt status under section 501(c)(3), and not questions of disqualified person status or the existence of an excess benefit transaction under section 4958. Nevertheless, at the public hearing and in supplemental comments received after the hearing, commentators referenced the Seventh Circuit decision and requested that the proposed regulations be modified so that section 4958 excise taxes will not be imposed on the first transaction or contract between an applicable tax-exempt organization and a previously unrelated person.

The temporary regulations address the issue raised by *United Cancer Council* by providing that section 4958 does not apply to any fixed payment made to a person pursuant to an initial contract, regardless of whether the payment would otherwise constitute an excess benefit transaction. For this purpose, an initial contract is defined as a binding written contract between an applicable tax-exempt organization and a person who was not a disqualified person immediately prior to entering into the contract. A *fixed payment* means an amount of cash or other property specified in the contract, or determined by a fixed formula specified in the contract, which is paid or transferred in exchange for the provision of specified services or property. A fixed formula may incorporate an amount that depends upon future specified events or contingencies (*e.g.,* revenues generated by activities of the organization), provided that no person exercises discretion when calculating the amount of a payment or deciding whether to make a payment. As suggested by some commentators, however, the initial contract rule does not apply if the contract is materially modified or if a person fails to substantially perform his or her obligations under the contract.

Thus, under the temporary regulations, to the extent that an applicable tax-exempt organization and a person who is not yet a disqualified person conduct negotiations and specify the amounts to be paid to the person (or specify an objective formula for paying that person), then these fixed payments are not subject to scrutiny under section 4958, even if paid after the person becomes a disqualified person. An initial contract may provide for both fixed and non-fixed (*i.e.,* discretionary) payments. In this case, the fixed payments are not subject to section 4958, while the non-fixed payments will be subject to scrutiny under section 4958 (taking into account all consideration exchanged between the parties). In effect, the initial contract rule contained in the temporary regulations protects from section 4958 liability those payments made pursuant to fixed, objective terms specified in a contract entered into before the person was in a position to exercise substantial influence, yet allows for scrutiny under section 4958 to the extent the contract allows for subsequent discretion to be exercised (which may be subject to influence by the disqualified person) when calculating the amount of a payment or deciding whether to make a payment. The temporary regulations include eleven examples to illustrate the application of the initial contract rule.

Certain Economic Benefits Disregarded for Purposes of Section 4958

For ease of administration, the proposed regulations list several economic benefits that are disregarded for purposes of section 4958. These disregarded items include reimbursements for reasonable expenses of attending meetings of the governing body (but not luxury or spousal travel); certain economic benefits provided to a disqualified person solely as a member of, or volunteer for, the organization; and economic benefits provided to a disqualified person solely as a member of a charitable class. A number of comments recommended modifying these provisions.

With respect to reimbursements for expenses of attending meetings of the governing body (but not luxury travel or spousal travel), suggestions were made to clarify or delete these terms; to provide as an alternative that all travel expenses that are not lavish or extravagant within the meaning of section 162 may be disregarded; to disregard spousal travel expenses in circumstances where the spousal attendance furthers the exempt purposes of the organization or meets the section 274 bona fide business purpose test; and to address the issue of travel expenses by generally disregarding working condition fringe benefits and de minimis fringe benefits described in sections 132(d) and (e). Other commentators requested that any benefits received by a disqualified person should be disregarded if incidental to the organization's achievement of its exempt purposes, such as when disqualified persons attend fundraising dinners or conferences on behalf of the organization.

In response to these comments, the temporary regulations delete the separate provision that provides that reasonable expenses of attending meetings of the governing body may be disregarded. In place of this provision, the temporary regulations substitute a more general rule providing that all fringe benefits excluded from income under section 132 (except for certain liability insurance premiums, payments or reimbursements, discussed below) are disregarded for section 4958 purposes. This change addresses comments received on the limitation in the proposed regulations with respect to luxury and spousal travel. By referring to fringe benefits excluded from income under section 132, the temporary regulations adopt existing standards under section 162 and section 274 (which are incorporated into section 132) to determine whether payments or reimbursements of travel expenses of an employee or— any other expenses—should be disregarded for section 4958 purposes or, instead, treated as part of the disqualified person's compensation.

With respect to economic benefits provided to a disqualified person solely as a member of, or volunteer for, the organization, the proposed regulations disregard such benefits for section 4958 purposes only if the organization provides the same benefits to members of the general public in exchange for a membership fee of $75 or less per year. Commentators suggested that this provision be expanded in the final regulations to apply to any benefit (without a dollar limitation) provided to a disqualified person solely by virtue of that person being a donor, volunteer, or member, provided that any member of the general public making a comparable contribution receives a similar benefit. Another commentator requested a similar modification, with the additional requirement that a significant number of non-disqualified persons (*e.g.,* 10 or more) actually make a comparable payment to the organization and are given the option of receiving substantially the same benefit.

The temporary regulations continue to disregard for section 4958 purposes economic benefits provided to a volunteer (who is also a disqualified person) if that benefit is provided by the organization to the general public in exchange for a membership fee or contribution of $75 or less per year. In contrast, economic benefits provided to a disqualified person as a member of, or a donor to, an applicable tax-exempt organization are no longer limited by a specific dollar cap. The temporary regulations disregard economic benefits provided to a member of an organization solely on account of the payment of a membership fee, or to a donor solely on account of a contribution deductible under section 170 if: (1) Any non-disqualified person paying a membership fee or making a contribution above a specified amount to the organization is given the option of receiving substantially the same economic benefit; and (2) the disqualified person and a significant number of non-disqualified persons in fact make a payment or contribution of at least the specified amount.

The temporary regulations clarify that section 162 standards apply in determining reasonableness of compensation for section 4958 purposes, taking into account all benefits provided to a person (other than benefits that are specifically disregarded for section 4958 purposes) and the rate at which any deferred compensation accrues. The temporary regulations also provide that the fact that a bonus or revenue-sharing arrangement is subject to a cap is a relevant factor in determining the reasonableness of compensation.

Insurance or Indemnification of Excise Taxes

The legislative history to section 4958 indicates that reimbursements of excise tax liability, or payment of premiums for liability insurance for excess benefit taxes, by an applicable tax-exempt organization constitute an excess benefit unless they are included in the disqualified person's compensation during the year paid and the total compensation package for that person is reasonable. See H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 58. Following this legislative history, the proposed regulations specifically provide that payment of a premium for insurance for section 4958 taxes or indemnification of a disqualified person for these taxes is not an excess benefit transaction if the premium or the indemnification is treated as compensation to the disqualified person when paid, and the total compensation paid to the person is reasonable. However, some commentators read the special rule in conjunction with another section of the proposed regulations—which listed ''[t]he amount of premiums paid for liability or any other insurance coverage, as well as any payment or reimbursement by the organization of charges, expenses, fees, or taxes not covered ultimately by the insurance coverage'' as an item included in compensation for purposes of section 4958—as potentially mandating that such insurance premium or indemnification payments be treated as taxable income to the disqualified person in order to avoid being characterized as an excess benefit transaction.

Several commentators requested that premiums for liability insurance be disregarded entirely for section 4958 purposes, along with non-compensatory indemnification of members of the governing body and officers against liability in civil proceedings (as described in the private foundation self-dealing regulations under section 4941), or that de minimis costs (*e.g.*, $200) associated with such insurance coverage be disregarded.

Other commentators suggested that a portion of the premium payment be allocated to section 4958 tax coverage, and that only that portion be included in compensation of the disqualified person. Others requested that the portion of a premium allocable to liability insurance coverage for an organization manager who is also a disqualified person to cover the person's potential liability for the manager-level tax under section 4958(a)(2) be considered a working condition fringe under section 132(d). Others requested that benefits under indemnification plans be taken into account for section 4958 purposes only if and when paid.

To clarify the treatment of insurance premiums and reimbursements of excise tax liability, the temporary regulations include a special rule, which includes in a disqualified person's compensation for section 4958 purposes the payment of liability insurance premiums for, or the payment or reimbursement by the organization of: (1) Any penalty, tax, or expense of correction owed under section 4958; (2) any expense not reasonably incurred by the person in connection with a civil judicial or civil administrative proceeding arising out of the person's performance of services on behalf of the applicable tax-exempt organization; and (3) any expense resulting from an act or failure to act with respect to which the person has acted willfully and without reasonable cause. This rule parallels the section 4941 regulations governing the treatment of directors and officers liability insurance and indemnification. As under the section 4941 regulations, however, the temporary regulations provide that insurance premiums and reimbursements may be disregarded if they qualify as de minimis fringe benefits excludable from income under section 132(a)(4).

In addition, the temporary regulations clarify that the inclusion of an item in compensation for section 4958 purposes does not govern its income tax treatment. Thus, the mere fact that a premium or reimbursement payment, or any other benefit, provided to a disqualified person must be taken into account in determining the reasonableness of that person's total compensation package for section 4958 purposes is not determinative of whether or not that benefit is included in the disqualified person's gross income for income tax purposes.

Timing Rules for Determining Reasonableness

Section 4958(c)(1) defines an excess benefit transaction as a transaction in which the value of an economic benefit provided to a disqualified person exceeds the value of the consideration received (including the performance of services), but the statutory provisions do not directly address the issue of when to value the benefits and consideration exchanged. In this regard, the proposed regulations provide that whether compensation is reasonable is generally determined when the parties enter into the contract for services. The proposed regulations further provide, however, that ''where reasonableness of compensation cannot be determined based on circumstances existing at the date when the contract for services was made, then that determination is made based on all facts and circumstances, up to and including circumstances as of the date of payment.'' Many commentators objected to the uncertainty created by this additional sentence.

To clarify the issue of the timing of the reasonableness determination, the temporary regulations provide that reasonableness is determined with respect to any *fixed payment* (as defined for purposes of the initial contract rule discussed above) at the time the parties enter into the contract. However, the temporary regulations provide that the reasonableness of any amounts not fixed in the contract itself or paid pursuant to an objective formula is determined based on all facts and circumstances, up to and including circumstances as of the date of the payment at issue, because determining the amount of such a payment (or whether a payment is made) requires the exercise of discretion after the contract is entered into.

Establishing Intent To Treat Economic Benefit as Consideration for the Performance of Services

The second sentence of section 4958(c)(1)(A) defining *excess benefit transaction* states that an economic benefit will not be treated as consideration for the performance of services unless the applicable tax-exempt organization clearly indicated its intent to so treat the benefit. The proposed regulations generally require the organization to provide clear and convincing evidence of its intent to treat the benefit as compensation for services when the benefit is paid. Under the proposed regulations, this requirement is satisfied if the organization reports the economic benefit on a federal tax information return filed before the commencement of an IRS examination in which the reporting of the benefit is questioned, or if the recipient disqualified person reports the benefit as income on the person's Form 1040 for the year in which the benefit is received. In addition, an organization is deemed to satisfy the clear and convincing evidence requirement if the organization's failure to report a payment is due to reasonable cause as defined in the section 6724 regulations. The proposed regulations also provide that an organization may use other methods to provide clear and convincing evidence of its intent. The preamble of the proposed regulations explicitly solicited comments on appropriate ways of applying this rule that would not create an unnecessary burden on affected organizations.

A number of comments were received with regard to establishing an organization's intent to treat a benefit as compensation for services. Several commentators suggested that the clear and convincing standard is higher than appropriate. Others requested that organizations not be required to demonstrate intent with respect to specific benefits, such as: reimbursement arrangements that are clearly part of the employment arrangement; de minimis amounts (for example, taxable benefits of up to $500 per year provided to a disqualified person); and certain nontaxable benefits. Other commentators requested that final regulations clarify the appropriate method for substantiating an organization's intent in the case of certain nontaxable benefits and transfers of property subject to section 83. Others requested guidance on how to report compensation paid to a disqualified person on Form 990 if that person is not an officer or director or one of the five highest paid employees. Some commentators suggested that the final regulations allow other methods to establish an intention to treat benefits as compensation, such as a written contract of employment. Commentators also suggested that an organization's reasonable belief that a benefit is nontaxable should constitute reasonable cause for failure to report, or that the reasonable cause standard be expanded to ordinary business care and prudence.

In response to these comments, the temporary regulations modify the requirement that an organization provide clear and convincing evidence of its intent to treat benefits provided to a disqualified person as compensation for services. Consistent with the legislative history, the temporary regulations provide instead that an organization must provide ''written substantiation that is contemporaneous with the transfer of benefits at issue.'' H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 57, note 8.

The temporary regulations also provide a safe harbor for nontaxable benefits. Under this safe harbor, an applicable tax-exempt organization is not required to indicate its intent to provide an economic benefit as compensation for services if the economic benefit is excluded from the disqualified person's gross income for income tax purposes under chapter 1 of the Internal Revenue Code. Examples of such benefits include: employer-provided health benefits, contributions to a qualified pension, profit-sharing, or stock bonus plan under Internal Revenue Code section 401(a), and benefits described in sections 127 (educational assistance programs) and 137 (adoption assistance programs). The safe harbor is consistent with the legislative history, which indicates that Congress intended to except nontaxable benefits from this contemporaneous substantiation requirement. H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 57, note 8. However, the benefits must still be taken into account (unless specifically disregarded under the regulations) in determining the reasonableness of the disqualified person's compensation for purposes of section 4958.

Consistent with the legislative history, the temporary regulations also clarify that, if a benefit is not reported on a return filed with the IRS, other written contemporaneous evidence (such as an approved written employment contract executed on or before the date of the transfer) may be used to demonstrate that the appropriate decision-making body or an authorized officer approved a transfer as compensation for services in accordance with established procedures.

Transaction in Which the Amount of the Economic Benefit Is Determined in Whole or in Part by the Revenues of One or More Activities of the Organization

Section 4958(c)(2) describes a second type of excess benefit transaction: ''any transaction in which the amount of any economic benefit provided to or for the use of a disqualified person is determined in whole or in part by the revenues of 1 or more activities of the organization * * *'', if the transaction results in inurement under section 501(c)(3) or (4). However, a revenue-sharing transaction is treated as an excess benefit transaction under this special statutory rule only ''[t]o the extent provided in regulations prescribed by the Secretary * * *. ''

The proposed regulations provide that whether a revenue-sharing transaction results in inurement, and therefore constitutes an excess benefit transaction, depends upon all relevant facts and circumstances. The proposed regulations provide that, in general, a revenue-sharing transaction may constitute an excess benefit transaction regardless of whether the economic benefit provided to the disqualified person exceeds the fair market value of services (or other consideration) rendered, if a disqualified person is permitted to receive additional compensation without providing proportional benefits that contribute to the organization's accomplishment of its exempt purpose.

The proposed regulations consider an improper revenue-sharing transaction, in its entirety, to be an excess benefit subject to section 4958. Special rules governing revenue-sharing transactions, however, will be effective only for transactions occurring on or after the date of publication of final regulations containing such rules. Until special rules for revenue-sharing transactions are adopted in final regulations, these transactions are potentially subject to section 4958 liability under the general rules governing excess benefit transactions, but only to the extent that the value of the economic benefits provided to the disqualified person is shown to exceed the value of the services (or other consideration) received in return.

Numerous comments were received with respect to revenue-sharing transactions. Some commentators did not believe a different standard from that applied to all other transactions (fair market value) should apply, and that the value of consideration provided by a disqualified person in a revenue-sharing transaction should be taken into account in determining the excess benefit in these transactions.

Others objected to the revenue-sharing transaction standard of the proposed regulations, and requested that it be replaced by a standard based on approaches the IRS has taken in prior unpublished rulings. Some commentators requested guidance as to the meaning of *proportional benefits* or other concepts incorporated in the proposed regulations standard. Others requested that existing contractual arrangements not be subject to this section of the final regulations, or that the effect of the final rules for existing arrangements be phased in. In addition, several commentators requested that the final regulations clarify whether the rebuttable presumption of reasonableness is available for revenue-sharing transactions. In sum, commentators offered multiple, often conflicting, suggestions and recommendations to address the many issues raised with respect to revenue-sharing transactions.

The temporary regulations reserve the separate section governing revenue-sharing transactions. Accordingly, the IRS and the Treasury Department will continue to consider the many comments received on this issue. Any revised regulations that may, in the future, be issued governing revenue-sharing transactions in particular will be issued in proposed form. This will provide an additional opportunity for public comment, and any special rules governing revenue-sharing transactions will become effective only after being published in final form. In the meantime, revenue sharing transactions will be evaluated under the general rules (contained in § 53.4958–4T of the temporary regulations) defining excess benefit transactions, which apply to all transactions with disqualified persons regardless of whether the person's compensation is computed by reference to revenues of the organization.

Rebuttable Presumption That a Transaction is not an Excess Benefit Transaction

Although the statute is silent on this point, the legislative history accompanying section 4958 indicated Congress' intent that the parties to a transaction are entitled to rely on a rebuttable presumption of reasonableness with respect to any transaction with a disqualified person that is approved by a board of directors or trustees (or committee thereof) that: (1) Is composed entirely of individuals unrelated to and not subject to the control of the disqualified person(s) involved in the transaction; (2) obtained and relied upon appropriate data as to comparability; and (3) adequately documented the basis for its determination. If these three requirements are satisfied, the IRS can impose section 4958 taxes only if it develops sufficient contrary evidence to rebut the probative value of the evidence put forth by the parties to the transaction. H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 56–7.

The proposed regulations incorporate this rebuttable presumption and provide guidance regarding the three requirements for invoking the rebuttable presumption. The proposed regulations provide that the presumption established by satisfying the three requirements may be rebutted by additional information showing that the compensation was not reasonable or that the transfer was not at fair market value. Additionally, the proposed regulations provide that, if the reasonableness of compensation cannot be determined based on circumstances existing at the date when a contract for services was made, then the presumption cannot arise until reasonableness of compensation can be determined and the three requirements subsequently are satisfied.

Comments were received on various aspects of the rebuttable presumption of reasonableness. With regard to the requirement that the compensation arrangement or property transfer must be approved by a governing body (or committee) composed entirely of individuals who do not have a conflict of interest with respect to the transaction, one commentator suggested that the final regulations adopt standards consistent with the model conflicts of interest policy published by the IRS. The IRS and the Treasury Department believe that the standards contained in the proposed regulations for determining the absence of a conflict of interest are consistent with the legislative history of section 4958, which requires that the governing body (or committee) be composed entirely of individuals who are free of any conflict of interest, and not merely that its members disclose the existence of any conflict of interest. Accordingly, the temporary regulations retain these standards.

With regard to the requirement that the governing body (or a committee thereof) obtain appropriate data as to comparability, numerous commentators requested that the final regulations expand the acceptable types of comparability data and authorize additional methods for determining fair market value or reasonable compensation. For example, some commentators requested clarification that an organization need not obtain an independent, customized survey, but may rely on an independent salary survey prepared for general publication if that survey contains information specific enough to provide meaningful data for comparison purposes. Other commentators requested that the governing body (or committee) be permitted to rely on compensation surveys compiled by staff members (other than disqualified persons) under the supervision of an independent director or committee member, rather than incurring the additional cost of obtaining compensation surveys compiled by independent firms. Some commentators requested that the final regulations provide that comparability data is viable for some period of time (*e.g.*, three years).

The temporary regulations continue to require only that the authorized body have sufficient information to determine whether, consistent with the valuation standards in other sections of the regulations, the compensation arrangement is reasonable, or the property transfer is at fair market value. The temporary regulations clarify that a compensation arrangement in its entirety must be evaluated and also provide examples of relevant comparability data. In the case of a compensation arrangement, the temporary regulations provide that relevant information may include a current compensation survey compiled by an independent firm. As in the proposed regulations, this list of relevant comparability data is not exclusive, and the authorized body may rely on other appropriate data. For clarity, the temporary regulations list separately examples of the types of relevant information for compensation arrangements and property transfers. The temporary regulations add competitive bids received from unrelated third parties as another example of relevant information in the case of a property transfer. In response to comments, the temporary regulations revise examples from the proposed regulations and add several examples illustrating appropriate comparability data.

Comments were also received regarding the special rule for compensation paid by small organizations. The proposed regulations allow small organizations (those with annual gross receipts of less than $1 million) to satisfy the requirement of appropriate data as to comparability by obtaining data on compensation paid by five comparable organizations in the same or similar communities for similar services. Some commentators indicated that the $1 million threshold is too low, because organizations having gross receipts above that amount may lack the resources to hire an independent compensation firm. These commentators requested that the ceiling for small organizations be increased from $1 million to $5 million in gross receipts. Others suggested allowing small organizations to obtain data from fewer than five comparable organizations.

The IRS and the Treasury Department believe the general rule regarding appropriate comparability data is flexible enough to permit any organization (not just small organizations) to compile its own comparability data. Therefore, the IRS and the Treasury Department did not believe it was necessary to extend the special safe-harbor rule to organizations with annual gross receipts over $1 million. As requested by commentators, however, the temporary regulations reduce the number of comparables small organizations must obtain for that safe harbor from five to three.

Certain commentators requested that the final regulations provide a mechanism for an applicable tax-exempt organization to satisfy the requirements of the rebuttable presumption of reasonableness with respect to large groups of employees, such as mid-level managers, rather than requiring the governing body to approve the compensation paid to each individual. The IRS and the Treasury Department believe that changes to the definition of *disqualified person* in the temporary regulations, including eliminating as a factor tending to show substantial influence the fact that a person has any managerial authority, or serves as a key advisor to a manager, reduce the potential burden on the governing body. Moreover, the temporary regulations continue to allow the governing body to delegate responsibility for approving compensation arrangements and property transfers, to the extent permitted under State law. Consistent with the legislative history, the temporary regulations continue to require that the rebuttable presumption requirements be satisfied on an individual basis.

With respect to the requirement that the governing body (or committee) adequately document the basis for its determination, comments were received requesting that the final regulations allow additional time for records to be prepared. In response to these comments, the temporary regulations provide that the records must be prepared by the later of the next meeting of the authorized body or 60 days after final approval of the particular arrangement or transfer. Although one commentator objected to the requirement in the proposed regulations that the governing body (or committee) review and approve the records within a reasonable period of time thereafter, the temporary regulations retain this requirement in order to ensure that the records are accurate and complete.

Several commentators requested that the final regulations permit organizations to establish a rebuttable presumption of reasonableness with respect to deferred or contingent compensation arrangements when the contract for services is entered into if the terms of the arrangement are sufficiently certain (even if the exact dollar amounts are not known) and the governing body (or committee) obtains appropriate data as to comparability. Other commentators simply requested that the final regulations indicate when the board should take the necessary steps to put the presumption in place in the event that reasonableness cannot be determined as of the date the contract is entered into. Consistent with the general rule contained in the temporary regulations regarding the timing of the reasonableness determination, the temporary regulations provide that, with respect to fixed payments (including payments made pursuant to a fixed formula, although the exact dollar amount is not known at the time the contract is entered into), the rebuttable presumption can arise at the time the parties enter into the contract giving rise to the payments. Under a special rule in the temporary regulations, payments pursuant to a qualified pension, profit-sharing, or stock bonus plan under section 401(a) are treated as fixed payments for purposes of section 4958, even if the employer exercises discretion with respect to the plan or program. Therefore, a rebuttable presumption can arise with respect to such payments at the time the parties enter into the contract for services.

In contrast, the temporary regulations provide that the rebuttable presumption generally can arise with respect to a payment that is not a fixed payment (as defined for purposes of the initial contract exception) only after discretion is exercised, the exact amount of the payment is determined (or a fixed formula for calculating the payment is specified), and the three requirements for the presumption subsequently are satisfied. The temporary regulations contain a limited exception to this general rule for certain non-fixed payments which are subject to a cap. Under this exception, an applicable tax-exempt organization may establish the rebuttable presumption, even with respect to non-fixed payments, at the time the contract is entered into if: (1) Prior to approving the contract, the governing body (or committee) obtains appropriate comparability data indicating that a fixed payment of up to a certain amount to a particular disqualified person would represent reasonable compensation; (2) the maximum amount payable under the contract (including both fixed and non-fixed payment amounts) does not exceed the reasonable compensation figure; and (3) the other requirements for establishing the rebuttable presumption are satisfied. However, the general rules for the timing of the reasonableness determination apply, such that the IRS may rebut the presumption of reasonableness with respect to a non-fixed payment subject to a cap based on all facts and circumstances, up to and including circumstances as of the date of payment.

Some commentators suggested that the final regulations provide specific standards the IRS must meet in order to rebut any presumption established by satisfying the three requirements described above. For example, one commentator suggested that the IRS should be allowed to overcome the presumption only if it is able to produce clear and convincing evidence that the transaction was, in fact, an excess benefit transaction. Another commentator suggested that the IRS should be required to establish that one of the requirements for invoking the presumption has not been met in order to rebut the presumption. Consistent with the legislative history, the temporary regulations provide that, if the rebuttable presumption of reasonableness is established, the IRS may rebut the presumption only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body.

Finally, some commentators requested clarification whether entities controlled by or affiliated with an applicable tax-exempt organization that provide economic benefits to a disqualified person can establish the presumption, even if those entities are not themselves applicable tax-exempt organizations. Consistent with the rules relating to indirect excess benefit transactions, the temporary regulations clarify that an authorized body of an entity controlled by an applicable tax-exempt organization (as defined for purposes of describing indirect transfers of economic benefits) may establish the rebuttable presumption.

Special Rules

The proposed regulations provided several special rules, one of which stated that the procedures of section 7611 will be used in initiating and conducting any inquiry or examination into whether an excess benefit transaction has occurred between a church and a disqualified person. Several comments were received on this rule, including one stating that there is no statutory authority to extend section 7611 protection to churches for section 4958 tax inquiries. Other comments requested that final regulations specify when information from an informant alone is sufficient to form the basis for a reasonable belief on the part of the IRS for purposes of applying this rule, and clarify how section 4958 interacts with the section 7611 exception for records related to the income tax of an individual employed by the church. The temporary regulations do not modify the special rules for churches.

Additional Issues

Section 4958 does not contain provisions governing the relationship of the taxes imposed under that section to revocation of the organization's tax-exempt status under sections 501(c)(3) and (4). With respect to this issue, the legislative history to section 4958 indicates as follows: ''In general, the intermediate sanctions are the sole sanction imposed in those cases in which the excess benefit does not rise to a level where it calls into question whether, on the whole, the organization functions as a charitable or other tax-exempt organization. In practice, revocation of tax-exempt status, with or without the imposition of excise taxes, would occur only when the organization no longer operates as a charitable organization.'' H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 59, note 15. However, the same legislative history also indicates that ''[t]he intermediate sanctions for 'excess benefit transactions' may be imposed by the IRS in lieu of (*or in addition to*) revocation of the organization's tax-exempt status.'' *Id.* at 59 (emphasis added)

In the Comments and Requests for a Public Hearing section of the preamble of the proposed regulations, the IRS and the Treasury Department specifically requested comments concerning the relationship between revocation of tax-exempt status and imposition of section 4958 taxes. Additionally, the preamble of the proposed regulations lists four factors that the IRS will consider in determining whether to revoke an applicable tax-exempt organization's status: (1) Whether the organization has been involved in repeated excess benefit transactions; (2) the size and scope of the excess benefit transaction; (3) whether, after concluding that it has been party to an excess benefit transaction, the organization has implemented safeguards to prevent future recurrences; and (4) whether there was compliance with other applicable laws. The preamble also states that the IRS intends to publish the factors that it will consider in exercising its administrative discretion in guidance issued in conjunction with the issuance of final regulations under section 4958.

A number of commentators requested that the final regulations expressly provide that section 4958 taxes are the principal sanction with respect to excess benefit transactions, in lieu of revocation of the organization's tax-exempt status. Other commentators suggested that the final regulations incorporate factors to be considered by the IRS in deciding whether to impose section 4958 excise taxes or revoke tax-exempt status, or both.

The temporary regulations do not foreclose revocation of tax-exempt status in appropriate cases. The IRS and the Treasury Department believe that to do so would effectively change the substantive standard for tax-exempt status under sections 501(c)(3) and (4). Accordingly, the IRS intends to exercise its administrative discretion in enforcing the requirements of sections 4958, 501(c)(3) and 501(c)(4) in accordance with the direction given in the legislative history. The IRS will publish guidance concerning the factors that it will consider in exercising its discretion as it gains more experience administering the section 4958 regime.

The temporary regulations reiterate that section 4958 does not affect the substantive standards for tax exemption under section 501(c)(3) or (4), including the requirements that the organization be organized and operated exclusively for exempt purposes, and that no part of its earnings inure to the benefit of any private shareholder or individual. Thus, regardless of whether a particular transaction is subject to excise taxes under section 4958, existing principles and rules may be implicated, such as the limitation on private benefit. For example, transactions that are not subject to section 4958 because of the initial contract exception may, under certain circumstances, jeopardize an organizations's tax-exempt status.

Some comments regarding revenue-sharing transactions included requests to address gainsharing arrangements in the final regulations; or to provide that certain transactions are not revenue-sharing arrangements because they do not involve a payment that is contingent on the revenues of (but rather the cost savings to) the organization. As noted earlier, these temporary regulations reserve the separate section governing revenue-sharing transactions. However, because the Office of Inspector General, Department of Health and Human Services, believes the methodology involved in calculating payments under gainsharing arrangements may violate sections 1128A(b)(1) and (2) of the Social Security Act in situations where patient care may be affected by the cost savings, the IRS will not issue private letter rulings under section 4958 on these arrangements. The Office of Inspector General issued a Special Advisory Bulletin on July 8, 1999, addressing the application of sections 1128A(b)(1) and (2) of the Social Security Act to gainsharing arrangements, entitled ''Gainsharing Arrangements and CMPs [Civil Money Penalties] for Hospital Payments to Physicians to Reduce or Limit Services to Beneficiaries''.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no preceding notice of proposed rulemaking is required for this temporary regulation, the provisions of the Regulatory Flexibility Act do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this temporary regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on business.

Drafting Information

The principal author of these regulations is Phyllis D. Haney, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and The Treasury Department participated in their development.

List of Subjects

26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements, Trusts and trustees.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements

Amendments to the Regulations

Accordingly, 26 CFR parts 53, 301, and 602 are amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Sections 53.4958–0T through 53.4958–8T are added to read as follows:

§ 53.4958–0T Table of contents (temporary).

This section lists the major captions contained in §§ 53.4958–1T through 53.4958–8T.

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(b) Interaction between section 4958 and section 7611 rules for church tax inquiries and examinations.
(c) Three year duration of these temporary regulations.

§ 53.4958–1T Taxes on excess benefit transactions (temporary).

(a) *In general.* Section 4958 imposes excise taxes on each excess benefit transaction (as defined in section 4958(c) and § 53.4958–4T) between an applicable tax-exempt organization (as defined in section 4958(e) and § 53.4958–2T) and a disqualified person (as defined in section 4958(f)(1) and § 53.4958–3T). A disqualified person who receives an excess benefit from an excess benefit transaction is liable for payment of a section 4958(a)(1) excise tax equal to 25 percent of the excess benefit. If an initial tax is imposed by section 4958(a)(1) on an excess benefit transaction and the transaction is not corrected (as defined in section 4958(f)(6) and § 53.4958–7T) within the taxable period (as defined in section 4958(f)(5) and paragraph (c)(2)(ii) of this section), then any disqualified person who received an excess benefit from the excess benefit transaction on which the initial tax was imposed is liable for an additional tax of 200 percent of the excess benefit. An organization manager (as defined in section 4958(f)(2) and paragraph (d) of this section) who participates in an excess benefit transaction, knowing that it was such a transaction, is liable for payment of a section 4958(a)(2) excise tax equal to 10 percent of the excess benefit, unless the participation was not willful and was due to reasonable cause. If an organization manager also receives an excess benefit from an excess benefit transaction, the manager may be liable for both taxes imposed by section 4958(a).

(b) *Excess benefit defined.* An excess benefit is the amount by which the value of the economic benefit provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person exceeds the value of the consideration (including the performance of services) received for providing such benefit.

(c) *Taxes paid by disqualified person*—(1) *Initial tax.* Section 4958(a)(1) imposes a tax equal to 25 percent of the excess benefit on each excess benefit transaction. The section 4958(a)(1) tax shall be paid by any disqualified person who received an excess benefit from that excess benefit transaction. With respect to any excess benefit transaction, if more than one disqualified person is liable for the tax imposed by section 4958(a)(1), all such persons are jointly and severally liable for that tax.

(2) *Additional tax on disqualified person*—(i) *In general.* Section 4958(b) imposes a tax equal to 200 percent of the excess benefit in any case in which section 4958(a)(1) imposes a 25-percent tax on an excess benefit transaction and the transaction is not corrected (as defined in section 4958(f)(6) and § 53.4958–7T) within the taxable period (as defined in section 4958(f)(5) and paragraph (c)(2)(ii) of this section). If a disqualified person makes a payment of less than the full correction amount under the rules of § 53.4958–7T, the 200-percent tax is imposed only on the unpaid portion of the correction amount (as described in § 53.4958–7T(c)). The tax imposed by section 4958(b) is payable by any disqualified person who

received an excess benefit from the excess benefit transaction on which the initial tax was imposed by section 4958(a)(1). With respect to any excess benefit transaction, if more than one disqualified person is liable for the tax imposed by section 4958(b), all such persons are jointly and severally liable for that tax.

(ii) *Taxable period. Taxable period* means, with respect to any excess benefit transaction, the period beginning with the date on which the transaction occurs and ending on the earlier of—

(A) The date of mailing a notice of deficiency under section 6212 with respect to the section 4958(a)(1) tax; or

(B) The date on which the tax imposed by section 4958(a)(1) is assessed.

(iii) *Abatement if correction during the correction period.* For rules relating to abatement of taxes on excess benefit transactions that are corrected within the correction period, as defined in section 4963(e), see sections 4961(a), 4962(a), and the regulations thereunder. The abatement rules of section 4961 specifically provide for a 90-day correction period after the date of mailing a notice of deficiency under section 6212 with respect to the section 4958(b) 200-percent tax. If the excess benefit is corrected during that correction period, the 200-percent tax imposed shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment. For special rules relating to abatement of the 25-percent tax, see section 4962.

(d) *Tax paid by organization managers*—(1) *In general.* In any case in which section 4958(a)(1) imposes a tax, section 4958(a)(2) imposes a tax equal to 10 percent of the excess benefit on the participation of any organization manager who knowingly participated in the excess benefit transaction, unless such participation was not willful and was due to reasonable cause. Any organization manager who so participated in the excess benefit transaction must pay the tax.

(2) *Organization manager defined*—(i) *In general.* An organization manager is, with respect to any applicable tax-exempt organization, any officer, director, or trustee of such organization, or any individual having powers or responsibilities similar to those of officers, directors, or trustees of the organization, regardless of title. A person is an officer of an organization if that person—

(A) Is specifically so designated under the certificate of incorporation, by-laws, or other constitutive documents of the organization; or

(B) Regularly exercises general authority to make administrative or policy decisions on behalf of the organization. An independent contractor who acts solely in a capacity as an attorney, accountant, or investment manager or advisor, is not an officer. For purposes of this paragraph (d)(2)(i)(B), any person who has authority merely to recommend particular administrative or policy decisions, but not to implement them without approval of a superior, is not an officer.

(ii) *Special rule for certain committee members.* An individual who is not an officer, director, or trustee, yet serves on a committee of the governing body of an applicable tax-exempt organization (or as a designee of the governing body described in § 53.4958–6T(c)(1)) that is attempting to invoke the rebuttable presumption of reasonableness described in § 53.4958–6T based on the committee's (or designee's) actions, is an organization manager for purposes of the tax imposed by section 4958(a)(2).

(3) *Participation.* For purposes of section 4958(a)(2) and paragraph (d) of this section, participation includes silence or inaction on the part of an organization manager where the manager is under a duty to speak or act, as well as any affirmative action by such manager. An organization manager is not considered to have participated in an excess benefit transaction, however, where the manager has opposed the transaction in a manner consistent with the fulfillment of the manager's responsibilities to the applicable tax-exempt organization.

(4) *Knowing*—(i) *In general.* For purposes of section 4958(a)(2) and paragraph (d) of this section, a manager participates in a transaction knowingly only if the person—

(A) Has actual knowledge of sufficient facts so that, based solely upon those facts, such transaction would be an excess benefit transaction;

(B) Is aware that such a transaction under these circumstances may violate the provisions of federal tax law governing excess benefit transactions; and

(C) Negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction, or the manager is in fact aware that it is such a transaction.

(ii) *Amplification of general rule. Knowing* does not mean having reason to know. However, evidence tending to show that a manager has reason to know of a particular fact or particular rule is relevant in determining whether the manager had actual knowledge of such a fact or rule. Thus, for example, evidence tending to show that a manager has reason to know of sufficient facts so that, based solely upon such facts, a transaction would be an excess benefit transaction is relevant in determining whether the manager has actual knowledge of such facts.

(iii) *Reliance on professional advice.* An organization manager's participation in a transaction is ordinarily not considered knowing within the meaning of section 4958(a)(2), even though the transaction is subsequently held to be an excess benefit transaction to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. For purposes of section 4958(a)(2) and this paragraph (d), a written opinion is reasoned even though it reaches a conclusion that is subsequently determined to be incorrect so long as the opinion addresses itself to the facts and the applicable standards. However, a written opinion is not reasoned if it does nothing more than recite the facts and express a conclusion. The absence of a written opinion of an appropriate professional with respect to a transaction shall not, by itself, however, give rise to any inference that an organization manager participated in the transaction knowingly. For purposes of this paragraph, appropriate professionals on whose written opinion an organization manager may rely, are limited to—

(A) Legal counsel, including in-house counsel;

(B) Certified public accountants or accounting firms with expertise regarding the relevant tax law matters; and

(C) Independent valuation experts who—

(*1*) Hold themselves out to the public as appraisers or compensation consultants;

(*2*) Perform the relevant valuations on a regular basis;

(*3*) Are qualified to make valuations of the type of property or services involved; and

(*4*) Include in the written opinion a certification that the requirements of paragraphs (d)(4)(iii)(C)(*1*) through (*3*) of this section are met.

(iv) *Reliance on rebuttable presumption of reasonableness.* An organization manager's participation in a transaction is ordinarily not considered knowing within the meaning of section 4958(a)(2), even though the transaction is subsequently held to be an excess benefit transaction, if the organization manager relies on the fact that the requirements of § 53.4958–6T(a) are satisfied with respect to the transaction.

(5) *Willful.* For purposes of section 4958(a)(2) and this paragraph (d), participation by an organization manager is willful if it is voluntary, conscious, and intentional. No motive to avoid the restrictions of the law or the incurrence of any tax is necessary to make the participation willful. However, participation by an organization manager is not willful if the manager does not know that the transaction in which the manager is participating is an excess benefit transaction.

(6) *Due to reasonable cause.* An organization manager's participation is due to reasonable cause if the manager has exercised responsibility on behalf of the organization with ordinary business care and prudence.

(7) *Limits on liability for management.* The maximum aggregate amount of tax collectible under section 4958(a)(2) and this paragraph (d) from organization managers with respect to any one excess benefit transaction is $10,000.

(8) *Joint and several liability.* In any case where more than one person is liable for a tax imposed by section 4958(a)(2), all such persons shall be jointly and severally liable for the taxes imposed under section 4958(a)(2) with respect to that excess benefit transaction.

(9) *Burden of proof.* For provisions relating to the burden of proof in cases involving the issue of whether an organization manager has knowingly participated in an excess benefit transaction, see section 7454(b) and § 301.7454–2. In these cases, the Commissioner bears the burden of proof.

(e) *Date of occurrence*—(1) *In general.* Except as otherwise provided, an excess benefit transaction occurs on the date on which the disqualified person receives the economic benefit for Federal income tax purposes. When a single contractual arrangement provides for a series of compensation or other payments to (or for the use of) a disqualified person over the course of the disqualified person's taxable year (or part of a taxable year), any excess benefit transaction with respect to these aggregate payments is deemed to occur on the last day of the taxable year (or if the payments continue for part of the year, the date of the last payment in the series).

(2) *Special rules.* In the case of benefits provided pursuant to a qualified pension, profit-sharing, or stock bonus plan, the transaction occurs on the date the benefit is vested. In the case of a transfer of property that is subject to a substantial risk of forfeiture or in the case of rights to future compensation or property (including benefits under a nonqualified deferred compensation plan), the transaction occurs on the date the property, or the rights to future compensation or property, is not subject to a substantial risk of forfeiture. However, where the disqualified person elects to include an amount in gross income in the taxable year of transfer pursuant to section 83(b), the general rule of paragraph (e)(1) of this section applies to the property with respect to which the section 83(b) election is made. Any excess benefit transaction with respect to benefits under a deferred compensation plan which vest during any taxable year of the disqualified person is deemed to occur on the last day of such taxable year. For the rules governing the timing of the reasonableness determination for deferred, contingent, and certain other noncash compensation, see § 53.4958–4T(b)(2).

(3) *Statute of limitations rules.* See sections 6501(e)(3) and 6501(l) and the regulations thereunder for statute of limitations rules as they apply to section 4958 excise taxes.

(f) *Effective date for imposition of taxes*—(1) *In general.* The section 4958 taxes imposed on excess benefit transactions or on participation in excess benefit transactions apply to transactions occurring on or after September 14, 1995.

(2) *Existing binding contracts.* The section 4958 taxes do not apply to any transaction occurring pursuant to a written contract that was binding on September 13, 1995, and at all times thereafter before the transaction occurs. A written binding contract that is terminable or subject to cancellation by the applicable tax-exempt organization without the disqualified person's consent (including as the result of a breach of contract by the disqualified person) and without substantial penalty to the organization, is no longer treated as a binding contract as of the earliest date that any such termination or cancellation, if made, would be effective. If a binding written contract is materially changed, it is treated as a new contract entered into as of the date the material change is effective. A material change includes an extension or renewal of the contract (other than an extension or renewal that results from the person contracting with the applicable tax-exempt organization unilaterally exercising an option expressly granted by the contract), or a more than incidental change to any payment under the contract.

§ 53.4958–2T Definition of applicable tax-exempt organization (temporary).

(a) *Organizations described in section 501(c)(3) or (4) and exempt from tax under section 501(a)*—(1) *In general.* An applicable tax-exempt organization is any organization that, without regard to any excess benefit, would be described in section 501(c)(3) or (4) and exempt from tax under section 501(a). An applicable tax-exempt organization also includes any organization that was described in section 501(c)(3) or (4) and was exempt from tax under section 501(a) at any time during a five-year period ending on the date of an excess benefit transaction (the lookback period). A private foundation as defined in section 509(a) is not an applicable tax-exempt organization for section 4958 purposes. A governmental entity that is exempt from (or not subject to) taxation without regard to section 501(a) is not an applicable tax-exempt organization for section 4958 purposes.

(2) *Organizations described in section 501(c)(3).* An organization is described in section 501(c)(3) for purposes of section 4958 only if the organization provides the notice described in section 508, unless the organization otherwise is described in section 501(c)(3) and specifically is excluded from the requirements of section 508 by that section.

(3) *Organizations described in section 501(c)(4).* An organization is described in section 501(c)(4) for purposes of section 4958 if the organization—

(i) Has applied for and received recognition from the Internal Revenue Service as an organization described in section 501(c)(4); or

(ii) Has filed an application for recognition under section 501(c)(4) with the Internal Revenue Service, has filed an annual information return as a section 501(c)(4) organization under the Internal Revenue Code or regulations promulgated thereunder, or has otherwise held itself out as being described in section 501(c)(4) and exempt from tax under section 501(a).

(4) *Effect of non-recognition or revocation of exempt status.* An organization is not described in paragraph (a)(2) or (a)(3) of this section during any period covered by a final determination or adjudication that the organization is not exempt from tax under section 501(a) as an organization described in section 501(c)(3) or (4), so long as that determination or adjudication is not based upon participation in inurement or one or more excess benefit transactions. However, the organization may be an applicable tax-exempt organization for that period as a result of the five-year

lookback rule described in paragraph (a)(1) of this section.

(b) *Special rules*—(1) *Transition rule for lookback period.* In the case of any excess benefit transaction occurring before September 14, 2000, the lookback period described in paragraph (a)(1) of this section begins on September 14, 1995, and ends on the date of the transaction.

(2) *Certain foreign organizations.* A foreign organization, recognized by the Internal Revenue Service or by treaty, that receives substantially all of its support (other than gross investment income) from sources outside of the United States is not an organization described in section 501(c)(3) or (4) for purposes of section 4958.

§ 53.4958–3T Definition of disqualified person (temporary).

(a) *In general*—(1) *Scope of definition.* Section 4958(f)(1) defines *disqualified person,* with respect to any transaction, as any person who was in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization at any time during the five-year period ending on the date of the transaction (the lookback period). Paragraph (b) of this section describes persons who are defined to be disqualified persons under the statute, including certain family members of an individual in a position to exercise substantial influence, and certain 35-percent controlled entities. Paragraph (c) of this section describes persons in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization by virtue of their powers and responsibilities or certain interests they hold. Paragraph (d) of this section describes persons deemed not to be in a position to exercise substantial influence. Whether any person who is not described in paragraph (b), (c) or (d) of this section is a disqualified person with respect to a transaction for purposes of section 4958 is based on all relevant facts and circumstances, as described in paragraph (e) of this section. Paragraph (f) of this section describes special rules for affiliated organizations. Examples in paragraph (g) of this section illustrate these categories of persons.

(2) *Transition rule for lookback period.* In the case of any excess benefit transaction occurring before September 14, 2000, the lookback period described in paragraph (a)(1) of this section begins on September 14, 1995, and ends on the date of the transaction.

(b) *Statutory categories of disqualified persons*—(1) *Family members.* A person is a disqualified person with respect to any transaction with an applicable tax-exempt organization if the person is a member of the family of a person who is a disqualified person described in paragraph (a) of this section (other than as a result of this paragraph) with respect to any transaction with the same organization. For purposes of the following sentence, a legally adopted child of an individual is treated as a child of such individual by blood. A person's family is limited to—

(i) Spouse;

(ii) Brothers or sisters (by whole or half blood);

(iii) Spouses of brothers or sisters (by whole or half blood);

(iv) Ancestors;

(v) Children;

(vi) Grandchildren;

(vii) Great grandchildren; and

(viii) Spouses of children, grandchildren, and great grandchildren.

(2) *Thirty-five percent controlled entities*—(i) *In general.* A person is a disqualified person with respect to any transaction with an applicable tax-exempt organization if the person is a 35-percent controlled entity. A 35-percent controlled entity is—

(A) A corporation in which persons described in this section (except in paragraphs (b)(2) and (d) of this section) own more than 35 percent of the combined voting power;

(B) A partnership in which persons described in this section (except in paragraphs (b)(2) and (d) of this section) own more than 35 percent of the profits interest; or

(C) A trust or estate in which persons described in this section (except in paragraphs (b)(2) and (d) of this section) own more than 35 percent of the beneficial interest.

(ii) *Combined voting power.* For purposes of this paragraph (b)(2), combined voting power includes voting power represented by holdings of voting stock, direct or indirect, but does not include voting rights held only as a director, trustee, or other fiduciary.

(iii) *Constructive ownership rules*—(A) *Stockholdings.* For purposes of section 4958(f)(3) and this paragraph (b)(2), indirect stockholdings are taken into account as under section 267(c), except that in applying section 267(c)(4), the family of an individual shall include the members of the family specified in section 4958(f)(4) and paragraph (b)(1) of this section.

(B) *Profits or beneficial interest.* For purposes of section 4958(f)(3) and this paragraph (b)(2), the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than section 267(c)(3)), except that in applying section 267(c)(4), the family of an individual shall include the members of the family specified in section 4958(f)(4) and paragraph (b)(1) of this section.

(c) *Persons having substantial influence.* A person who holds any of the following powers, responsibilities, or interests is in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization:

(1) *Voting members of the governing body.* This category includes any individual serving on the governing body of the organization who is entitled to vote on any matter over which the governing body has authority.

(2) *Presidents, chief executive officers, or chief operating officers.* This category includes any person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization. A person who serves as president, chief executive officer, or chief operating officer has this ultimate responsibility unless the person demonstrates otherwise. If this ultimate responsibility resides with two or more individuals (*e.g.,* co-presidents), who may exercise such responsibility in concert or individually, then each individual is in a position to exercise substantial influence over the affairs of the organization.

(3) *Treasurers and chief financial officers.* This category includes any person who, regardless of title, has ultimate responsibility for managing the finances of the organization. A person who serves as treasurer or chief financial officer has this ultimate responsibility unless the person demonstrates otherwise. If this ultimate responsibility resides with two or more individuals who may exercise the responsibility in concert or individually, then each individual is in a position to exercise substantial influence over the affairs of the organization.

(4) *Persons with a material financial interest in a provider-sponsored organization.* For purposes of section 4958, if a hospital that participates in a provider-sponsored organization (as defined in section 1855(e) of the Social Security Act, 42 U.S.C. 1395w–25) is an applicable tax-exempt organization, then any person with a material financial interest (within the meaning of section 501(o)) in the provider-sponsored organization has substantial influence with respect to the hospital.

(d) *Persons deemed not to have substantial influence.* A person is deemed not to be in a position to exercise substantial influence over the affairs of an applicable tax-exempt organization if that person is described in one of the following categories:

(1) *Tax-exempt organizations described in section 501(c)(3).* This category includes any organization described in section 501(c)(3) and exempt from tax under section 501(a).

(2) *Certain section 501(c)(4) organizations.* Only with respect to an applicable tax-exempt organization described in section 501(c)(4) and § 53.4958–2T(a)(3), this category includes any other organization so described.

(3) *Employees receiving economic benefits of less than a specified amount in a taxable year.* This category includes, for the taxable year in which benefits are provided, any full-or part-time employee of the applicable tax-exempt organization who—

(i) Receives economic benefits, directly or indirectly from the organization, of less than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i);

(ii) Is not described in § 53.4958–3T(b) or (c) with respect to the organization; and

(iii) Is not a substantial contributor to the organization within the meaning of section 507(d)(2)(A), taking into account only contributions received by the organization during its current taxable year and the four preceding taxable years.

(e) *Facts and circumstances govern in all other cases*—(1) *In general.* Whether a person who is not described in paragraph (b), (c) or (d) of this section is a disqualified person depends upon all relevant facts and circumstances.

(2) *Facts and circumstances tending to show substantial influence.* Facts and circumstances tending to show that a person has substantial influence over the affairs of an organization include, but are not limited to, the following—

(i) The person founded the organization;

(ii) The person is a substantial contributor to the organization (within the meaning of section 507(d)(2)(A)), taking into account only contributions received by the organization during its current taxable year and the four preceding taxable years;

(iii) The person's compensation is primarily based on revenues derived from activities of the organization that the person controls;

(iv) The person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees;

(v) The person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole;

(vi) The person owns a controlling interest (measured by either vote or value) in a corporation, partnership, or trust that is a disqualified person; or

(vii) The person is a non-stock organization controlled, directly or indirectly, by one or more disqualified persons.

(3) *Facts and circumstances tending to show no substantial influence.* Facts and circumstances tending to show that a person does not have substantial influence over the affairs of an organization include, but are not limited to, the following—

(i) The person has taken a bona fide vow of poverty as an employee, agent, or on behalf, of a religious organization;

(ii) The person is an independent contractor (such as an attorney, accountant, or investment manager or advisor) whose sole relationship to the organization is providing professional advice (without having decision-making authority) with respect to transactions from which the independent contractor will not economically benefit either directly or indirectly (aside from customary fees received for the professional advice rendered);

(iii) The direct supervisor of the individual is not a disqualified person;

(iv) The person does not participate in any management decisions affecting the organization as a whole or a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole; or

(v) Any preferential treatment a person receives based on the size of that person's donation is also offered to all other donors making a comparable contribution as part of a solicitation intended to attract a substantial number of contributions.

(f) *Affiliated organizations.* In the case of multiple organizations affiliated by common control or governing documents, the determination of whether a person does or does not have substantial influence shall be made separately for each applicable tax-exempt organization. A person may be a disqualified person with respect to transactions with more than one applicable tax-exempt organization.

(g) *Examples.* The following examples illustrate the principles of this section. Finding a person to be a disqualified person in the following examples does not indicate that an excess benefit transaction has occurred. If a person is a disqualified person, the rules of section 4958(c) and § 53.4958–4T apply to determine whether an excess benefit transaction has occurred. The examples are as follows:

Example 1. N, an artist by profession, works part-time at R, a local museum. In the first taxable year in which R employs N, R pays N a salary and provides no additional benefits to N except for free admission to the museum, a benefit R provides to all of its employees and volunteers. The total economic benefits N receives from R during the taxable year are less than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i). The part-time job constitutes N's only relationship with R. N is not related to any other disqualified person with respect to R. N is deemed not to be in a position to exercise substantial influence over the affairs of R. Therefore, N is not a disqualified person with respect to R in that year.

Example 2. The facts are the same as in *Example 1,* except that in addition to the salary that R pays N for N's services during the taxable year, R also purchases one of N's paintings for $*x*. The total of N's salary plus $*x* exceeds the amount referenced for highly compensated employees in section 414(q)(1)(B)(i). Consequently, whether N is in a position to exercise substantial influence over the affairs of R for that taxable year depends upon all of the relevant facts and circumstances.

Example 3: Q is a member of K, a section 501(c)(3) organization with a broad-based public membership. Members of K are entitled to vote only with respect to the annual election of directors and the approval of major organizational transactions such as a merger or dissolution. Q is not related to any other disqualified person of K. Q has no other relationship to K besides being a member of K and occasionally making modest donations to K. Whether Q is a disqualified person is determined by all relevant facts and circumstances. Q's voting rights, which are the same as granted to all members of K, do not place Q in a position to exercise substantial influence over K. Under these facts and circumstances, Q is not a disqualified person with respect K.

Example 4. E is the headmaster of Z, a school that is an applicable tax-exempt organization for purposes of section 4958. E reports to Z's board of trustees and has ultimate responsibility for supervising Z's day-to-day operations. For example, E can hire faculty members and staff, make changes to the school's curriculum and discipline students without specific board approval. Because E has ultimate responsibility for supervising the operation of Z, E is in a position to exercise substantial influence over the affairs of Z. Therefore, E is a disqualified person with respect to Z.

Example 5. Y is an applicable tax-exempt organization for purposes of section 4958 that decides to use bingo games as a method of generating revenue. Y enters into a contract with B, a company that operates bingo games. Under the contract, B manages the promotion and operation of the bingo activity, provides all necessary staff, equipment, and services, and pays Y *q* percent of the revenue from this activity. B retains the balance of the proceeds. Y provides no goods or services in connection with the bingo operation other than the use of its hall for the bingo games. The annual gross revenue earned from the bingo games represents more than half of Y's total annual revenue. B's compensation is primarily based on revenues from an activity B controls. B also manages a discrete activity of Y that represents a substantial portion of Y's income compared to the organization as a whole. Under these facts and circumstances, B is in a position to exercise substantial influence over the affairs of Y. Therefore, B is a disqualified person with respect to Y.

Example 6. The facts are the same as in *Example 5,* with the additional fact that P owns a majority of the stock of B and is actively involved in managing B. Because P owns a controlling interest (measured by either vote or value) in and actively manages B, P is also in a position to exercise substantial influence over the affairs of Y. Therefore, under these facts and circumstances, P is a disqualified person with respect to Y.

Example 7. A, an applicable tax-exempt organization for purposes of section 4958, owns and operates one acute care hospital. B, a for-profit corporation, owns and operates a number of hospitals. A and B form C, a limited liability company. In exchange for proportional ownership interests, A contributes its hospital, and B contributes other assets, to C. All of A's assets then consist of its membership interest in C. A continues to be operated for exempt purposes based almost exclusively on the activities it conducts through C. C enters into a management agreement with a management company, M, to provide day to day management services to C. M is generally subject to supervision by C's board, but M is given broad discretion to manage C's day to day operation. Under these facts and circumstances, M is in a position to exercise substantial influence over the affairs of A because it has day to day control over the hospital operated by C, A's ownership interest in C is its primary asset, and C's activities form the basis for A's continued exemption as an organization described in section 501(c)(3). Therefore, M is a disqualified person with respect to A.

Example 8. T is a large university and an applicable tax-exempt organization for purposes of section 4958. L is the dean of the College of Law of T, a substantial source of revenue for T, including contributions from alumni and foundations. L is not related to any other disqualified person of T. L does not serve on T's governing body or have ultimate responsibility for managing the university as whole. However, as dean of the College of Law, L plays a key role in faculty hiring and determines a substantial portion of the capital expenditures and operating budget of the College of Law. L's compensation is greater than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i) in the year benefits are provided. L's management of a discrete segment of T that represents a substantial portion of the income of T (as compared to T as a whole) places L in a position to exercise substantial influence over the affairs of T. Under these facts and circumstances L is a disqualified person with respect to T.

Example 9. S chairs a small academic department in the College of Arts and Sciences of the same university T described in *Example 8.* S is not related to any other disqualified person of T. S does not serve on T's governing body or as an officer of T. As department chair, S supervises faculty in the department, approves the course curriculum, and oversees the operating budget for the department. S's compensation is greater than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i) in the year benefits are provided. Even though S manages the department, that department does not represent a substantial portion of T's activities, assets, income, expenses, or operating budget. Therefore, S does not participate in any management decisions affecting either T as a whole, or a discrete segment or activity of T that represents a substantial portion of its activities, assets, income, or expenses. Under these facts and circumstances, S does not have substantial influence over the affairs of T, and therefore S is not a disqualified person with respect to T.

Example 10. U is a large acute-care hospital that is an applicable tax-exempt organization for purposes of section 4958. U employs X as a radiologist. X gives instructions to staff with respect to the radiology work X conducts, but X does not supervise other U employees or manage any substantial part of U's operations. X's compensation is primarily in the form of a fixed salary. In addition, X is eligible to receive an incentive award based on revenues of the radiology department. X's compensation is greater than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i) in the year benefits are provided. X is not related to any other disqualified person of U. X does not serve on U's governing body or as an officer of U. Although U participates in a provider-sponsored organization (as defined in section 1855(e) of the Social Security Act), X does not have a material financial interest in that organization. X does not receive compensation primarily based on revenues derived from activities of U that X controls. X does not participate in any management decisions affecting either U as a whole or a discrete segment of U that represents a substantial portion of its activities, assets, income, or expenses. Under these facts and circumstances, X does not have substantial influence over the affairs of U, and therefore X is not a disqualified person with respect to U.

Example 11. W is a cardiologist and head of the cardiology department of the same hospital U described in *Example 10.* The cardiology department is a major source of patients admitted to U and consequently represents a substantial portion of U's income, as compared to U as a whole. W does not serve on U's governing board or as an officer of U. W does not have a material financial interest in the provider-sponsored organization (as defined in section 1855(e) of the Social Security Act) in which U participates. W receives a salary and retirement and welfare benefits fixed by a three-year renewable employment contract with U. W's compensation is greater than the amount referenced for a highly compensated employee in section 414(q)(1)(B)(i) in the year benefits are provided. As department head, W manages the cardiology department and has authority to allocate the budget for that department, which includes authority to distribute incentive bonuses among cardiologists according to criteria that W has authority to set. W's management of a discrete segment of U that represents a substantial portion of its income and activities (as compared to U as a whole) places W in a position to exercise substantial influence over the affairs of U. Under these facts and circumstances, W is a disqualified person with respect to U.

Example 12. M is a museum that is an applicable tax-exempt organization for purposes of section 4958. D provides accounting services and tax advice to M as an independent contractor in return for a fee. D has no other relationship with M and is not related to any disqualified person of M. D does not provide professional advice with respect to any transaction from which D might economically benefit either directly or indirectly (aside from fees received for the professional advice rendered). Because D's sole relationship to M is providing professional advice (without having decision-making authority) with respect to transactions from which D will not economically benefit either directly or indirectly (aside from customary fees received for the professional advice rendered), under these facts and circumstances, D is not a disqualified person with respect to M.

Example 13. F is a repertory theater company that is an applicable tax-exempt organization for purposes of section 4958. F holds a fund-raising campaign to pay for the construction of a new theater. J is a regular subscriber to F's productions who has made modest gifts to F in the past. J has no relationship to F other than as a subscriber and contributor. F solicits contributions as part of a broad public campaign intended to attract a large number of donors, including a substantial number of donors making large gifts. In its solicitations for contributions, F promises to invite all contributors giving $*z* or more to a special opening production and party held at the new theater. These contributors are also given a special number to call in F's office to reserve tickets for performances, make ticket exchanges, and make other special arrangements for their convenience. J makes a contribution of $*z* to F, which makes J a substantial contributor within the meaning of section 507(d)(2)(A), taking into account only contributions received by F during its current and the four preceding taxable years. J receives the benefits described in F's solicitation. Because F offers the same benefit to all donors of $*z* or more, the preferential treatment that J receives does not indicate that J is in a position to exercise substantial influence over the affairs of the organization. Therefore, under these facts and circumstances, J is not a disqualified person with respect to F.

§ 53.4958–4T Excess benefit transaction (temporary).

(a) *Definition of excess benefit transaction*—(1) *In general.* An excess *benefit transaction* means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, and the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit. Subject to the limitations of paragraph (c) of this section (relating to the treatment of economic benefits as compensation for the performance of services), to determine whether an excess benefit transaction has occurred, all consideration and benefits (except disregarded benefits described in paragraph (a)(4) of this section) exchanged between a disqualified person and the applicable tax-exempt organization and all entities the organization controls (within the meaning of paragraph (a)(2)(ii)(B) of this section) are taken into account. For example, in determining the reasonableness of compensation that is paid (or vests, or is no longer subject to a substantial risk of forfeiture) in one year, services performed in prior years may be taken into account. For rules regarding valuation standards, see paragraph (b) of this section. For the requirement that an applicable tax-exempt organization clearly indicate its intent to treat a benefit as compensation for services when paid, see paragraph (c) of this section.

(2) *Economic benefit provided indirectly*—(i) *In general.* A transaction that would be an excess benefit transaction if the applicable tax-exempt organization engaged in it directly with a disqualified person is likewise an excess benefit transaction when it is accomplished indirectly. An applicable tax-exempt organization may provide an excess benefit indirectly to a disqualified person through a controlled entity or through an intermediary, as described in paragraphs (a)(2)(ii) and (iii) of this section, respectively.

(ii) *Through a controlled entity*—(A) *In general.* An applicable tax-exempt organization may provide an excess benefit indirectly through the use of one or more entities it controls. For purposes of section 4958, economic benefits provided by a controlled entity will be treated as provided by the applicable tax-exempt organization.

(B) *Definition of control*—(*1*) *In general.* For purposes of this paragraph, control by an applicable tax-exempt organization means—

(i) In the case of a stock corporation, ownership (by vote or value) of more than 50 percent of the stock in such corporation;

(*ii*) In the case of a partnership, ownership of more than 50 percent of the profits interests or capital interests in the partnership;

(*iii*) In the case of a nonstock organization (*i.e.,* an entity in which no person holds a proprietary interest), that at least 50 percent of the directors or trustees of the organization are either representatives (including trustees, directors, agents, or employees) of, or directly or indirectly controlled by, an applicable tax-exempt organization; or

(*iv*) In the case of any other entity, ownership of more than 50 percent of the beneficial interest in the entity.

(2) *Constructive ownership.* Section 318 (relating to constructive ownership of stock) shall apply for purposes of determining ownership of stock in a corporation. Similar principles shall apply for purposes of determining ownership of interests in any other entity.

(iii) *Through an intermediary.* An applicable tax-exempt organization may provide an excess benefit indirectly through an intermediary. An intermediary is any person (including an individual or a taxable or tax-exempt entity) who participates in a transaction with one or more disqualified persons of an applicable tax-exempt organization. For purposes of section 4958, economic benefits provided by an intermediary will be treated as provided by the applicable tax-exempt organization when—

(A) An applicable tax-exempt organization provides an economic benefit to an intermediary; and

(B) In connection with the receipt of the benefit by the intermediary—

(*1*) There is evidence of an oral or written agreement or understanding that the intermediary will provide economic benefits to or for the use of a disqualified person; or

(*2*) The intermediary provides economic benefits to or for the use of a disqualified person without a significant business purpose or exempt purpose of its own.

(iv) *Examples.* The following examples illustrate when economic benefits are provided indirectly under the rules of paragraph (a)(2) of this section:

Example 1. K is an applicable tax-exempt organization for purposes of section 4958. L is an entity controlled by K within the meaning of paragraph (a)(2)(ii)(B) of this section. J is employed by K, and is a disqualified person with respect to K. K pays J an annual salary of $*12m*, and reports that amount as compensation during calendar year 2001. Although J only performed services for K for nine months of 2001, J performed equivalent services for L during the remaining three months of 2001. Taking into account all of the economic benefits K provided to J, and all of the services J performed for K and L, $*12m* does not exceed the fair market value of the services J performed for K and L during 2001. Therefore, under these facts, K does not provide an excess benefit to J directly or indirectly.

Example 2. F is an applicable tax-exempt organization for purposes of section 4958. D is an entity controlled by F within the meaning of paragraph (a)(2)(ii)(B) of this section. T is the chief executive officer (CEO) of F. As CEO, T is responsible for overseeing the activities of F. T's duties as CEO make him a disqualified person with respect to F. T's compensation package with F represents the maximum reasonable compensation for T's services as CEO. Thus, any additional economic benefits that F provides to T without T providing additional consideration constitute an excess benefit. D contracts with T to provide enumerated ''consulting services'' to D. However, the contract does not require T to perform any additional services for D that T is not already obligated to perform as F's chief executive officer. Therefore, any payment to T pursuant to the consulting contract with D represents an indirect excess benefit that F provides through a controlled entity, even if F, D, or T treats the additional payment to T as compensation.

Example 3. P is an applicable tax-exempt organization for purposes of section 4958. S is a taxable entity controlled by P within the meaning of paragraph (a)(2)(ii)(B) of this section. V is the chief executive officer of S, for which S pays V $*w* in salary and benefits. V also serves as a voting member of P's governing body. Consequently, V is a disqualified person with respect to P. P provides V with $*x* representing compensation for the services V provides P as a member of its governing body. Although $*x* represents reasonable compensation for the services V provides directly to P as a member of its governing body, the total compensation of $*w* + $*x* exceeds reasonable compensation for the services V provides to P and S collectively. Therefore, the portion of total compensation that exceeds reasonable compensation is an excess benefit provided to V.

Example 4. G is an applicable tax-exempt organization for section 4958 purposes. F is a disqualified person who was last employed by G in a position of substantial influence three years ago. H is an entity engaged in scientific research and is unrelated to either F or G. G makes a grant to H to fund a research position. H subsequently advertises for qualified candidates for the research position. F is among several highly qualified candidates who apply for the research position. H hires F. There was no evidence of an oral or written agreement or understanding with G that H will use G's grant to provide economic benefits to or for the use of F. Although G provided economic benefits to H, and in connection with the receipt of such benefits, H will provide economic benefits to or for the use of F, H acted with a significant business purpose or exempt purpose of its own. Under these facts, G did not provide an economic benefit to F indirectly through the use of an intermediary.

(3) *Exception for fixed payments made pursuant to an initial contract*—(i) *In general*. Except as provided in paragraph (iv), section 4958 does not apply to any fixed payment made to a person pursuant to an initial contract.

(ii) *Fixed payment*—(A) *In general.* For purposes of paragraph (a)(3)(i) of this section, *fixed payment* means an amount of cash or other property specified in the contract, or determined by a fixed formula specified in the contract, which is to be paid or transferred in exchange for the provision of specified services or property. A fixed formula may incorporate an amount that depends upon future specified events or contingencies, provided that no person exercises discretion when calculating the amount of a payment or deciding whether to make a payment (such as a bonus). A specified event or contingency may include the amount of revenues generated by (or other objective measure of) one or more activities of the applicable tax-exempt organization. A fixed payment does not include any amount paid to a person under a reimbursement (or similar) arrangement where discretion is exercised by any person with respect to the amount of expenses incurred or reimbursed.

(B) *Special rules.* Amounts payable pursuant to a qualified pension, profit-sharing, or stock bonus plan under Internal Revenue Code section 401(a), or pursuant to an employee benefit program that is subject to and satisfies coverage and nondiscrimination rules under the Code (*e.g.,* sections 127 and 137), other than nondiscrimination rules under section 9802, are treated as fixed payments for purposes of this section, regardless of the applicable tax-exempt organization's discretion with respect to the plan or program. The fact that a person contracting with an applicable tax-exempt organization is expressly granted the choice whether to accept or reject any economic benefit is disregarded in determining whether the benefit constitutes a fixed payment for purposes of this paragraph.

(iii) *Initial contract.* For purposes of paragraph (a)(3)(i) of this section, *initial contract* means a binding written contract between an applicable tax-exempt organization and a person who was not a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T immediately prior to entering into the contract.

(iv) *Substantial performance required.* Paragraph (a)(3)(i) of this section does not apply to any fixed payment made pursuant to the *initial contract* during any taxable year of the person contracting with the applicable tax-exempt organization if the person fails to perform substantially the person's obligations under the initial contract during that year.

(v) *Treatment as a new contract.* A written binding contract that provides that the contract is terminable or subject to cancellation by the applicable tax-exempt organization (other than as a result of a lack of substantial performance by the disqualified person, as described in paragraph (a)(3)(iv) of this section) without the other party's consent and without substantial penalty to the organization is treated as a new contract as of the earliest date that any such termination or cancellation, if made, would be effective. Additionally, if the parties make a material change to a contract, it is treated as a new contract as of the date the material change is effective. A material change includes an extension or renewal of the contract (other than an extension or renewal that results from the person contracting with the applicable tax-exempt organization unilaterally exercising an option expressly granted by the contract), or a more than incidental change to any amount payable under the contract. The new contract is tested under paragraph (a)(3)(iii) of this section to determine whether it is an initial contract for purposes of this section.

(vi) *Evaluation of non-fixed payments.* Any payment that is not a fixed payment (within the meaning of paragraph (a)(3)(ii) of this section) is evaluated to determine whether it constitutes an excess benefit transaction under section 4958. In making this determination, all payments and consideration exchanged between the parties are taken into account, including any fixed payments made pursuant to an initial contract with respect to which section 4958 does not apply.

(vii) *Examples.* The following examples illustrate the rules governing fixed payments made pursuant to an initial contract. Unless otherwise stated, assume that the person contracting with the applicable tax-exempt organization has performed substantially the person's obligations under the contract with respect to the payment.

The examples are as follows:

Example 1. T is an applicable tax-exempt organization for purposes of section 4958. On January 1, 2000, T hires S as its chief financial officer by entering into a five-year written employment contract with S. S was not a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T immediately prior to entering into the January 1, 2000, contract (initial contract). S's duties and responsibilities under the contract make S a disqualified person with respect to T (see § 53.4958–3T(a)). Under the initial contract, T agrees to pay S an annual salary of $200,000, payable in monthly installments. The contract provides that, beginning in 2001, S's annual salary will be adjusted by the increase in the Consumer Price Index (CPI) for the prior year. Section 4958 does not apply because S's compensation under the contract is a fixed payment pursuant to an initial contract within the meaning of paragraph (a)(3) of this section. Thus, for section 4958 purposes, it is unnecessary to evaluate whether any portion of the compensation paid to S pursuant to the initial contract is an excess benefit transaction.

Example 2. The facts are the same as in *Example 1,* except that the initial contract provides that, in addition to a base salary of $200,000, T may pay S an annual performance-based bonus. The contract provides that T's governing body will determine the amount of the annual bonus as of the end of each year during the term of the contract, based on the board's evaluation of S's performance, but the bonus cannot exceed $100,000 per year. Unlike the base salary portion of S's compensation, the bonus portion of S's compensation is not a fixed payment pursuant to an initial contract, because the governing body has discretion over the amount, if any, of the bonus payment. Section 4958 does not apply to payment of the $200,000 base salary (as adjusted for inflation), because it is a fixed payment pursuant to an initial contract within the meaning of paragraph (a)(3) of this section. By contrast, the annual bonuses that may be paid to S under the initial contract are not protected by the initial contract exception. Therefore, each bonus payment will be evaluated under section 4958, taking into account all payments and consideration exchanged between the parties.

Example 3. The facts are the same as in *Example 1,* except that in 2001, T changes its payroll system, such that T makes biweekly, rather than monthly, salary payments to its employees. Beginning in 2001, T also grants its employees an additional two days of paid vacation each year. Neither change is a material change to S's initial contract within the meaning of paragraph (a)(3)(v) of this section. Therefore, section 4958 does not apply to the base salary payments to S due to the initial contract exception.

Example 4. The facts are the same as in *Example 1,* except that on January 1, 2001, S becomes the chief executive officer of T and a new chief financial officer is hired. At the same time, T's board of directors approves an increase in S's annual base salary from $200,000 to $240,000, effective on that day. These changes in S's employment relationship constitute material changes of the initial contract within the meaning of paragraph (a)(3)(v) of this section. As a result, S is treated as entering into a new contract with T on January 1, 2001, at which time S is a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T. T's payments to S made pursuant to the new contract will be evaluated under section 4958, taking into account all payments and consideration exchanged between the parties.

Example 5. J is a performing arts organization and an applicable tax-exempt organization for purposes of section 4958. J hires W to become the chief executive officer of J. W was not a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T immediately prior to entering into the employment contract with J. As a result of this employment contract, W's duties and responsibilities make W a disqualified person with respect to J (see § 53.4958–3T(c)(2)). Under the contract, J will pay W $*x* (a specified amount) plus a bonus equal to 2 percent of the total season subscription sales that exceed $*100z*. The $*x* base salary is a fixed payment pursuant to an initial contract within the meaning of paragraph (a)(3) of this section. The bonus payment is also a fixed payment pursuant to an initial contract within the meaning of paragraph (a)(3) of this section, because no person exercises discretion when calculating the amount of the bonus payment or deciding whether the bonus will be paid. Therefore, section 4958 does not apply to any of J's payments to W pursuant to the employment contract due to the initial contract exception.

Example 6. Hospital B is an applicable tax-exempt organization for purposes of section 4958. Hospital B hires E as its chief operating officer. E was not a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T immediately prior to entering into the employment contract with Hospital B. As a result of this employment contract, E's duties and responsibilities make E a disqualified person with respect to Hospital B (see § 53.4958–3T(c)(2)). E's initial employment contract provides that E will have authority to enter into hospital management arrangements on behalf of Hospital B. In E's personal capacity, E owns more than 35 percent of the combined voting power of Company X. Consequently, at the time E becomes a disqualified person with respect to B, Company X also becomes a disqualified person with respect to B (see § 53.4958–3T(b)(2)(A)). E, acting on behalf of Hospital B as chief operating officer, enters into a contract with Company X under which Company X will provide billing and collection services to Hospital B. The initial contract exception of paragraph (a)(3)(i) of this section does not apply to the billing and collection services contract, because at the time that this contractual arrangement was entered into, Company X was a disqualified person with respect to Hospital B. Although E's employment contract (which is an initial contract) authorizes E to enter into hospital management arrangements on behalf of Hospital B, the payments made to Company X are not made pursuant to E's employment contract, but rather are made by Hospital B pursuant to a separate contractual arrangement with Company X. Therefore, even if payments made to Company X under the billing and collection services contract are fixed payments (within the meaning of paragraph (a)(3)(ii) of this section), section 4958 nonetheless applies to payments made by Hospital B to Company X because the billing and collection services contract itself does not constitute an initial contract under paragraph (a)(3)(iii) of this section. Accordingly, all payments made to Company X under the billing and collection services contract will be evaluated under section 4958.

Example 7. Hospital C, an applicable tax-exempt organization, enters into a contract with Company Y, under which Company Y will provide a wide range of hospital management services to Hospital C. Upon entering into this contractual arrangement, Company Y becomes a disqualified person with respect to Hospital C. The contract provides that Hospital C will pay Company Y a management fee of *x* percent of adjusted gross revenue (*i.e.,* gross revenue increased by the cost of charity care provided to indigents) annually for a five-year period. The management services contract specifies the cost accounting system and the standards for *indigents* to be used in calculating the cost of charity care. The cost accounting system objectively defines the direct and indirect costs of all health care goods and services provided as charity care. Because Company Y was not a disqualified person with respect to Hospital C immediately before entering into the management services contract, that contract is an initial contract within the meaning of paragraph (a)(3)(iii) of this section. The annual management fee paid to Company Y is determined by a fixed formula specified in the contract, and is therefore a fixed payment within the meaning of paragraph (a)(3)(ii) of this section. Accordingly, section 4958 does not apply to the annual management fee due to the initial contract exception.

Example 8. The facts are the same as in *Example 7,* except that the management services contract also provides that Hospital C will reimburse Company Y on a monthly basis for certain expenses incurred by Company Y that are attributable to management services provided to Hospital C (*e.g.,* legal fees and travel expenses). These reimbursement payments that Hospital C makes to Company Y for the various expenses covered by the contract are not fixed payments within the meaning of paragraph (a)(3)(ii) of this section, because Company Y exercises discretion with respect to the amount of expenses incurred. Therefore, any reimbursement payments that Hospital C pays pursuant to the contract will be evaluated under section 4958.

Example 9. X, an applicable tax-exempt organization for purposes of section 4958, hires C to conduct scientific research. On January 1, 2000, C enters into a three-year written employment contract with X (''initial contract''). Under the terms of the contract, C is required to work full-time at X's laboratory for a fixed annual salary of $90,000. Immediately prior to entering into the employment contract, C was not a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T, nor did C become a disqualified person pursuant to the initial contract. However, two years after joining X, C marries D, who is the child of X's president. As D's spouse, C is a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3T with respect to X. Nonetheless, section 4958 does not apply to X's salary payments to C due to the initial contract exception.

Example 10. The facts are the same as in *Example 9,* except that the initial contract included a below-market loan provision under which C has the unilateral right to borrow up to a specified dollar amount from X at a specified interest rate for a specified term. After C's marriage to D, C borrows money from X to purchase a home under the terms of the initial contract. Section 4958 does not apply to X's loan to C due to the initial contract exception.

Example 11. The facts are the same as in *Example 9,* except that after C's marriage to D, C works only sporadically at the laboratory, and performs no other services for X. Notwithstanding that C fails to perform substantially C's obligations under the initial contract, X does not exercise its right to terminate the initial contract for nonperformance and continues to pay full salary to C. Pursuant to paragraph (a)(3)(iv) of this section, the initial contract exception does not apply to any payments made pursuant to the initial contract during any taxable year of C in which C fails to perform substantially C's obligations under the initial contract.

(4) *Certain economic benefits disregarded for purposes of section 4958.* The following economic benefits are disregarded for purposes of section 4958:

(i) *Nontaxable fringe benefits.* An economic benefit that is excluded from income under section 132, except any liability insurance premium, payment, or reimbursement that must be taken into account under § 53.4958–4T(b)(1)(ii)(B)(*2*);

(ii) *Certain economic benefits provided to a volunteer for the organization.* An economic benefit provided to a volunteer for the organization if the benefit is provided to the general public in exchange for a membership fee or contribution of $75 or less per year;

(iii) *Certain economic benefits provided to a member of, or donor to, the organization.* An economic benefit provided to a member of an organization solely on account of the payment of a membership fee, or to a donor solely on account of a contribution deductible under section 170, if—

(A) Any non-disqualified person paying a membership fee or making a contribution above a specified amount to the organization is given the option of receiving substantially the same economic benefit; and

(B) The disqualified person and a significant number of non-disqualified persons make a payment or contribution of at least the specified amount;

(iv) *Economic benefits provided to a charitable beneficiary.* An economic benefit provided to a person solely as a member of a charitable class that the applicable tax-exempt organization intends to benefit as part of the accomplishment of the organization's exempt purpose; and

(v) *Certain economic benefits provided to a governmental unit.* Any transfer of an economic benefit to or for the use of a governmental unit defined in section 170(c)(1), if the transfer is for exclusively public purposes.

(b) *Valuation standards*—(1) *In general.* This section provides rules for determining the value of economic benefits for purposes of section 4958.

(i) *Fair market value of property.* The value of property, including the right to use property, for purposes of section 4958 is the fair market value (*i.e.,* the price at which property or the right to use property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy, sell or transfer property or the right to use property, and both having reasonable knowledge of relevant facts).

(ii) *Reasonable compensation*—(A) *In general.* The value of services is the amount that would ordinarily be paid for like services by like enterprises under like circumstances (*i.e.,* reasonable compensation). Section 162 standards apply in determining reasonableness of compensation, taking into account the aggregate benefits (other than any benefits specifically disregarded under paragraph (a)(4) of this section) provided to a person and the rate at which any deferred compensation accrues. The fact that a bonus or revenue-sharing arrangement is subject to a cap is a relevant factor in determining the reasonableness of compensation. The fact that a State or local legislative or agency body or court has authorized or approved a particular compensation package paid to a disqualified person is not determinative of the reasonableness of compensation for purposes of section 4958.

(B) *Items included in determining the value of compensation for purposes of determining reasonableness under section 4958.* Except for economic benefits that are disregarded for purposes of section 4958 under paragraph (a)(4) of this section, compensation for purposes of determining reasonableness under section 4958 includes all economic benefits provided by an applicable tax-exempt organization in exchange for the performance of services. These benefits include, but are not limited to—

(*1*) All forms of cash and noncash compensation, including salary, fees, bonuses, severance payments, and deferred and noncash compensation described in § 53.4958–1T(e)(2);

(*2*) Unless excludable from income as a de minimis fringe benefit pursuant to section 132(a)(4), the payment of liability insurance premiums for, or the payment or reimbursement by the organization of—

(*i*) Any penalty, tax, or expense of correction owed under section 4958;

(*ii*) Any expense not reasonably incurred by the person in connection with a civil judicial or civil administrative proceeding arising out of the person's performance of services on behalf of the applicable tax-exempt organization; or

(*iii*) Any expense resulting from an act or failure to act with respect to which the person has acted willfully and without reasonable cause; and

(*3*) All other compensatory benefits, whether or not included in gross income for income tax purposes, including payments to welfare benefit plans, such as plans providing medical, dental, life insurance, severance pay, and disability benefits, and both taxable and nontaxable fringe benefits (other than fringe benefits described in section 132), including expense allowances or reimbursements, and foregone interest on loans.

(C) *Inclusion in compensation for reasonableness determination does not govern income tax treatment.* The determination of whether any item listed in paragraph (b)(1)(ii)(B) of this section is included in the disqualified person's gross income for income tax purposes is made on the basis of the provisions of chapter 1 of Subtitle A of the Internal Revenue Code, without regard to whether the item is taken into account for purposes of determining reasonableness of compensation under section 4958.

(2) *Timing of reasonableness determination*—(i) *In general.* The facts and circumstances to be taken into consideration in determining reasonableness of a fixed payment (within the meaning of paragraph (a)(3)(ii) of this section) are those existing on the date the parties enter into the contract pursuant to which the payment is made. However, in the event of substantial non-performance, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. In the case of a payment that is not a fixed payment under a contract, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. In no event shall circumstances existing at the date when the payment is questioned be considered in making a determination of the reasonableness of the payment.

(ii) *Treatment as a new contract.* For purposes of paragraph (b)(2)(i) of this section, a written binding contract that provides that the contract is terminable or subject to cancellation by the applicable tax-exempt organization without the other party's consent and without substantial penalty to the organization is treated as a new contract as of the earliest date that any such termination or cancellation, if made, would be effective. Additionally, if the parties make a material change to a contract (within the meaning of paragraph (a)(3)(v) of this section), it is treated as a new contract as of the date the material change is effective.

(iii) *Examples.* The following examples illustrate the timing of the reasonableness determination under the rules of this paragraph (b)(2):

Example 1. G is an applicable tax-exempt organization for purposes of section 4958. H is an employee of G and a disqualified person with respect to G. H's new multi-year employment contract provides for payment of a salary and provision of specific benefits pursuant to a qualified pension plan under Internal Revenue Code section 401(a) and an accident and health plan that meets the requirements of section 105(h)(2). The contract provides that H's salary will be adjusted by the increase in the Consumer Price Index (CPI) for the prior year. The contributions G makes to the qualified pension plan are equal to the maximum amount G is permitted to contribute under the rules applicable to qualified plans. Under these facts, all items comprising H's total compensation are treated as fixed payments within the meaning of paragraph (a)(3)(ii) of this section. Therefore, the reasonableness of H's compensation is determined based on the circumstances existing at the time G and H enter into the employment contract.

Example 2. N is an applicable tax-exempt organization for purposes of section 4958. On January 2, N's governing body enters into a new one-year employment contract with K, its executive director, who is a disqualified person with respect to N. The contract provides that K will receive a specified amount of salary, contributions to a qualified pension plan under Internal Revenue Code section 401(a), and other benefits pursuant to a section 125 cafeteria plan. In addition, the contract provides that N's governing body may, in its discretion, declare a bonus to be paid to K at any time during the year covered by the contract. K's salary and other specified benefits constitute fixed payments within the meaning of paragraph (a)(3)(ii) of this section. Therefore, the reasonableness of those economic benefits is determined on the date when the contract was made. However, because the bonus payment is not a fixed payment within the meaning of paragraph (a)(3)(ii) of this section, the determination of whether any bonus awarded to N is reasonable must be made based on all facts and circumstances (including all payments and consideration exchanged between the parties), up to and including circumstances as of the date of payment of the bonus.

(c) *Establishing intent to treat economic benefit as consideration for the performance of services*—(1) *In general.* An economic benefit is not treated as consideration for the performance of services unless the organization providing the benefit clearly indicates its intent to treat the benefit as compensation when the benefit is paid. Except as provided in paragraph (c)(2) of this section, an applicable tax-exempt organization (or entity controlled by an applicable tax-exempt organization, within the meaning of paragraph (a)(2)(ii)(B) of this section) is treated as clearly indicating its intent to provide an economic benefit as compensation for services only if the organization provides written substantiation that is contemporaneous with the transfer of the economic benefit at issue. If an organization fails to provide this contemporaneous substantiation, any services provided by the disqualified person will not be treated as provided in consideration for the economic benefit for purposes of determining the reasonableness of the transaction.

(2) *Nontaxable benefits.* For purposes of section 4958(c)(1)(A) and this section, an applicable tax-exempt organization is not required to indicate its intent to provide an economic benefit as compensation for services if the economic benefit is excluded from the disqualified person's gross income for income tax purposes on the basis of the provisions of chapter 1 of Subtitle A of the Internal Revenue Code. Examples of these benefits include, but are not limited to, employer-provided health benefits and contributions to a qualified pension, profit-sharing, or stock bonus plan under Internal Revenue Code section 401(a), and benefits described in sections 127 and 137. However, except for economic benefits that are disregarded for purposes of section 4958 under paragraph (a)(4) of this section, all compensatory benefits (regardless of the federal income tax treatment) provided by an organization in exchange for the performance of services are taken into account in determining the reasonableness of a person's compensation for purposes of section 4958.

(3) *Contemporaneous substantiation*—(i) *Reporting of benefit.* An applicable tax-exempt organization provides contemporaneous written substantiation of its intent to provide an economic benefit as compensation if—

(A) The organization reports the economic benefit as compensation on an original Federal tax information return with respect to the payment (*e.g.,* Form W–2 or 1099) or with respect to the organization (*e.g.,* Form 990), or on an amended Federal tax information return filed prior to the commencement of an Internal Revenue Service examination of the applicable tax-exempt organization or the disqualified person for the taxable year in which the transaction occurred (as determined under § 53.4958–1T(e)); or

(B) The recipient disqualified person reports the benefit as income on the person's original Federal tax return (*e.g.,* Form 1040), or on the person's amended Federal tax return filed prior to the commencement of an Internal Revenue Service examination described in paragraph (b)(3)(i)(A) of this section.

(ii) *Other evidence of contemporaneous substantiation.* In addition, other written contemporaneous evidence may be used to demonstrate that the appropriate decision-making body or an authorized officer approved a transfer as compensation for services in accordance with established procedures, including an approved written employment contract executed on or before the date of the transfer, or documentation satisfying the requirements of § 53.4958–6T(a)(3) indicating that an authorized body approved the transfer as compensation for services on or before the date of the transfer.

(iii) *Failure to report due to reasonable cause.* If an applicable tax-exempt organization's failure to report an economic benefit as required under the Internal Revenue Code is due to reasonable cause (within the meaning of § 301.6724–1 of this chapter), then the organization will be treated as having clearly indicated its intent to provide an economic benefit as compensation for services. To show that its failure to report an economic benefit that should have been reported on an information return was due to reasonable cause, an applicable tax-exempt organization must establish that there were significant mitigating factors with respect to its failure to report (as described in § 301.6724–1(b) of this chapter), or the failure arose from events beyond the organization's control (as described in § 301.6724–1(c) of this chapter), and that the organization acted in a responsible manner both before and after the failure occurred (as described in § 301.6724–1(d) of this chapter).

(4) *Examples.* The following examples illustrate the requirement that an organization contemporaneously substantiate its intent to provide an economic benefit as compensation for services, as defined in paragraph (c) of this section:

Example 1. G is an applicable tax-exempt organization for purposes of section 4958. G hires an individual contractor, P, who is also the child of a disqualified person of G, to design a computer program for it. G executes a contract with P for that purpose in accordance with G's established procedures, and pays P $1,000 during the year pursuant to the contract. Before January 31 of the next year, G reports the full amount paid to P under the contract on a Form 1099 filed with the Internal Revenue Service. G will be treated as providing contemporaneous written substantiation of its intent to provide the $1,000 paid to P as compensation for the services P performed under the contract by virtue of either the Form 1099 filed with the Internal Revenue Service reporting the amount, or by virtue of the written contract executed between G and P.

Example 2. G is an applicable tax-exempt organization for purposes of section 4958. D is the chief operating officer of G, and a disqualified person with respect to G. D receives a bonus at the end of the year. G's accounting department determines that the bonus is to be reported on D's Form W–2. Due to events beyond G's control, the bonus is not reflected on D's Form W–2. As a result, D fails to report the bonus on his individual income tax return. G acts to amend Forms W–2 affected as soon as G is made aware of the error during an Internal Revenue Service examination. G's failure to report the bonus on an information return issued to D arose from events beyond G's control, and G acted in a responsible manner both before and after the failure occurred. Thus, because G had reasonable cause (within the meaning of § 301.6724–1 of this chapter) for failing to report D's bonus, G will be treated as providing contemporaneous written substantiation of its intent to provide the bonus as compensation for services when paid.

§ 53.4958–5T Transaction in which the amount of the economic benefit is determined in whole or in part by the revenues of one or more activities of the organization (temporary). [Reserved]

§ 53.4958–6T Rebuttable presumption that a transaction is not an excess benefit transaction (temporary).

(a) *In general.* Payments under a compensation arrangement are presumed to be reasonable, and a transfer of property, or the right to use property, is presumed to be at fair market value, if the following conditions are satisfied—

(1) The compensation arrangement or the terms of the property transfer are Approved in advance by an authorized body of the applicable tax-exempt organization (or an entity controlled by

the organization with the meaning of § 53.4958–4T(a)(2)(ii)(B)) composed entirely of individuals who do not have a conflict of interest (within the meaning of paragraph (c)(1)(iii) of this section) with respect to the compensation arrangement or property transfer, as described in paragraph (c)(1) of this section;

(2) The authorized body obtained and relied upon appropriate data as to comparability prior to making its determination, as described in paragraph (c)(2) of this section; and

(3) The authorized body adequately documented the basis for its determination concurrently with making that determination, as described in paragraph (c)(3) of this section.

(b) *Rebutting the presumption.* If the three requirements of paragraph (a) of this section are satisfied, then the Internal Revenue Service may rebut the presumption that arises under paragraph (a) of this section only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body. With respect to any fixed payment (within the meaning of § 53.4958–4T(a)(3)(ii)), rebuttal evidence is limited to evidence relating to facts and circumstances existing on the date the parties enter into the contract pursuant to which the payment is made (except in the event of substantial nonperformance). With respect to all other payments (including non-fixed payments subject to a cap, as described in paragraph (d)(2) of this section), rebuttal evidence may include facts and circumstances up to and including the date of payment. See § 53.4958–4T(b)(2)(i).

(c) *Requirements for invoking rebuttable presumption*—(1) *Approval by an authorized body*—(i) *In general.* An authorized body means—

(A) The governing body (*i.e.,* the board of directors, board of trustees, or equivalent controlling body) of the organization;

(B) A committee of the governing body, which may be composed of any individuals permitted under State law to serve on such a committee, to the extent that the committee is permitted by State law to act on behalf of the governing body; or

(C) To the extent permitted under State law, other parties authorized by the governing body of the organization to act on its behalf by following procedures specified by the governing body in approving compensation arrangements or property transfers.

(ii) *Individuals not included on authorized body.* For purposes of determining whether the requirements of paragraph (a) of this section have been met with respect to a specific compensation arrangement or property transfer, an individual is not included on the authorized body when it is reviewing a transaction if that individual meets with other members only to answer questions, and otherwise recuses himself or herself from the meeting and is not present during debate and voting on the compensation arrangement or property transfer.

(iii) *Absence of conflict of interest.* A member of the authorized body does not have a conflict of interest with respect to a compensation arrangement or property transfer only if the member—

(A) Is not a disqualified person participating in or economically benefitting from the compensation arrangement or property transfer, and is not a member of the family of any such disqualified person, as described in section 4958(f)(4) or § 53.4958–3T(b)(1);

(B) Is not in an employment relationship subject to the direction or control of any disqualified person participating in or economically benefitting from the compensation arrangement or property transfer;

(C) Does not receive compensation or other payments subject to approval by any disqualified person participating in or economically benefitting from the compensation arrangement or property transfer;

(D) Has no material financial interest affected by the compensation arrangement or property transfer; and

(E) Does not approve a transaction providing economic benefits to any disqualified person participating in the compensation arrangement or property transfer, who in turn has approved or will approve a transaction providing economic benefits to the member.

(2) *Appropriate data as to comparability*—(i) *In general.* An authorized body has appropriate data as to comparability if, given the knowledge and expertise of its members, it has information sufficient to determine whether, under the standards set forth in § 53.4958–4T(b), the compensation arrangement in its entirety is reasonable or the property transfer is at fair market value. In the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the availability of similar services in the geographic area of the applicable tax-exempt organization; current compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the disqualified person. In the case of property, relevant information includes, but is not limited to, current independent appraisals of the value of all property to be transferred; and offers received as part of an open and competitive bidding process.

(ii) *Special rule for compensation paid by small organizations.* For organizations with annual gross receipts (including contributions) of less than $1 million reviewing compensation arrangements, the authorized body will be considered to have appropriate data as to comparability if it has data on compensation paid by three comparable organizations in the same or similar communities for similar services. No inference is intended with respect to whether circumstances falling outside this safe harbor will meet the requirement with respect to the collection of appropriate data.

(iii) *Application of special rule for small organizations.* For purposes of determining whether the special rule for small organizations described in paragraph (c)(2)(ii) of this section applies, an organization may calculate its annual gross receipts based on an average of its gross receipts during the three prior taxable years. If any applicable tax-exempt organization is controlled by or controls another entity (as defined in § 53.4958–4T(a)(2)(ii)(B)), the annual gross receipts of such organizations must be aggregated to determine applicability of the special rule stated in paragraph (c)(2)(ii) of this section.

(iv) *Examples.* The following examples illustrate the rules for appropriate data as to comparability for purposes of invoking the rebuttable presumption of reasonableness described in this section. In all examples, compensation refers to the aggregate value of all benefits provided in exchange for services. The examples are as follows:

Example 1. Z is a university that is an applicable tax-exempt organization for purposes of section 4958. Z is negotiating a new contract with Q, its president, because the old contract will expire at the end of the year. In setting Q's compensation for its president at $*600x* per annum, the executive committee of the Board of Trustees relies solely on a national survey of compensation for university presidents that indicates university presidents receive annual compensation in the range of $*100x* to $*700x;* this survey does not divide its data by any criteria, such as the number of students served by the institution, annual revenues, academic ranking, or geographic location. Although many members of the executive committee have significant business experience, none of the members has any particular expertise in higher education compensation matters. Given the failure of the survey to provide information specific to universities comparable to Z, and because no other information was presented, the executive committee's decision with respect to Q's compensation was not based upon appropriate data as to comparability.

Example 2. The facts are the same as *Example 1,* except that the national compensation survey divides the data regarding compensation for university presidents into categories based on various university-specific factors, including the size of the institution (in terms of the number of students it serves and the amount of its revenues) and geographic area. The survey data shows that university presidents at institutions comparable to and in the same geographic area as Z receive annual compensation in the range of $*200x* to $*300x.* The executive committee of the Board of Trustees of Z relies on the survey data and its evaluation of Q's many years of service as a tenured professor and high-ranking university official at Z in setting Q's compensation at $*275x* annually. The data relied upon by the executive committee constitutes appropriate data as to comparability.

Example 3. X is a tax-exempt hospital that is an applicable tax-exempt organization for purposes of section 4958. Before renewing the contracts of X's chief executive officer and chief financial officer, X's governing board commissioned a customized compensation survey from an independent firm that specializes in consulting on issues related to executive placement and compensation. The survey covered executives with comparable responsibilities at a significant number of taxable and tax-exempt hospitals. The survey data are sorted by a number of different variables, including the size of the hospitals and the nature of the services they provide, the level of experience and specific responsibilities of the executives, and the composition of the annual compensation packages. The board members were provided with the survey results, a detailed written analysis comparing the hospital's executives to those covered by the survey, and an opportunity to ask questions of a member of the firm that prepared the survey. The survey, as prepared and presented to X's board, constitutes appropriate data as to comparability.

Example 4. The facts are the same as *Example 3,* except that one year later, X is negotiating a new contract with its chief executive officer. The governing board of X has no information indicating that the relevant market conditions have changed or that the results of the prior year's survey are no longer valid. Therefore, X may continue to rely on the independent compensation survey prepared for the prior year in setting annual compensation under the new contract.

Example 5. W is a local repertory theater and an applicable tax-exempt organization for purposes of section 4958. W has had annual gross receipts ranging from $400,000 to $800,000 over its past three taxable years. In determining the next year's compensation for W's artistic director, the board of directors of W relies on data compiled from a telephone survey of three other unrelated repertory theaters of similar size in similar communities. A member of the board drafts a brief written summary of the annual compensation information obtained from this informal survey. The annual compensation information obtained in the telephone survey is appropriate data as to comparability.

(3) *Documentation*—(i) For a decision to be documented adequately, the written or electronic records of the authorized body must note—

(A) The terms of the transaction that was approved and the date it was approved;

(B) The members of the authorized body who were present during debate on the transaction that was approved and those who voted on it;

(C) The comparability data obtained and relied upon by the authorized body and how the data was obtained; and

(D) Any actions taken with respect to consideration of the transaction by anyone who is otherwise a member of the authorized body but who had a conflict of interest with respect to the transaction.

(ii) If the authorized body determines that reasonable compensation for a specific arrangement or fair market value in a specific property transfer is higher or lower than the range of comparability data obtained, the authorized body must record the basis for its determination. For a decision to be documented concurrently, records must be prepared before the later of the next meeting of the authorized body or 60 days after the final action or actions of the authorized body are taken. Records must be reviewed and approved by the authorized body as reasonable, accurate and complete within a reasonable time period thereafter.

(d) *No presumption with respect to non-fixed payments until amounts are determined*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, in the case of a payment that is not a fixed payment (within the meaning of § 53.4958–4T(a)(3)(ii)), the rebuttable presumption of this section arises only after the exact amount of the payment is determined, or a fixed formula for calculating the payment is specified, and the three requirements for the presumption under paragraph (a) of this section subsequently are satisfied. See § 53.4958–4T(b)(2)(i).

(2) *Special rule for certain non-fixed payments subject to a cap.* If the authorized body approves an employment contract with a disqualified person that includes a non-fixed payment (such as a discretionary bonus) subject to a specified cap, the authorized body may establish a rebuttable presumption with respect to the non-fixed payment at the time the employment contract is entered into if—

(i) Prior to approving the contract, the authorized body obtains appropriate comparability data indicating that a fixed payment of up to a certain amount to the particular disqualified person would represent reasonable compensation;

(ii) The maximum amount payable under the contract (taking into account both fixed and non-fixed payments) does not exceed the amount referred to in paragraph (d)(2)(i) of this section; and

(iii) The other requirements for the rebuttable presumption of reasonableness under paragraph (a) of this section are satisfied.

(e) *No inference from absence of presumption.* The fact that a transaction between an applicable tax-exempt organization and a disqualified person is not subject to the presumption described in this section neither creates any inference that the transaction is an excess benefit transaction, nor exempts or relieves any person from compliance with any federal or state law imposing any obligation, duty, responsibility, or other standard of conduct with respect to the operation or administration of any applicable tax-exempt organization.

(f) *Period of reliance on rebuttable presumption.* Except as provided in paragraph (d) of this section with respect to non-fixed payments, the rebuttable presumption applies to all payments made or transactions completed in accordance with a contract, provided that the provisions of paragraph (a) of this section were met at the time the parties entered into the contract.

§ 53.4958–7T Correction (temporary).

(a) *In general.* An excess benefit transaction is corrected by undoing the excess benefit to the extent possible, and taking any additional measures necessary to place the applicable tax-exempt organization involved in the excess benefit transaction in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards. Paragraph (b) of this section describes the acceptable forms of correction. Paragraph (c) of this section defines the correction amount. Paragraph (d) of this section describes correction where a contract has been partially performed. Paragraph (e) of this section describes correction where the applicable tax-exempt organization involved in the transaction has ceased to exist or is no longer tax-exempt. Paragraph (f) of this section provides examples illustrating correction.

(b) *Form of correction*—(1) *Cash or cash equivalents.* Except as provided in paragraphs (b)(3) and (4) of this section, a disqualified person corrects an excess benefit only by making a payment in cash or cash equivalents, excluding payment by a promissory note, to the applicable tax-exempt organization equal to the correction amount, as defined in paragraph (c) of this section.

(2) *Anti-abuse rule.* A disqualified person will not satisfy the requirements of paragraph (b)(1) of this section if the Commissioner determines that the disqualified person engaged in one or more transactions with the applicable tax-exempt organization to circumvent the requirements of this correction section, and as a result, the disqualified person effectively transferred property other than cash or cash equivalents.

(3) *Special rule relating to nonqualified deferred compensation.* If an excess benefit transaction results, in whole or in part, from the vesting (as described in § 53.4958–1T(e)(2)) of benefits provided under a nonqualified deferred compensation plan, then, to the extent that such benefits have not yet been distributed to the disqualified person, the disqualified person may correct the portion of the excess benefit resulting from such undistributed deferred compensation by relinquishing any right to receive such benefits (including any earnings thereon).

(4) *Return of specific property*—(i) *In general.* A disqualified person may, with the agreement of the applicable tax-exempt organization, make a payment by returning specific property previously transferred in the excess benefit transaction. In this case, the disqualified person is treated as making a payment equal to the lesser of—

(A) The fair market value of the property determined on the date the property is returned to the organization; or

(B) The fair market value of the property on the date the excess benefit transaction occurred.

(ii) *Payment not equal to correction amount.* If the payment described in paragraph (b)(4)(i) of this section is less than the correction amount (as described in paragraph (c) of this section), the disqualified person must make an additional cash payment to the organization equal to the difference. Conversely, if the payment described in paragraph (b)(4)(i) of this section exceeds the correction amount (as described in paragraph (c) of this section), the organization may make a cash payment to the disqualified person equal to the difference.

(iii) *Disqualified person may not participate in decision.* Any disqualified person who received an excess benefit from the excess benefit transaction may not participate in the applicable tax-exempt organization's decision whether to accept the return of specific property under paragraph (b)(4)(i) of this section.

(c) *Correction amount.* The correction amount with respect to an excess benefit transaction equals the sum of the excess benefit (as defined in § 53.4958–1T(b)) and interest on the excess benefit. The amount of the interest charge for purposes of this section is determined by multiplying the excess benefit by an interest rate, compounded annually, for the period from the date the excess benefit transaction occurred (as defined in § 53.4958–1T(e)) to the date of correction. The interest rate used for this purpose must be a rate that equals or exceeds the applicable Federal rate (AFR), compounded annually, for the month in which the transaction occurred. The period from the date the excess benefit transaction occurred to the date of correction is used to determine whether the appropriate AFR is the Federal short-term rate, the Federal mid-term rate, or the Federal long-term rate. See section 1274(d)(1)(A).

(d) *Correction where contract has been partially performed.* If the excess benefit transaction arises under a contract that has been partially performed, termination of the contractual relationship between the organization and the disqualified person is not required in order to correct. However, the parties may need to modify the terms of any ongoing contract to avoid future excess benefit transactions.

(e) *Correction in the case of an applicable tax-exempt organization that has ceased to exist, or is no longer tax-exempt*—(1) *In general.* A disqualified person must correct an excess benefit transaction in accordance with this paragraph where the applicable tax-exempt organization that engaged in the transaction no longer exists or is no longer described in section 501(c)(3) or (4) and exempt from tax under section 501(a).

(2) *Section 501(c)(3) organizations.* In the case of an excess benefit transaction with a section 501(c)(3) applicable tax-exempt organization, the disqualified person must pay the correction amount, as defined in paragraph (c) of this section, to another organization described in section 501(c)(3) and exempt from tax under section 501(a) in accordance with the dissolution clause contained in the constitutive documents of the applicable tax-exempt organization involved in the excess benefit transaction, provided that the other organization is not related to the disqualified person.

(3) *Section 501(c)(4) organizations.* In the case of an excess benefit transaction with a section 501(c)(4) applicable tax-exempt organization, the disqualified person must pay the correction amount, as defined in paragraph (c) of this section, to a successor section 501(c)(4) organization or, if no tax-exempt successor, to any section 501(c)(3) or other section 501(c)(4) organization not related to the disqualified person.

(f) *Examples.* The following examples illustrate the principles of this section describing the requirements of correction:

Example 1. W is an applicable tax-exempt organization for purposes of section 4958. D is a disqualified person with respect to W. W employed D in 1999 and made payments totaling *$12t* to D as compensation throughout the taxable year. The fair market value of D's services in 1999 was *$7t.* Thus, D received excess compensation in the amount of *$5t,* the excess benefit for purposes of section 4958. In accordance with § 53.4958–1T(e)(1), the excess benefit transaction with respect to the series of compensatory payments during 1999 is deemed to occur on December 31, 1999, the last day of D's taxable year. In order to correct the excess benefit transaction on June 30, 2002, D must pay W, in cash or cash equivalents, excluding payment with a promissory note, *$5t* (the excess benefit) plus interest on *$5t* for the period from the date the excess benefit transaction occurred to the date of correction (*i.e.,* December 31, 1999, to June 30, 2002). Because this period is not more than three years, the interest rate D must use to determine the interest on the excess benefit must equal or exceed the short-term AFR, compounded annually, for December, 1999 (5.74%, compounded annually).

Example 2. X is an applicable tax-exempt organization for purposes of section 4958. B is a disqualified person with respect to X. On January 1, 2000, B paid X *$6v* for Property F. Property F had a fair market value of *$10v* on January 1, 2000. Thus, the sales transaction on that date provided an excess benefit to B in the amount of *$4v.* In order to correct the excess benefit on July 5, 2005, B pays X, in cash or cash equivalents, excluding payment with a promissory note, *$4v* (the excess benefit) plus interest on *$4v* for the period from the date the excess benefit transaction occurred to the date of correction (*i.e.,* January 1, 2000, to July 5, 2005). Because this period is over three but not over nine years, the interest rate B must use to determine the interest on the excess benefit must equal or exceed the mid-term AFR, compounded annually, for January, 2000 (6.21%, compounded annually).

Example 3. The facts are the same as in *Example 2,* except that B offers to return Property F. X agrees to accept the return of Property F, a decision in which B does not participate. Property F has declined in value since the date of the excess benefit transaction. On July 5, 2005, the property has a fair market value of *$9v.* For purposes of correction, B's return of Property F to X is treated as a payment of *$9v,* the fair market value of the property determined on the date the property is returned to the organization. If *$9v* is greater than the correction amount (*$4v* plus interest on *$4v* at a rate that equals or exceeds 6.21%, compounded annually, for the period from January 1, 2000, to July 5, 2005), then X may make a cash payment to B equal to the difference.

Example 4. The facts are the same as in *Example 3,* except that Property F has increased in value since January 1, 2000, the date the excess benefit transaction occurred, and on July 5, 2005, has a fair market value of *$13v.* For purposes of correction, B's return of Property F to X is treated as a payment of *$10v,* the fair market value of the property on the date the excess benefit transaction occurred. If *$10v* is greater than the correction amount (*$4v* plus interest on *$4v* at a rate that equals or exceeds 6.21%, compounded annually, for the period from January 1, 2000, to July 5, 2005), then X may make a cash payment to B equal to the difference.

Example 5. The facts are the same as in *Example 2.* Assume that the correction amount B paid X in cash on July 5, 2005, was *$5.58v.* On July 4, 2005, X loaned *$5.58v* to B, in exchange for a promissory note signed by B in the amount of *$5.58v,* payable with interest at a future date. These facts indicate that B engaged in the loan transaction to circumvent the requirement of this section that (except as provided in paragraph (b)(3) or (4) of this section), the correction amount must be paid only in cash or cash equivalents. As a result, the Commissioner may determine that B effectively transferred property other than cash or cash equivalents, and therefore did not satisfy the correction requirements of this section.

§ 53.4958–8T Special rules (temporary).

(a) *Substantive requirements for exemption still apply.* Section 4958 does not affect the substantive standards for tax exemption under section 501(c)(3) or (4), including the requirements that the organization be organized and operated exclusively for exempt purposes, and that no part of its net earnings inure to the benefit of any private shareholder or individual. Thus, regardless of whether a particular transaction is subject to excise taxes under section 4958, existing principles and rules may be implicated, such as the limitation on private benefit. For example, transactions that are not subject to section 4958 because of the initial contract exception described in § 53.4958–4T(a)(3) may, under certain circumstances, jeopardize the organization's tax-exempt status.

(b) *Interaction between section 4958 and section 7611 rules for church tax inquiries and examinations.* The procedures of section 7611 will be used in initiating and conducting any inquiry or examination into whether an excess benefit transaction has occurred between a church and a disqualified person. For purposes of this rule, the reasonable belief required to initiate a church tax inquiry is satisfied if there is a reasonable belief that a section 4958 tax is due from a disqualified person with respect to a transaction involving a church. See § 301.7611–1 Q&A 19 of this chapter.

(c) *Three year duration of these temporary regulations.* Sections 53.4958–1T through 53.4958–8T will cease to apply on January 9, 2004.

§ 53.4963–1 [Amended]

Par. 3. In § 53.4963–1, paragraphs (a), (b), and (c) are amended by adding the reference ''4958,'' immediately after the reference ''4955,'' in each place it appears.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read in part as follows:

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

§ 301.6213–1 [Amended]

Par. 5. In § 301.6213–1, paragraph (e) is amended by adding the reference ''4958,'' immediately after the reference ''4955,'' in the first sentence.

§ 301.6501(e)–1 [Amended]

Par. 6. Section 301.6501(e)–1 is amended as follows:

1. Paragraph (c)(3)(ii), first and second sentences are amended by removing the language ''or trust'' and adding ''trust, or other organization'' in its place.

2. Paragraph (c)(3)(ii), the first sentence is amended by removing the language ''and 4953'' and adding ''4953, and 4958'' in its place.

§ 301.6501(n)–1 [Amended]

Par. 7. Section 301.6501(n)-1 is amended as follows:

1. The paragraph heading for paragraph (a) is amended by removing the language ''or trust'' and adding ''trust, or other organization'' in its place.

2. Paragraph (a)(1), the first sentence is amended by removing the language ''or trust'' and adding ''trust, or other organization'' in its place.

3. Paragraph (b), the heading and the first sentence are amended by removing the language ''or trust'' and adding ''trust, or other organization'' in its place.

§ 301.7422–1 [Amended]

Par. 8. In § 301.7422–1, paragraph (a) introductory text, paragraph (c) introductory text and paragraph (d) are amended by adding the reference ''4958,'' immediately after the reference ''4955,''.

§ 301.7454–2 [Amended]

Par. 9. In § 301.7454–2, paragraph (a) is amended by adding the language ''or whether an organization manager (as defined in section 4958(f)(2) has ''knowingly'' participated in an excess benefit transaction (as defined in section 4958(c),'' immediately after ''4945''.

§ 301.7611–1 [Amended]

Par. 10. In § 301.7611–1, the Table of contents is amended by:

1. Adding ''Application to Section 4958. . . . . . . 19'' immediately after ''Effective Date. . . . . . . 18''.

2. Adding an undesignated centerheading and Q–19 and A–19 at the end of the section to read as follows:

§ 301.7611–1 Questions and answers relating to church tax inquiries and examinations.

* * * * *

Application to Section 4958

Q–19: When do the church tax inquiry and examination procedures described in section 7611 apply to a determination of whether there was an excess benefit transaction described in section 4958?

A–19: See § 53.4958–7(b) of this chapter for rules governing the interaction between section 4958 excise taxes on excess benefit transactions and section 7611 church tax inquiry and examination procedures.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 11. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. In § 602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

§ 602.101 OMB control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
53.4958–6T	1545–1623
* * * * *	

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: December 19, 2000.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury.

[FR Doc. 01–256 Filed 1–9–01; 8:45 am]

BILLING CODE 4830–01–P