

## Highlights

Appendices A, B, C, D, and G are based on materials contained in the current Form 990 instructions. Appendices E and F are new and provide special instructions in the case of group returns or organizations with disregarded entities or joint venture investments. Appendix H is reserved and is expected to be included with the final instructions.

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## Appendix of Special Instructions to Form 990

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### Appendix A: Exempt Organizations Reference Chart

To determine how the instructions for Form 990 apply to the organization, an organization must know the Code section under which the organization is exempt.

| Type of Organization  | I.R.C Section       |
|---|---------------------|
| Corporations Organized Under Act of Congress                            | 501(c)(1)           |
| Title Holding Corporations  | 501(c)(2)           |
| Charitable, Religious, Educational, Scientific, etc. Organizations      | 501(c)(3)           |
| Civic Leagues and Social Welfare Organizations                          | 501(c)(4)           |
| Labor, Agricultural, and Horticultural Organizations                    | 501(c)(5)           |
| Business Leagues, etc.  | 501(c)(6)           |
| Social and Recreation Clubs   | 501(c)(7)           |
| Fraternal Beneficiary and Domestic Fraternal Societies and Associations | 501(c)(8) & (c)(10) |
| Voluntary Employees' Beneficiary Associations                           | 501(c)(9)           |
| Teachers' Retirement Fund Associations                                  | 501(c)(11)          |

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|--|----------------------|
| Benevolent Life Insurance Associations,<br>Mutual Ditch or Irrigation Companies,<br>Mutual or Cooperative Telephone<br>Companies, etc. | 501(c)(12)           |
| Cemetery Companies   | 501(c)(13)           |
| State Chartered Credit Unions, Mutual<br>Reserve Funds   | 501(c)(14)           |
| Insurance Companies or Associations<br>Other than Life   | 501(c)(15)           |
| Cooperative Organizations to Finance<br>Crop Operations  | 501(c)(16)           |
| Supplemental Unemployment Benefit<br>Trusts  | 501(c)(17)           |
| Employee Funded Pension Trusts<br>(created before 6/25/1959)   | 501(c)(18)           |
| Organizations of Past or Present<br>Members of the Armed Forces  | 501(c)(19) & (c)(23) |
| Black Lung Benefit Trusts  | 501(c)(21)           |
| Withdrawal Liability Payment Funds   | 501(c)(22)           |
| Title Holding Corporations or Trusts   | 501(c)(25)           |
| State-Sponsored Organizations<br>Providing Health Coverage for High-Risk<br>Individuals  | 501(c)(26)           |
| State-Sponsored Workmen's<br>Compensation and Insurance and<br>Reinsurance Organizations   | 501(c)(27)           |
| Religious and Apostolic Associations   | 501(d)               |
| Cooperative Hospital Service<br>Organizations  | 501(e)               |
| Cooperative Service Organizations of<br>Operating Educational Organizations  | 501(f)               |
| Child Care Organizations   | 501(k)               |

|                         |        |
|-------------------------|--------|
| Charitable Risk Pools   | 501(n) |
| Political Organizations | 527    |

## **Appendix B: How to Determine Whether an Organization's Gross Receipts Are Normally \$25,000 (or \$5000) or Less**

To figure whether an organization has to file Form 990-EZ (or Form 990) apply the \$25,000 (or \$5000) gross receipts test (below) using the following definition of gross receipts and information in *Figuring Gross Receipts* below.

### **Gross Receipts**

Gross receipts are the total amounts the organization received from all sources during its annual accounting period, without subtracting any costs or expenses.

**Caution:** Do not use the definition of gross receipts described in *Appendix C: Section 501(c)(15) Organizations and Gross Receipts* to figure gross receipts.

**Gross receipts when acting as an agent.** If a local chapter of a section 501(c)(8) fraternal organization collects insurance premiums for its parent lodge and merely sends those premiums to the parent without asserting any right to use the funds or otherwise deriving any benefit from them, the local chapter does not include the premiums in its gross receipts. The parent lodge reports them instead. The same treatment applies in other situations in which one organization collects funds merely as an agent for another.

### **Figuring Gross Receipts**

Figure gross receipts for Form 990 and Form 990-EZ as follows.

**Form 990.** Gross receipts are the sum of lines 6b (both columns), 7b (both columns), 8b, 9b, 10b, and 12, Column A of Form 990, Part VIII.

**Form 990-EZ.** Gross receipts are the sum of lines 5b, 6b, 7b, and 9 of Form 990-EZ, Part I.

**Example.** Organization M reported \$50,000 as total revenue on line 9 of its Form 990-EZ. M added back the costs and expenses it had deducted on lines 5b (\$2,000); 6b (\$1,500); and 7b (\$500) to its total revenue of \$50,000 and determined that its gross receipts for the tax year were \$54,000.

### **\$25,000 Gross Receipts Test**

To determine whether an organization's gross receipts are normally \$25,000 or less, apply the following test. An organization's gross receipts are considered normally to be \$25,000 or less if the organization is:

1. Up to a year old and has received, or donors have pledged to give, \$37,500 or less during its first tax year;
2. Between 1 and 3 years old and averaged \$30,000 or less in gross receipts during each of its first 2 tax years; or

3. Three years old or more and averaged \$25,000 or less in gross receipts for the immediately preceding 3 tax years (including the year for which the return would be filed).

### **\$5,000 Gross Receipts Test**

To determine whether an organization's gross receipts are normally \$5,000 or less, apply the following test. An organization's gross receipts are considered normally to be \$5,000 or less if the organization is:

1. Up to a year old and has received, or donors have pledged to give, \$7,500 or less during its first tax year;
2. Between 1 and 3 years old and averaged \$6,000 or less in gross receipts during each of its first 2 tax years; or
3. Three years old or more and averaged \$5,000 or less in gross receipts for the immediately preceding 3 tax years (including the year for which the return would be filed).

### **Appendix C: Section 501(c)(15) Organizations and Gross Receipts**

A section 501(c)(15) organization applies the same gross receipts test as other organizations to determine whether they must file the Form 990 or Form 990-EZ. However, section 501(c)(15) insurance companies are also subject to separate tests to determine whether they qualify as tax-exempt for the tax year. The following tests use a specific definition for gross receipts defined below only for purposes of the following tests. Insurance companies that do not qualify as tax-exempt must file Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return, or Form 1120, U.S. Corporation Income Tax Return, as taxable entities. See Notice 2006-42, which is on page 878 of the Internal Revenue Bulletin 2006-19 at [www.irs.gov/irs-irbs/irb06-19.pdf](http://www.irs.gov/irs-irbs/irb06-19.pdf).

**Tests for section 501(c)(15) insurance companies to qualify as tax-exempt for the tax year.** If any section 501(c)(15) insurance company (other than life insurance) normally has gross receipts of more than \$25,000 for the tax year and meets both parts of the following test, then the company can file Form 990 (or Form 990-EZ, if applicable).

1. The company's gross receipts must be equal to or less than \$600,000, and
2. The company's premiums must be more than 50% of its gross receipts.

If the company did not meet this test and the company is a mutual insurance company, then it must meet the *Alternate test* to qualify to file Form 990 (or Form 990-EZ, if applicable). Otherwise, the company must file Form 1120 or 1120-PC, as appropriate.

**Alternate test.** If any section 501(c)(15) insurance company (other than life insurance) is a mutual insurance company and it did not meet the above test, then the company must meet both parts of the following alternate test.

1. The company's gross receipts must be equal to or less than \$150,000, and
2. The company's premiums must be more than 35% of its gross receipts.

If the company does not meet either test, then it must file Form 1120-PC or Form 1120 (if the company is not entitled to insurance reserves) instead of Form 990 or Form 990-EZ.

**Caution:** *The alternate test does not apply if any employee of the mutual insurance company or a member of the employee's family is an employee of another company that is exempt under section 501(c)(15) (or would be exempt if this provision did not apply).*

**Gross receipts.** To determine whether a section 501(c)(15) organization satisfies either of the above tests, figure gross receipts by adding:

1. premiums (including deposits and assessments) without reduction for return premiums or premiums paid for reinsurance;
2. gross investment income of a non-life insurance company (as described in section 834(b)); and
3. other items that are included in the filer's gross income under Subchapter B, Chapter 1, Subtitle A of the Code.

This definition does not, however, include contributions to capital. For more information, see Notice 2006-42.

**Premiums.** Premiums consist of all amounts received as a result of entering into an insurance contract. They are reported in Form 990, Part VIII (Statement of Revenue), line 2.

**Anti-abuse rule.** The anti-abuse rule, found in section 501(c)(15)(C), explains how gross receipts (including premiums) from all members of a controlled group are aggregated in figuring the above tests.

## Appendix D: Public Inspection of Returns

Some members of the public rely on Form 990, or Form 990-EZ, as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its returns.

An organization's completed Form 990, or Form 990-EZ, is available for public inspection as required by section 6104. Schedule B (Form 990, 990-EZ, or 990-PF) is open for public inspection for section 527 organizations filing Form 990 or Form 990-EZ. For other organizations that file Form 990 or Form 990-EZ, parts of Schedule B may be open to public inspection. Form 990-T filed after August 17, 2006, by a 501(c)(3) organization to report any unrelated business income, is also available for public inspection and disclosure.

### Through the IRS

Use Form 4506-A to request:

- A copy of an exempt or political organization's return, report, notice, or exemption application;
- An inspection of a return, report, notice, or exemption application at an IRS office.

The IRS can provide copies of exempt organization returns on a compact disc (CD). Requesters can order the complete set (all Forms 990 and 990-EZ or all Forms 990-PF filed for a year) or a partial set by state or by month. For more information on the cost and how to order CD-ROMs, call the TEGE Customer Account Services toll-free number (1-877-829-5500) or write to the IRS:

Internal Revenue Service

TE/GE EO Determinations  
P.O. Box 2508  
Cincinnati, OH 45201

The IRS may not disclose portions of an exemption application relating to any trade secrets, etc. Additionally, the IRS may not disclose the names and addresses of contributors. See the Instructions for Schedule B (Form 990, 990-EZ, or 990-PF) for more information about the disclosure of that schedule.

Forms 990 or 990-EZ can only be requested for section 527 organizations for tax years beginning after June 30, 2000.

A return, report, notice, or exemption application may be inspected at an IRS office free of charge. Copies of these items may also be obtained through the organization as discussed in the following section.

### Through the Organization

**Public inspection and distribution of certain returns of unrelated business income.** Section 501(c)(3) organizations that are required to file Form 990-T after August 17, 2006, must make Form 990-T available for public inspection under section 6104(d)(1)(A)(ii).

**Public inspection and distribution of returns and reports for a political organization.** Section 527 political organizations required to file Form 990, or Form 990-EZ, must, in general, make their Form 8871, 8872, 990, or 990-EZ available for public inspection in the same manner as annual information returns of section 501(c) organizations and 4947(a)(1) nonexempt charitable trusts are made available. See the public inspection rules for *Tax-exempt organizations*, later. Generally, Form 8871 and Form 8872 are available for inspection and printing from the Internet. The website address for both of these forms is [/www.irs.gov/charities/political/article/0,,id=109332,00.html](http://www.irs.gov/charities/political/article/0,,id=109332,00.html).

**TIP:** Note that a section 527 political organization (and an organization filing Form 990-PF) must disclose their Schedule B (Form 990, 990-EZ, or 990-PF). See the Instructions for Schedule B. The penalties discussed in General Instruction H also apply to section 527 political organizations (Rev. Rul. 2003-49, 2003-204 I.R.B. 903).

**Public inspection and distribution of applications for tax exemption and annual information returns of tax-exempt organizations.** Under Regulations sections 301.6104(d)-1 through -3, a tax-exempt organization must:

- Make its application for recognition of exemption and its annual information returns available for public inspection without charge at its principal, regional and district offices during regular business hours.
- Make each annual information return available for a period of 3 years beginning on the date the return is required to be filed (determined with regard to any extension of time for filing) or is actually filed, whichever is later.
- Provide a copy without charge (for Form 990-T, this requirement applies only to Forms 990-T filed after August 17, 2006), other than a reasonable fee for reproduction and actual postage costs, of all or any part of any application or return required to be made

available for public inspection to any individual who makes a request for such copy in person or in writing (except as provided in Regulations sections 301.6104(d)-2 and -3).

**Definitions.**

**Tax-exempt organization** is any organization that is described in section 501(c) or (d) and is exempt from taxation under section 501(a). The term tax-exempt organization also includes any section 4947(a)(1) nonexempt charitable trust or nonexempt private foundation that is subject to the reporting requirements of section 6033.

**Application for tax exemption** includes:

- Any prescribed application form (such as Form 1023 or Form 1024),
- All documents and statements the IRS requires an applicant to file with the form,
- Any statement or other supporting document submitted in support of the application, and
- Any letter or other document issued by the IRS concerning the application.

**Application for tax exemption** does not include:

- Any application for tax exemption filed before July 15, 1987, unless the organization filing the application had a copy of the application on July 15, 1987;
- In the case of a tax-exempt organization other than a private foundation, the name and address of any contributor to the organization; or
- Any material that is not available for public inspection under section 6104.

**Caution:** If there is no prescribed application form, see Regulations section 301.6104(d)-1(b)(4)(i).

**Annual information return** includes:

- An exact copy of the Form 990, or Form 990-EZ filed by a tax-exempt organization as required by section 6033.
- Any amended return the organization files with the IRS after the date the original return is filed.
- An exact copy of Form 990-T if one is filed by a 501(c)(3) organization.

The copy must include all information furnished to the IRS on Form 990, Form 990-EZ, or Form 990-T as well as all schedules, attachments and supporting documents, except for the name and address of any contributor to the organization. See the Instructions for Schedule B (Form 990, 990-EZ, or 990-PF).

**Annual returns more than 3 years old.** An annual information return does not include any return after the expiration of 3 years from the date the return is required to be filed (including any extension of time that has been granted for filing such return) or is actually filed, whichever is later.

If an organization files an amended return, however, the amended return must be made available for a period of 3 years beginning on the date it is filed with the IRS.

**Local or subordinate organizations.** For rules relating to annual information returns of local or subordinate organizations, see Regulations section 301.6104(d)-1(f)(2).

**Regional or district offices.** A regional or district office is any office of a tax-exempt organization, other than its principal office, that has paid employees, whether part-time or full-time, whose aggregate number of paid hours a week are normally at least 120.

A site is not considered a regional or district office, however, if:

- The only services provided at the site further exempt purposes (such as day care, health care or scientific or medical research); and
- The site does not serve as an office for management staff, other than managers who are involved solely in managing the exempt function activities at the site.

### Special rules relating to public inspection.

**Permissible conditions on public inspection.** A tax-exempt organization:

- May have an employee present in the room during an inspection.
- Must allow the individual conducting the inspection to take notes freely during the inspection.
- Must allow the individual to photocopy the document at no charge, if the individual provides photocopying equipment at the place of inspection.

**Organizations that do not maintain permanent offices.** A tax-exempt organization with no permanent office:

- Must make its application for tax exemption and its annual information returns available for inspection at a reasonable location of its choice.
- Must permit public inspection within a reasonable amount of time after receiving a request for inspection (normally not more than 2 weeks) and at a reasonable time of day.
- May mail, within 2 weeks of receiving the request, a copy of its application for tax exemption and annual information returns to the requester instead of allowing an inspection.
- May charge the requester for copying and actual postage costs only if the requester consents to the charge.

An organization that has a permanent office, but has no office hours, or very limited hours during certain times of the year, must make its documents available during those periods when office hours are limited, or not available, as though it were an organization without a permanent office.

### Special rules relating to copies.

**Time and place for providing copies in response to requests made in-person.** A tax-exempt organization must:

- Provide copies of required documents under section 6104(d) in response to a request made in person at its principal, regional and district offices during regular business hours.
- Provide such copies to a requester on the day the request is made, except for unusual circumstances (see below).

**Unusual circumstances.** In the case of an in-person request, where unusual circumstances exist so that fulfilling the request on the same business day causes an unreasonable burden to the tax-exempt organization, the organization must provide the copies no later than the next

business day following the day that the unusual circumstances cease to exist, or the 5th business day after the date of the request, whichever occurs first.

Unusual circumstances include:

- Requests received that exceed the organization's daily capacity to make copies;
- Requests received shortly before the end of regular business hours that require an extensive amount of copying; or
- Requests received on a day when the organization's managerial staff capable of fulfilling the request is conducting special duties, such as student registration or attending an off-site meeting or convention, rather than its regular administrative duties.

**Agents for providing copies.** For rules relating to use of agents to provide copies, see Regulations sections 301.6104(d)-1(d)(1) and (2).

**Request for copies in writing.** A tax-exempt organization must honor a written request for a copy of documents (or the requested part) required under section 6104(d) if the request:

1. Is addressed to, and delivered by mail, electronic mail, facsimile, or a private delivery service, as defined in section 7502(f), to a principal, regional, or district office of the organization; and
2. Sets forth the address to which the copy of the documents should be sent.

**Time and manner of fulfilling written requests.**

| IF the organization  | THEN the organization  |
|--|--|
| Receives a written request for a copy,   | Must mail the copy of the requested documents (or the requested parts) within 30 days from the date it receives the request.   |
| Mails the copy of the requested document,  | Is deemed to have provided the copy on the postmark date or private delivery mark (if sent by certified or registered mail, the date of registration or the date of the postmark on the sender's receipt). |
| Requires payment in advance,   | Is required to provide the copies within 30 days from the date it receives payment.  |
| Receives a request or payment by mail,   | Is deemed to have received it 7 days after the date of the postmark, absent evidence to the contrary.  |
| Receives a request transmitted by electronic mail or facsimile,  | Is deemed to have received it the day the request is transmitted successfully.   |
| Receives a written request without payment or with an insufficient payment, when payment in advance is required, | Must notify the requester of the prepayment policy and the amount due within 7 days from the date of the request's receipt.  |
| Receives consent from an individual making a request,  | May provide a copy of the requested document exclusively by electronic mail (the material is provided on the date the organization successfully transmits the electronic mail).                            |

**Request for a copy of parts of a document.** A tax-exempt organization must fulfill a request for a copy of the organization's entire application for tax exemption or annual information return

or any specific part or schedule of its application or return. A request for a copy of less than the entire application or less than the entire return must specifically identify the requested part or schedule.

**Fees for copies.** A tax-exempt organization may charge a reasonable fee for providing copies. Before the organization provides the documents, it may require that the individual requesting copies of the documents pay the fee. If the organization has provided an individual making a request with notice of the fee, and the individual does not pay the fee within 30 days, or if the individual pays the fee by check and the check does not clear upon deposit, the organization may disregard the request.

**Form of payment—(A) Request made in person.** If a tax-exempt organization charges a fee for copying, it must accept payment by cash and money order for requests made in person. The organization may accept other forms of payment, such as credit cards and personal checks.

**(B) Request made in writing.** If a tax-exempt organization charges a fee for copying and postage, it must accept payment by certified check, money order, and either personal check or credit card for requests made in writing. The organization may accept other forms of payment.

**Avoidance of unexpected fees.** Where a tax-exempt organization does not require prepayment and a requester does not enclose payment with a request, an organization must receive consent from a requester before providing copies for which the fee charged for copying and postage exceeds \$20.

**Documents to be provided by regional and district offices.** Except as otherwise provided, a regional or district office of a tax-exempt organization must satisfy the same rules as the principal office with respect to allowing public inspection and providing copies of its application for tax exemption and annual information returns.

A regional or district office is not required, however, to make its annual information return available for inspection or to provide copies until 30 days after the date the return is required to be filed (including any extension of time that is granted for filing such return) or is actually filed, whichever is later.

**Documents to be provided by local and subordinate organizations.**

**Applications for tax exemption.** Except as otherwise provided, a tax-exempt organization that did not file its own application for tax exemption (because it is a local or subordinate organization covered by a group exemption letter) must, upon request, make available for public inspection, or provide copies of, the application submitted to the IRS by the central or parent organization to obtain the group exemption letter and those documents which were submitted by the central or parent organization to include the local or subordinate organization in the group exemption letter.

However, if the central or parent organization submits to the IRS a list or directory of local or subordinate organizations covered by the group exemption letter, the local or subordinate organization is required to provide only the application for the group exemption ruling and the pages of the list or directory that specifically refer to it. The local or subordinate organization must permit public inspection, or comply with a request for copies made in person, within a

reasonable amount of time (normally not more than 2 weeks) after receiving a request made in person for public inspection or copies and at a reasonable time of day. See Regulations section 301.6104(d)-1(f) for further information.

**Annual information returns.** A local or subordinate organization that does not file its own annual information return (because it is affiliated with a central or parent organization that files a group return) must, upon request, make available for public inspection, or provide copies of, the group returns filed by the central or parent organization.

However, if the group return includes separate schedules with respect to each local or subordinate organization included in the group return, the local or subordinate organization receiving the request may omit any schedules relating only to other organizations included in the group return.

The local or subordinate organization must permit public inspection, or comply with a request for copies made in person, within a reasonable amount of time (normally not more than 2 weeks) after receiving a request made in person for public inspection or copies and at a reasonable time of day.

In a case where the requester seeks inspection, the local or subordinate organization may mail a copy of the applicable documents to the requester within the same time period instead of allowing an inspection. In such a case, the organization may charge the requester for copying and actual postage costs only if the requester consents to the charge.

If the local or subordinate organization receives a written request for a copy of its annual information return, it must fulfill the request by providing a copy of the group return in the time and manner specified in the paragraph earlier, *Request for copies in writing*.

The requester has the option of requesting from the central or parent organization, at its principal office, inspection or copies of group returns filed by the central or parent organization. The central or parent organization must fulfill such requests in the time and manner specified in the paragraphs, *Special rules relating to public inspection* and *Special rules relating to copies* earlier.

**Failure to comply.** If an organization fails to comply with the requirements specified in this paragraph, the penalty provisions of sections 6652(c)(1)(C), 6652(c)(1)(D), and 6685 apply.

**Making applications and returns widely available.** A tax-exempt organization is not required to comply with a request for a copy of its application for tax exemption or an annual information return if the organization has made the requested document widely available (see below).

An organization that makes its application for tax exemption and/or annual information return widely available must nevertheless make the document available for public inspection as required under Regulations section 301.6104(d)-1(a).

A tax-exempt organization makes its application for tax exemption and/or an annual information return widely available if the organization complies with the Internet posting requirements and the notice requirements given below.

**Internet posting.** A tax-exempt organization can make its application for tax exemption and/or an annual information return widely available by posting the document on a World Wide Web page that the tax-exempt organization establishes and maintains or by having the document posted, as part of a database of similar documents of other tax-exempt organizations, on a World Wide Web page established and maintained by another entity. The document will be considered widely available only if:

- The World Wide Web page through which it is available clearly informs readers that the document is available and provides instructions for downloading it;
- The document is posted in a format that, when accessed, downloaded, viewed and printed in hard copy, exactly reproduces the image of the application for tax exemption or annual information return as it was originally filed with the IRS, except for any information permitted by statute to be withheld from public disclosure; and
- Any individual with access to the Internet can access, download, view and print the document without special computer hardware or software required for that format (other than software that is readily available to members of the public without payment of any fee) and without payment of a fee to the tax-exempt organization or to another entity maintaining the World Wide Web page.

**Reliability and accuracy.** In order for the document to be widely available through an Internet posting, the entity maintaining the World Wide Web page must have procedures for ensuring the reliability and accuracy of the document that it posts on the page and must take reasonable precautions to prevent alteration, destruction or accidental loss of the document when posted on its page. In the event that a posted document is altered, destroyed or lost, the entity must correct or replace the document.

**Notice requirement.** If a tax-exempt organization has made its application for tax exemption and/or an annual information return widely available, it must notify any individual requesting a copy where the documents are available (including the address on the World Wide Web, if applicable). If the request is made in person, the organization must provide such notice to the individual immediately. If the request is made in writing, the notice must be provided within 7 days of receiving the request.

**Tax-exempt organization subject to harassment campaign.** If the Director EO Examination (or designee) determines that the organization is being harassed, a tax-exempt organization is not required to comply with any request for copies that it reasonably believes is part of a harassment campaign.

Whether a group of requests constitutes a harassment campaign depends on the relevant facts and circumstances such as:

- a sudden increase in requests;
- an extraordinary number of requests by form letters or similarly worded correspondence;
- hostile requests;
- evidence showing bad faith or deterrence of the organization's exempt purpose;
- prior provision of the requested documents to the purported harassing group; and
- a demonstration that the organization routinely provides copies of its documents upon request.

A tax-exempt organization may disregard any request for copies of all or part of any document beyond the first two received within any 30-day period or the first four received within any 1-year period from the same individual or the same address, regardless of whether the Director EO Examination (or designee) has determined that the organization is subject to a harassment campaign.

A tax-exempt organization may apply for a determination that it is the subject of a harassment campaign and that compliance with requests that are part of the campaign would not be in the public interest by submitting a signed application to the Director EO Examination (or designee) for the area where the organization's principal office is located.

In addition, the organization may suspend compliance with any request it reasonably believes to be part of the harassment campaign until it receives a response to its application for a harassment campaign determination. However, if the Director EO Examination (or designee) determines that the organization did not have a reasonable basis for requesting a determination that it was subject to a harassment campaign or reasonable belief that a request was part of the campaign, the officer, director, trustee, employee, or other responsible individual of the organization remains liable for any penalties for not providing the copies in a timely fashion. See Regulations section 301.6104(d)-3.

#### **Appendix E: Group Returns: Reporting Information on Behalf of the Group.**

Except where otherwise instructed, where a line calls for a dollar amount or numerical data, the central organization filing the group return must aggregate the data from all the subordinates included in the group return and report the aggregate number. For example, in answering Form 990, Part I, line 6, the total number of volunteers for all of the subordinate organizations would be reported.

For purposes of Form 990, Part III, report on an aggregate basis for the mission and activities of all of the subordinates (in effect, treating all of the subordinates as one entity).

In general, if a line requires a Yes/No answer and the answer is not the same for all subordinates to which the line applies, then state "Yes" and explain the answer in the Schedule supplemental information (if applicable) or in Schedule O. For the following lines, however, state "No" if the answer is "No" for any of the subordinates to which the line applies, and explain in Schedule O):

- Form 990, Part V, lines 1c, 2b, 3b, 5c, 6b, 7b, 7g, and 7h
- Form 990, Part VI, lines 8a, 8b, 9b, 12b, and 12c
- Form 990, Schedule C, Part I-B, lines 3 and 4a
- Form 990, Schedule C, Part I-C, line 4
- Form 990, Schedule C, Part II-A, line 1j
- Form 990, Schedule C, Part II-B, line 2d
- Form 990, Schedule C, Part III-A, lines 1-3
- Form 990, Schedule D, Part I, lines 5 and 6
- Form 990, Schedule D, Part II, lines 5 and 8
- Form 990, Schedule E, lines 1-4d and 7
- Form 990, Schedule F, Part I, line 1

Form 990, Schedule G, Part III, line 9a  
Form 990, Schedule I, Part I, line 1  
Form 990, Schedule J, Part I, lines 1b and 2  
Form 990, Schedule M, Part I, line 31  
Form 990, Schedule N, Part I, lines 3, 5b, 6, and 7b

The following is a list of other special instructions for group returns:

1. **Header Item B. Termination.** If the group is terminating its group exemption and filing its final group return, do not check the termination box. Refer to Rev. Proc. 80-27, 1980-1 C.B. 677, for procedures for terminating the group exemption.
2. **Header Items C, D, E, F, J.** Enter information for central organization only.
3. **Header Item H. Group returns.** Enter the four-digit group exemption number (GEN). Also, if not all affiliated subordinate organizations are included in the group return, then attach a list (not in Schedule O) showing the name, address, and EIN of each affiliated subordinate organization included in the group return.
4. **Header Item J. Website.** Enter the Website of the central organization (if any).
5. **Header Item K. Type of organization.** Check "other" if the group has more than one type of organization.
6. **Header Item L. Year of formation.** Leave blank for group return.
7. **Header Item M. State of legal domicile.** Leave blank for group return.
8. **Part IV, lines 14b-19, 21-22, and 29 dollar thresholds.** Apply the dollar thresholds with respect to the aggregate data for the group as a whole, not subordinate by subordinate.
9. **Part IV, line 20. Hospitals.** Answer "Yes," if any affiliate within the group operated a hospital facility.
10. **Part VI, line 4. Significant changes to organizational documents.** Report only changes to standardized organizational documents maintained by the central organization that subordinates are required to adopt.
11. **Part VI, line 20. Person who possesses books and records.** Identify the person who possesses the books and records used to prepare the group return.
12. **Part VII. Compensation of officers, etc.** The central organization must either: (1) file separately a Form 990, Part VII and Schedule J, Part II for itself with its return, and a Form 990, Part VII and Schedule J, Part II with the group return for each subordinate included in the group return, or (2) file a single consolidated Form 990, Part VII and Schedule J, Part II for itself and all included subordinates with the group return. The central organization must state in Schedule O whether it has adopted the first or second method of reporting and may not change it without IRS consent. In either case, report the five highest compensated employees and independent contractors above \$100,000 for each subordinate (as well as for the central organization, if applicable), not the five highest for the whole group. If an organization reports by the first method and one or more officers, directors, trustees, key employees, or highest compensated employees receives compensation from more than one organization in the group, the person's compensation from the several organizations must be reported once but not more than once. Regardless of the method used, indicate which organization(s) paid the compensation.
13. **Part VII. Compensation from related organizations.** Report compensation from a related organization that is part of a group ruling, even if the related organization is not required to be reported in Schedule R.

14. **Part XI, lines 2a and b. Compiled, reviewed, or audited financial statements.** Answer "Yes" only for consolidated financial statements for the group.
15. **Schedule A. Part I. Reason for public charity status.** If the subordinates do not all have the same public charity status, then check the public charity status box for the largest number of subordinates in the group, and state in Schedule A, Part IV (or, alternatively, in the list required to be attached by Header item H(b)) the public charity status of each subordinate, including the type of 509(a)(3) organization.
16. **Schedule A, Parts II and III. Support Schedules.** Report aggregate data for all subordinates with the public charity status corresponding to Parts II and III.
17. **Schedule B. Contributors.** The central organization must file either: (1) a Schedule B for itself with its return, and a separate Schedule B with the group return for each subordinate organization included in the group return, or (2) a consolidated Schedule B for itself and all included subordinates with the group return. The same information must be reported whichever method of reporting is used, just formatted differently and appearing in different returns. The central organization must indicate in Schedule O whether it has adopted the first or second method of reporting and may not change it without IRS consent.
18. **Schedule C. Part II-A. Lobbying expenditures and affiliated groups.** Complete Part II-A, column (b) for the group as a whole. In column (a), except on lines g and h, include the amounts that apply to all electing members of the group if they are included in the group return. If the group return includes organizations that apply to more than one affiliated group, show in column (b) the totals for all such groups.
19. **Schedule D. Part X. Other liabilities.** The filing organization may summarize that portion, if any, of the FIN 48 footnote that applies to the liability of multiple organizations including the organization (for example, as a member of a group with consolidated financial statements), to describe the filing organization's share of the liability.
20. **Schedule H. Hospitals.** Complete one Schedule H for all of the hospitals operated by subordinates in the group, and report aggregate data from all such hospitals.
21. **Schedule J. Compensation from related organizations.** See the Part VII instructions above.
22. **Schedule N. Liquidation or significant disposition of assets.** Explain in Schedule N, Part III which of the subordinates have undergone a liquidation, termination, dissolution, or significant disposition of assets.
23. **Schedule R. Related organizations.** An organization that is part of a group exemption ruling is not required to list any of the subordinate organizations of the group in Schedule R, Part II (regardless of whether they qualify as related organizations). Similarly, an organization is not required to list in Part II any other related organization that is itself part of another group exemption ruling, although the organization must explain in Schedule O its relationship with the other group exemption ruling. In the case of a subordinate organization filing an individual Form 990 return, the subordinate must list only the central or parent organization as a related organization in Schedule R, Part II. In the case of a group return, the central organization must attach a list of the subordinate organizations in response to Form 990, page one, item H(b). Even if a related organization is not required to be listed in Schedule R, Part II, however, the organization must report its transactions with the related organization in Part V, including listing the name of the related organization in Part V, line 2, column (A) for transactions that must be reported in line 2.

## **Appendix F : Disregarded Entities and Joint Ventures; Inclusion of Activities and Items.**

### **Disregarded Entities**

A disregarded entity, as described in Regulations sections 301.7701-1 through 301.7701-3, is treated as a branch or division of its parent organization for federal tax purposes. Therefore, financial and other information applicable to a disregarded entity must be reported as the parent organization's information.

An organization must report in its Form 990, including Parts VIII through X, all of the revenues, expenses, assets, liabilities, and net assets or funds of a disregarded entity of which it is the sole member. The organization also must report the activities of a disregarded entity in the appropriate parts (including Schedules) of the Form 990. For example, political campaign activity or lobbying activity conducted by a disregarded entity of which the organization is the sole member must be reported in Schedule C, Political Campaign and Lobbying Activities.

The following is a list of special instructions for the Form and Schedules regarding the reporting of a disregarded entity of which the organization is the sole member:

1. **Part I, line 5. Number of employees.** See instruction for Part V, lines 1 and 2 below.
2. **Part I, line 6. Number of volunteers.** The total number of volunteers to be reported may, but is not required to, include volunteers of any disregarded entity.
3. **Part III. Program service accomplishments.** Consider activities and accomplishments of all disregarded entities when answering this Part.
4. **Part IV, line 12. Audited financial statement.** The organization is not to answer "Yes," to this question merely because it received an audited statement of one or more disregarded entities, if the statement of the filing organization was not audited.
5. **Part IV, lines 31-32. Liquidation or significant disposition of assets.** See instruction for Schedule N below.
6. **Part IV, lines 35-36. Transactions with related organizations.** See instruction for Schedule R below.
7. **Part V, lines 1 and 2. Forms 1096 and W-3.** The total number of information returns and employees to be reported, and compliance with backup withholding rules, includes all backup withholding, information returns and employees of any disregarded entity, regardless of whether the disregarded entity has a separate EIN for employment tax and information reporting purposes.
8. **Part V, line 7. Organizations that may receive deductible contributions.** For purposes of Form 990 reporting, lines 7a through 7h are to be answered by taking into account any contributions made to a disregarded entity.
9. **Part VI, Section A, lines 1-11. Governing body and management.** Members of the governing body, officers, directors, trustees, and employees of a disregarded entity will not be treated as governing body members, officers, directors, or trustees of the filing organization, but such persons may constitute a key employee or highest compensated employee of the filing organization by virtue of compensation paid by the disregarded entity, or the person's responsibilities and authority over operations of the disregarded entity when compared to the filing organization as a whole.
10. **Part VI, Section B, lines 12 through 16. Policies.** The organization is to check "Yes," or "No," based on the filing organization's policies, but for each "Yes" response must

report in Schedule O whether the policy applies to all of the organization's disregarded entities (if any).

11. **Part VII, line 1a. Definitions of key employee and highest compensated employee.** Officers, directors, trustees, and employees of a disregarded entity may constitute a key employee or highest compensated employee of the filing organization by virtue of compensation paid by the disregarded entity, or the person's responsibilities and authority over operations of the disregarded entity when compared to the filing organization as a whole.
12. **Part XI, line 3. OMB and Single Audit Act audits.** The organization must check "Yes" if a disregarded entity was required to undergo an audit or audits.
13. **Schedule A. Public support tests.** Support of a disregarded entity must be taken into account for the test as it applies to the filing organization.
14. **Schedule B. Contributors.** Contributions to a disregarded entity must be reported.
15. **Schedule K. Tax exempt bonds.** Obligations or activities of a disregarded entity must be reported on the Schedule K.
16. **Schedule L. Transactions with interested persons.** Reportable transactions include transactions involving disqualified persons who have such status because of their relationship with a disregarded entity (such as an employee of the disregarded entity who qualifies as a key employee of the organization as a whole). A transaction between an interested person and a disregarded entity of the organization is reportable on Schedule L.
17. **Schedule M. Noncash contributions.** Noncash contributions to a disregarded entity must be reported.
18. **Schedule N. Liquidation or significant disposition of assets.** The organization is not to prepare Part I to report a termination, liquidation, or dissolution of a disregarded entity if the filing organization continues to operate. Transfers to (or by) a filing organization by (or to) its disregarded entity are not to be reported in Part II, but transfers by or contractions of a disregarded entity are to be taken into account to determine whether a reportable event (based on 25% of the filing organization's net assets, including those of its disregarded entities) has occurred.
19. **Schedule R, Part V, line 2. Transactions with related organizations.** Specified payments to a disregarded entity by a controlled entity of the filing organization, and transfers by a disregarded entity to an exempt non-charitable entity, are to be reported in Schedule R, Part V, line 2.

#### **Joint Ventures Taxed as a Partnership**

If the organization participates as a partner or member of a joint venture, partnership, LLC, or other entity treated as a partnership for federal tax purposes (referred to here as a "joint venture"), as described in Regulations sections 301.7701-1 through 301.7701-3, then the organization in general must report the activities of the joint venture as its own activities, to the extent of the organization's profits or capital interest in the joint venture, whichever is greater. For example, a pro rata portion of the political campaign activity or lobbying activity conducted by a joint venture of which the organization is a member must be reported in Schedule C, Political Campaign and Lobbying Activities. If the joint venture is a member of a second joint venture, which is a member of a third joint venture, etc., the activities similarly pass through all joint ventures to the organization.

The following is a list of special instructions for the Form and Schedules regarding the reporting of a joint venture of which the organization is a member:

1. **Part I, line 2. Disposition of 25% of assets.** See instruction for Schedule N below.
2. **Part I, line 7. Unrelated business income.** Include the organization's share (whether or not distributed) of income or loss of the joint venture that is unrelated business income in determining the organization's gross and net unrelated business income.
3. **Part IV, lines 3-5. Political campaign and lobbying activities.** See instruction for Schedule C below.
4. **Part IV, line 7. Conservation easements.** See instruction for Schedule D below.
5. **Part IV, lines 14-16. Activities outside the U.S.** See instruction for Schedule F below.
6. **Part IV, lines 17-19. Fundraising and gaming.** See instruction for Schedule G below.
7. **Part IV, line 20. Hospitals.** See instruction for Schedule H below.
8. **Part IV, line 21-22. Grants in the U.S.** See instruction for Schedule I below.
9. **Part IV, lines 26-28. Loans, grants, and business transactions involving interested persons.** See instruction for Schedule L below.
10. **Part IV, line 32. Disposition of 25% of assets.** See instruction for Schedule N below.
11. **Part IV, lines 34-37. Related organizations and unrelated partnerships.** See instruction for Schedule R below.
12. **Part V, line 3a. Unrelated business income.** Include the organization's share (whether or not distributed) of income or loss of the joint venture that is unrelated business income in determining the organization's gross unrelated business income.
13. **Part VI. Governance, management, and disclosure.** Do not take into account a joint venture for purposes of Part VI (except for line 16).
14. **Part VII. Compensation.** See instruction for Schedule J below.
15. **Parts VIII, IX, and X. Financial Statements.** Report in accordance with the organization's books and records.
16. **Part XI. Financial statements and reporting.** Disregard a joint venture.
17. **Schedule C. Political campaign and lobbying activities.** Report the organization's share of political campaign or lobbying activities conducted by a joint venture.
18. **Schedule D, Part II. Conservation easements.** Include conservation easements held by a joint venture formed for the purpose of holding such easements.
19. **Schedule F. Activities outside the U.S.** Include activities of a joint venture, including grants to organizations or individuals outside the U.S.
20. **Schedule G. Fundraising and gaming.** Include activities of a joint venture and the organization's share of revenues and expenses. In Part III, line 12, check "Yes" if the joint venture was formed to administer charitable gaming.
21. **Schedule H. Hospitals.** Include activities of a joint venture and the organization's share of revenues and expenses. See also Schedule H, Part IV regarding certain joint ventures with physicians, officers, etc.
22. **Schedule I. Grants in the U.S.** Include grants from a joint venture to organizations, governments, or individuals in the U.S.
23. **Schedule J. Compensation.** If an officer, director, trustee, or employee of the organization receives compensation from a joint venture, the compensation is not treated as paid pro rata by the organization. The compensation may need to be reported, however, as compensation from a related organization if the joint venture is a related organization.
24. **Schedule K, Part III, line 1. Private business use.** Report certain joint ventures that owned property financed by tax-exempt bonds.

25. **Schedule L, Parts II-IV. Loans, grants, and business transactions involving interested persons.** Report loans and grants made to an interested person by a joint venture. Also report certain joint ventures with interested persons.
26. **Schedule N, Part II. Disposition of 25% of assets.** In determining whether the organization made a disposition of more than 25% of its assets, take into account its share of dispositions by a joint venture.
27. **Schedule R. Related organizations.** Report relationships with certain joint ventures in Parts III and VI, and certain transactions with joint ventures in Part V.

## Appendix G: Section 4958 Excess Benefit Transactions

The intermediate sanction regulations are important to the exempt organization community as a whole, and for ensuring compliance in this area. The rules provide a roadmap by which an organization may steer clear of situations that may give rise to inurement.

Under section 4958, any disqualified person who benefits from an excess benefit transaction with an applicable tax-exempt organization is liable for a 25% tax on the excess benefit. The disqualified person is also liable for a 200% tax on the excess benefit if the excess benefit is not corrected by a certain date. Also, organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause are liable for a 10% tax on the excess benefit, not to exceed \$20,000 for all participating managers on each transaction.

### Applicable Tax-Exempt Organization

These rules only apply to certain applicable section 501(c)(3) and 501(c)(4) organizations. An *applicable tax-exempt organization* is a section 501(c)(3) or a section 501(c)(4) organization that is tax exempt under section 501(a), or was such an organization at any time during a 5-year period ending on the day of the excess benefit transaction.

An applicable tax-exempt organization does not include:

- A private foundation as defined in section 509(a).
- A governmental entity that is exempt from (or not subject to) taxation without regard to section 501(a) or relieved from filing an annual return under Regulations section 1.6033-2(g)(6).
- Certain foreign organizations.

An organization is not treated as a section 501(c)(3) or 501(c)(4) organization for any period covered by a final determination that the organization was not tax-exempt under section 501(a), so long as the determination was not based on private inurement or one or more excess benefit transactions.

### Disqualified Person

The vast majority of section 501(c)(3) or 501(c)(4) organization employees and contractors will not be affected by these rules. Only the few influential persons within these organizations are covered by these rules when they receive benefits, such as compensation, fringe benefits, or contract payments. The IRS calls this class of covered individuals disqualified persons.

A *disqualified person*, regarding any transaction, is any person who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization at any time

during a 5-year period ending on the date of the transaction. Persons who hold certain powers, responsibilities, or interests are among those who are in a position to exercise substantial influence over the affairs of the organization. This would include, for example, voting members of the governing body, and persons holding the power of:

- Presidents, chief executive officers, or chief operating officers.
- Treasurers and chief financial officers.

A disqualified person also includes certain family members of a disqualified person, and 35% controlled entities of a disqualified person.

The following persons are considered disqualified persons along with certain family members and 35% controlled entities associated with them:

- Donors of donor advised funds,
- Investment advisors of sponsoring organizations, and
- The disqualified persons of a section 509(a)(3) supporting organization for the organizations that organization supports.

Substantial contributors to supporting organizations are also considered disqualified persons along with their family members and 35% controlled entities.

See the instructions for Form 4720, Schedule I for more information regarding these disqualified persons.

**Who is not a disqualified person?** The rules also clarify which persons are not considered to be in a position to exercise substantial influence over the affairs of an organization. They include:

- An employee who receives benefits that total less than the highly compensated amount (\$100,000 in 2007) and who does not hold the executive or voting powers just mentioned; is not a family member of a disqualified person; and is not a substantial contributor;
- Tax-exempt organizations described in section 501(c)(3); and
- Section 501(c)(4) organizations with respect to transactions engaged in with other section 501(c)(4) organizations.

**Who else may be considered a disqualified person?** Other persons not described above can also be considered disqualified persons, depending on all the relevant facts and circumstances.

***Facts and circumstances tending to show substantial influence:***

- The person founded the organization.
- The person is a substantial contributor to the organization under the section 507(d)(2)(A) definition, only taking into account contributions to the organization for the past 5 years.
- The person's compensation is primarily based on revenues derived from activities of the organization that the person controls.
- 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.
- 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.

- The person owns a controlling interest (measured by either vote or value) in a corporation, partnership, or trust that is a disqualified person.
- The person is a nonstock organization controlled directly or indirectly by one or more disqualified persons.

**Facts and circumstances tending to show no substantial influence:**

- The person is an independent contractor 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.
- The person has taken a vow of poverty.
- Any preferential treatment the person receives based on the size of the person's donation is also offered to others making comparable widely solicited donations.
- The direct supervisor of the person is not a disqualified person.
- The person does not participate in any management decisions affecting the organization as a whole or a discrete segment 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.

**What about persons who staff affiliated organizations?** In the case of multiple affiliated organizations, the determination of whether a person has substantial influence is made separately for each applicable tax-exempt organization. A person may be a disqualified person with respect to more than one organization in the same transaction.

**Excess Benefit Transaction**

An *excess benefit transaction* is a 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 by the applicable tax-exempt organization exceeds the value of the consideration (including the performance of services) received for providing such benefit. An excess benefit transaction also can occur when a disqualified person embezzles from the exempt organization.

To determine whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the applicable tax exempt organization, and all entities it controls, are taken into account.

For purposes of determining the value of economic benefits, the value of property, including the right to use property, is the fair market value. Fair market value is 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.

**Donor advised funds.** For a donor advised fund, an excess benefit transaction includes a grant, loan, compensation, or similar payment from the fund to a:

- Donor or donor advisor,
- Family member of a donor, or donor advisor,
- 35% controlled entity of a donor, or donor advisor, or
- 35% controlled entity of a family member of a donor, or donor advisor.

The excess benefit in this transaction is the amount of the grant, loan, compensation, or similar payment. For additional information see the Instructions for Form 4720.

**Supporting organizations.** For any supporting organization, defined in section 509(a)(3), an excess benefit transaction includes grants, loans, compensation, or similar payment provided by the supporting organization to a:

- Substantial contributor
- Family member of a substantial contributor
- 35% controlled entity of a substantial contributor
- 35% controlled entity of a family member of a substantial contributor

Additionally, an excess benefit transaction includes any loans provided by the supporting organization to a disqualified person (other than an organization described in section 509(a)(1), (2), or (4)).

A substantial contributor is any person who contributed or bequeathed an aggregate of more than \$5000 to the organization, if that amount is more than 2% of the total contributions and bequests received by the organization before the end of the tax year of the organization in which the contribution or bequest is received by the organization from such person. A substantial contributor includes the grantor of a trust.

The excess benefit for substantial contributors and parties related to those contributors includes the amount of the grant, loan, compensation, or similar payment. For additional information see the Instructions for Form 4720.

**When does an excess benefit transaction usually occur?** An excess benefit transaction occurs on the date the disqualified person receives the economic benefit from the organization for federal income tax purposes. However, when a single contractual arrangement provides for a series of compensation payments or other payments to a disqualified person during the disqualified person's tax year, any excess benefit transaction with respect to these payments occurs on the last day of the taxpayer's tax year.

In the case of the transfer of property subject to a substantial risk of forfeiture, or in the case of rights to future compensation or property, 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. Where the disqualified person elects to include an amount in gross income in the tax year of transfer under section 83(b), the excess benefit transaction occurs on the date the disqualified person receives the economic benefit for federal income tax purposes.

**Section 4958 applies only to post-September 1995 transactions.** Section 4958 applies to excess benefit transactions occurring on or after September 14, 1995. Section 4958 does 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.

#### **What is reasonable compensation?**

*Reasonable compensation* is the valuation standard that is used to determine if there is an excess benefit in the exchange of a disqualified person's services for compensation.

*Reasonable compensation* is the value that would ordinarily be paid for like services by like enterprises under like circumstances. This is the section 162 standard that will apply in

determining the reasonableness of compensation. The fact that a bonus or revenue-sharing arrangement is subject to a cap is a relevant factor in determining the reasonableness of compensation.

For determining the reasonableness of compensation, all items of compensation provided by an applicable tax-exempt organization in exchange for the performance of services are taken into account in determining the value of compensation (except for certain economic benefits that are disregarded, as discussed in *What benefits are disregarded?* later). Items of compensation include:

- All forms of cash and noncash compensation, including salary, fees, bonuses, severance payments, and deferred and noncash compensation.
- The payment of liability insurance premiums for, or the payment or reimbursement by the organization of taxes or certain expenses under section 4958, unless excludable from income as a *de minimis* fringe benefit under section 132(a)(4). (A similar rule applies in the private foundation area.) Inclusion in compensation for purposes of determining reasonableness under section 4958 does not control inclusion in income for income tax purposes.
- All other compensatory benefits, whether or not included in gross income for income tax purposes.
- Taxable and nontaxable fringe benefits, except fringe benefits described in section 132.
- Foregone interest on loans.

***Written intent required to treat benefits as compensation.*** 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.

An applicable tax-exempt organization (or entity that it controls) 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 under consideration. Ways to provide contemporaneous written substantiation of its intent to provide an economic benefit as compensation include:

- The organization produces a signed written employment contract;
- The organization reports the benefit as compensation on an original Form W-2, Form 1099 or Form 990, or on an amended form filed prior to the start of an IRS examination; or
- The disqualified person reports the benefit as income on the person's original Form 1040 or on an amended form filed prior to the start of an IRS examination.

***Exception.*** To the extent the economic benefit is excluded from the disqualified person's gross income for income tax purposes, the applicable tax-exempt organization is not required to indicate its intent to provide an economic benefit as compensation for services. (For example: employer provided health benefits, and contributions to qualified plans under section 401(a).)

***What benefits are disregarded?*** The following economic benefits are disregarded for purposes of section 4958:

- Nontaxable fringe benefits. An economic benefit that is excluded from income under section 132.

- Benefits to volunteer. 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.
- Benefits to members or donors. An economic benefit provided to a member of an organization due to the payment of a membership fee, or to a donor as a result of a deductible contribution, if a significant number of nondisqualified persons make similar payments or contributions and are offered a similar economic benefit.
- Benefits 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 its exempt purpose.
- Benefits to a governmental unit. A transfer of an economic benefit to or for the use of a governmental unit, as defined in section 170(c)(1), if exclusively for public purposes.

**Is there an exception for initial contracts?** Section 4958 does not apply to any fixed payment made to a person pursuant to an initial contract. This is a very important exception, since it would potentially apply, for example, to all initial contracts with new, previously unrelated officers and contractors.

An *initial contract* is 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* is an amount of cash or other property specified in the contract, or determined by a fixed formula that is 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, in general, incorporate an amount that depends upon future specified events or contingencies, as long as no one has discretion when calculating the amount of a payment or deciding whether to make a payment (such as a bonus).

**Treatment as new contract.** A binding written contract providing that it may be terminated or cancelled by the applicable tax-exempt organization without the other party's consent (except as a result of substantial non-performance) and without substantial penalty, is treated as a new contract, as of the earliest date that any termination or cancellation would be effective. Also, a contract in which there is a material change, which includes an extension or renewal of the contract (except for an extension or renewal resulting from the exercise of an option by the disqualified person), or a more than incidental change to the amount payable under the contract, is treated as a new contract as of the effective date of the material change. Treatment as a new contract may cause the contract to fall outside the initial contract exception, and it thus would be tested under the fair market value standards of section 4958.

#### **Rebuttable Presumption of Reasonableness**

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

1. The transaction is approved by an authorized body of the organization (or an entity it controls) which is composed of individuals who do not have a conflict of interest concerning the transaction.
2. Prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability. There is a special safe harbor for small organizations. If the

organization has gross receipts of less than \$1 million, appropriate comparability data includes data on compensation paid by three comparable organizations in the same or similar communities for similar services.

3. The authorized body adequately documents the basis for its determination concurrently with making that determination. The documentation should include:

- a. The terms of the approved transaction and the date 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;
- d. Any actions by a member of the authorized body having a conflict of interest; and
- e. Documentation of the basis for the determination before the later of the next meeting of the authorized body or 60 days after the final actions of the authorized body are taken, and approval of records as reasonable, accurate and complete within a reasonable time thereafter.

**Special rebuttable presumption rule for nonfixed payments.** As a general rule, in the case of a nonfixed payment, no rebuttable presumption arises until the exact amount of the payment is determined, or a fixed formula for calculating the payment is specified, and the three requirements creating the presumption have been satisfied. However, if the authorized body approves an employment contract with a disqualified person that includes a nonfixed payment (for example, discretionary bonus) with a specified cap on the amount, the authorized body may establish a rebuttable presumption as to the nonfixed payment when the employment contract is entered into by, in effect, assuming that the maximum amount payable under the contract will be paid, and satisfying the requirements giving rise to the rebuttable presumption for that maximum amount.

**An IRS challenge to the presumption of reasonableness.** The Internal Revenue Service may refute the presumption of reasonableness only if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body. This provision gives taxpayers added protection if they faithfully find and use contemporaneous persuasive comparability data when they provide the benefits.

**Organizations that do not establish a presumption of reasonableness.** An organization may still comply with section 4958 even if it did not establish a presumption of reasonableness. In some cases, an organization may find it impossible or impracticable to fully implement each step of the rebuttable presumption process described above. In such cases, the organization should try to implement as many steps as possible, in whole or in part, in order to substantiate the reasonableness of benefits as timely and as well as possible. If an organization does not satisfy the requirements of the rebuttable presumption of reasonableness, a facts and circumstances approach will be followed, using established rules for determining reasonableness of compensation and benefit deductions in a manner similar to the established procedures for section 162 business expenses.

## Section 4958 Taxes

**Tax on disqualified persons.** An excise tax equal to 25% of the excess benefit is imposed on each excess benefit transaction between an applicable tax-exempt organization and a disqualified person. The disqualified person who benefited from the transaction is liable for the

tax. If the 25% tax is imposed and the excess benefit transaction is not corrected within the taxable period, an additional excise tax equal to 200% of the excess benefit is imposed.

If a disqualified person makes a payment of less than the full correction amount, the 200% tax is imposed only on the unpaid portion of the correction amount. If more than one disqualified person received an excess benefit from an excess benefit transaction, all such disqualified persons are jointly and severally liable for the taxes.

To avoid the imposition of the 200% tax, a disqualified person must correct the excess benefit transaction during the taxable period. The taxable period begins on the date the transaction occurs and ends on the earlier of the date the statutory notice of deficiency is issued or the section 4958 taxes are assessed. This 200% tax may be abated if the excess benefit transaction subsequently is corrected during a 90-day correction period.

**Tax on organization managers.** An excise tax equal to 10% of the excess benefit may be imposed on the participation of an organization manager in an excess benefit transaction between an applicable tax exempt organization and a disqualified person. This tax, which may not exceed \$20,000 with respect to any single transaction, is only imposed if the 25% tax is imposed on the disqualified person, the organization manager knowingly participated in the transaction, and the manager's participation was willful and not due to reasonable cause. There is also joint and several liability for this tax. An organization manager may be liable for both the tax on disqualified persons and on organization managers in appropriate circumstances.

An *organization manager* is any officer, director, or trustee of an applicable tax-exempt organization, or any individual having powers or responsibilities similar to officers, directors, or trustees of the organization, regardless of title. An organization manager is not considered to have participated in an excess benefit transaction where the manager has opposed the transaction in a manner consistent with the fulfillment of the manager's responsibilities to the organization. For example, a director who votes against giving an excess benefit would ordinarily not be subject to this tax.

A person participates in a transaction knowingly if the person has actual knowledge of sufficient facts so that, based solely upon such facts, the transaction would be an excess benefit transaction. Knowing does not mean having reason to know. The organization manager ordinarily will not be considered knowing if, after full disclosure of the factual situation to an appropriate professional, the organization manager relied on the professional's reasoned written opinion on matters within the professional's expertise or if the manager relied on the fact that the requirements for the rebuttable presumption of reasonableness have been satisfied. Participation by an organization manager is willful if it is voluntary, conscious, and intentional. 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.

### **Correcting an Excess Benefit Transaction**

A disqualified person corrects an excess benefit transaction by undoing the excess benefit to the extent possible, and by 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 organization is not required to rescind the underlying agreement; however, the parties may need to modify an ongoing contract with respect to future payments.

A disqualified person corrects an excess benefit by making a payment in cash or cash equivalents equal to the correction amount to the applicable tax-exempt organization. The correction amount equals the excess benefit plus the interest on the excess benefit; the interest rate may be no lower than the applicable Federal rate. There is an anti-abuse rule to prevent the disqualified person from effectively transferring property other than cash or cash equivalents.

**Exception.** For a correction of an excess benefit transaction described in *Donor advised funds* (discussed earlier), no amount repaid in a manner prescribed by the Secretary may be held in a donor advised fund.

**Property.** With the agreement of the applicable tax-exempt organization, a disqualified person may make a payment by returning the specific property previously transferred in the excess benefit transaction. The return of the property is considered a payment of cash (or cash equivalent) equal to the lesser of:

- The fair market value of the property 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.

**Insufficient payment.** If the payment resulting from the return of the property is less than the correction amount, the disqualified person must make an additional cash payment to the organization equal to the difference.

**Excess payment.** If the payment resulting from the return of the property exceeds the correction amount described above, the organization may make a cash payment to the disqualified person equal to the difference.

### **Churches and Section 4958**

The regulations make it clear that the IRS will apply the procedures of section 7611 when initiating and conducting any inquiry or examination into whether an excess benefit transaction has occurred between a church and a disqualified person.

### **Revenue Sharing Transactions**

Proposed intermediate sanction regulations were issued in 1998. The proposed regulations had special provisions covering "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 one or more activities of the organization. . ." — so-called revenue-sharing transactions. Rather than setting forth additional rules on revenue-sharing transactions, the final regulations reserve this section. Consequently, until the Service issues new regulations for this reserved section on revenue-sharing transactions, these transactions will be evaluated under the general rules (for example, the fair market value standards) that apply to all contractual arrangements between applicable tax-exempt organizations and their disqualified persons.

### **Revocation of Exemption and Section 4958**

Section 4958 does not affect the substantive standards for tax exemption under section 501(c)(3) or section 501(c)(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. The legislative history indicates that in most

instances, the imposition of this intermediate sanction will be in lieu of revocation. The IRS has indicated that the following four factors will be considered (among other facts and circumstances) in determining whether to revoke an applicable tax-exempt organization's exemption status where an excess benefit transaction has occurred:

- The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;
- The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- Whether the excess benefit transaction has been corrected, or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

**Appendix H : Ownership in a Subchapter S Corporation (Reserved)**