



# Exempt Organizations Technical Guide

## TG 65: Excise Taxes - Excess Benefit Transactions - IRC Section 4958

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## I. Overview

- (1) This technical guide (TG) discusses Section 4958 which imposes an excise tax on disqualified persons and organization managers who engage in an excess benefit transaction with an applicable tax-exempt organization (ATEO).

## A. Background / History

- (1) Section 4958 was added to the Internal Revenue Code (Code) by Section 1311 of the Taxpayer Bill of Rights 2, P. L. 104-168 (110 Stat. 1452), enacted July 30, 1996. It generally applies to excess benefit transactions occurring on or after September 14, 1995. See P.L. 104-168, Section 1311(d)(1) and Treasury Regulation (Treas. Reg.) 53.4958-1(f)(1).
  - a. Prior to the enactment of Section 4958, the Code generally didn't provide for the imposition of excise taxes in cases where a Section 501(c)(3) public charity or 501(c)(4) social welfare organization engaged in a transaction that resulted in inurement. In such cases, the only sanction specifically authorized under the Code was revocation of the organization's tax-exempt status.
  - b. P.L. 104-168 added intermediate sanctions (excise taxes on excess benefit transactions under Section 4958) that may be imposed when applicable tax-exempt organizations described in section 501(c)(3) or 501(c)(4) engage in transactions with certain insiders that result in private inurement.
  - c. The intermediate sanctions for "excess benefit transactions" may be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status. See H.R. Rep. No. 506, 104th Cong., 2d Sess. 53, 59 (1996).
  - d. In general, the intermediate sanctions are the sole sanction imposed in those cases where the excess benefit doesn't rise to a level that calls into question whether, overall, 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 only occur when the organization no longer meets the substantive requirements for tax exemption under Section 501(c)(3). See *Ibid*, note 15.
- (2) Notice 96-46, published September 23, 1996, summarizes Section 4958 enacted by P.L. 104-168 and specifies the tax form required to report and pay the excise tax.
- (3) Treasury Regulations were published and effective as of January 23, 2002. They were partially amended by final regulations that were published in the Federal Register March 28, 2008, 73 F.R. 16519.
- (4) Section 4958 was amended with regard to transactions involving Donor-Advised Funds (DAFs) and supporting organizations under Sections 1232 and 1242 of the Pension Protection Act of 2006, P.L. 109-280 (120 Stat. 780), enacted August 17, 2006.

- (5) Section 4958 was amended by Section 3 of the Tax Technical Corrections Act of 2007, P.L. 110-172 (121 Stat. 2473), enacted December 29, 2007. Sections 4958(c)(3)(A)(i)(II) and 4958(c)(3)(C)(ii) were amended to clarify the exclusions to disqualified persons in relation to the special rules for supporting organizations.
- (6) Section 4958 was amended by Section 1322 of the Patient Protection and Affordable Care Act of 2010, P.L. 111-148, enacted March 23, 2010. In Section 4958(e)(1), the amendment added Section 501(c)(29) as an ATEO in addition to Sections 501(c)(3) & (4).

**Note:** The Treasury Regulations have not yet been updated to reflect the changes made under the Pension Protection Act of 2006, Tax Technical Corrections Act of 2007 or the Patient Protection and Affordable Care Act of 2010.

## B. Relevant Terms

- (1) **Applicable Tax-Exempt Organizations (ATEO):** are those generally described in Sections 501(c)(3) (except private foundations), 501(c)(4), 501(c)(29), and any organization that was described under the above-listed subsections at any time during the 5-year period ending on the date of the transaction. See Section 4958(e) and section II.A below.
- (2) **Excess Benefit Transactions (EBT):** are any transactions where an economic benefit is provided by an ATEO 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. See Section 4958(c) and section II.C below.
- (3) **Disqualified Persons (DP):** includes persons who are in a position to exercise substantial influence over the affairs of the organization, members of the family of a disqualified person, 35% controlled entities, persons involved with a related Section 509(a)(3) supporting organization, donor/donor advisors involved in a transaction with a DAF, or investment advisors with respect to a sponsoring organization. See Section 4958(f)(1) and section II.B below.

## C. Law / Authority

- (1) Section 4958 – Taxes on excess benefit transactions
- (2) Treas. Reg. 53.4958-1 – Taxes on excess benefit transactions
- (3) Treas. Reg. 53.4958-2 – Definition of applicable tax-exempt organization
- (4) Treas. Reg. 53.4958-3 – Definition of disqualified person
- (5) Treas. Reg. 53.4958-4 – Excess benefit transaction
- (6) Treas. Reg. 53.4958-6 – Rebuttable presumption that a transaction is not an excess benefit transaction
- (7) Treas. Reg. 53.4958-7 – Correction
- (8) Treas. Reg. 53.4958-8 – Special Rules

## II. Section 4958: Taxes on Excess Benefit Transactions

- (1) Section 4958 imposes an excise tax (also referred to as intermediate sanctions) on disqualified persons and organization managers who engage in excess benefit transactions with an ATEO.

### A. Applicable Tax-Exempt Organizations

- (1) Before an examiner determines if they have an excess benefit transaction, they must confirm if the organization involved is an ATEO.
- (2) Section 4958(e) defines ATEO as:
  - a. Section 501(c)(3) organizations except those classified as private foundations under Section 509(a),
  - b. Organizations described in Section 501(c)(4),
  - c. Qualified health insurance issuers described in Section 501(c)(29), and
  - d. Any organization that was described under the above-listed subsections at any time during the 5-year period (also called the lookback period) ending on the date of the transaction. See Section 4958(e)(2).

**Note:** See section II.A.2 below for further discussion of the lookback period.

- e. See also Treas. Reg. 53.4958-2
- (3) A Section 501(c)(4) social welfare organization is an ATEO if it has
  - a. Applied for and received recognition as a tax-exempt organization described in Section 501(c)(4),
  - b. Filed an application for recognition of exemption under Section 501(c)(4),
  - c. Filed an annual information return as a Section 501(c)(4) organization, or
  - d. Otherwise held itself out as a social welfare organization under Section 501(c)(4).
    - One way an organization may hold itself out as an organization under Section 501(c)(4) is by filing Form 8976, Notice of Intent to Operate Under Section 501(c)(4). See Section 506 for notification requirements.

See also Treas. Reg. 53.4958-2(a)(4).

- (4) Since an organization can be treated as a Section 501(c)(4) organization even if it hasn't been recognized as exempt by the IRS, the organization "would be described" in Section 501(c)(4) for purposes of Section 4958(e) as an ATEO.
- (5) Treas. Reg. 53.4958-2(a)(6) provides examples that illustrate the definition of ATEO.
  - a. **Example 1.** O is a nonprofit corporation formed under state law. O filed its application for recognition of exemption under Section 501(c)(3) within the time prescribed under Section 508(a). In its application, O described its plans



for purchasing property from some of its directors at prices that would exceed fair market value. After reviewing the application, the IRS determined that because of the proposed property purchase transactions, O failed to establish that it met the requirements for an organization described in Section 501(c)(3). Accordingly, the IRS denied O's application. While O's application was pending, O engaged in the purchase transactions described in its application at prices that exceeded the fair market values of the properties. Although these transactions would constitute excess benefit transactions under Section 4958, because the IRS never recognized O as an organization described in Section 501(c)(3), O was never an applicable tax-exempt organization under Section 4958. Therefore, these transactions are not subject to the excise taxes provided in Section 4958.

- b. **Example 2.** O is a nonprofit corporation formed under state law. O files its application for recognition of exemption under Section 501(c)(3) within the time prescribed under Section 508(a). The IRS issues a favorable determination letter in Year 1 that recognizes O as an organization described in Section 501(c)(3). Subsequently, in Year 5 of O's operations, O engages in certain transactions that constitute excess benefit transactions under Section 4958 and violate the proscription against inurement under Section 501(c)(3) and Treas. Reg. 1.501(c)(3)-1(c)(2). The IRS examines the Form 990, "Return of Organization Exempt From Income Tax", that O filed for Year 5. After considering all the relevant facts and circumstances in accordance with Treas. Reg. 1.501(c)(3)-1(f), the IRS concludes that O is no longer described in Section 501(c)(3) effective in Year 5. The IRS does not examine the Forms 990 that O filed for its first four years of operations and, accordingly, does not revoke O's exempt status for those years. Although O's tax-exempt status is revoked effective in Year 5, under the lookback rules in paragraph (a)(1) of this section and Treas. Reg. 53.4958-3(a)(1) of this chapter, during the five-year period prior to the excess benefit transactions that occurred in Year 5, O was an applicable tax-exempt organization and O's directors were disqualified persons as to O. Therefore, the transactions between O and its directors during Year 5 are subject to the applicable excise taxes provided in Section 4958.

## **A.1. Special Rules for Churches**

- (1) If a transaction involves a church, Section 7611 procedures must be followed to initiate and conduct any inquiry or examination into whether an excess benefit transaction has occurred between a church and a disqualified person. See also Treas. Reg. 53.4958-8(b) and Treas. Reg. 301.7611-1 Q&A 19.
- (2) The reasonable belief required in Section 7611(a)(2) to initiate a church tax inquiry is satisfied if a reasonable belief exists that a Section 4958 excise tax is due from a disqualified person's excess benefit transaction involving a church. See Treas. Reg. 53.4958-8(b).

- (3) IRM 4.70.19, Church Tax Inquiries and Examinations Under IRC 7611, (or its successor) provides current procedures for conducting church tax inquiries and examinations.

**Note:** Also see TG 3-23, 501(c)(3) Foundation Status, Church Section 509(a)(1) and Section 170(b)(1)(A)(i). TG 3-23 will be published in the future. For a list of all TGs, published and in process, see the cumulative list of Technical Guides located in TG 0 Technical Guide Overview, Exhibit III, starting on page 10.

## **A.2. Lookback Period**

- (1) An organization is an ATEO if it meets the definition in Section 4958(e) at any time during the 5-year period ending on the date of the transaction. This is referred to as the lookback period. See Section 4958(e)(2) and Treas. Reg. Section 53.4958-2(a).
- (2) The lookback period prevents a revoked organization from avoiding the excise tax on past excess benefit transactions.
- (3) See example 2 in Treas. Reg. Section 53.4958-2(a)(6) for an example of the lookback period.

## **A.3. Exceptions**

- (1) Section 4958(e) excludes private foundations (as defined in Section 509(a)) from the definition of an ATEO. See also Treas. Reg. 53.4958-2(a)(2)(i).
- (2) Additionally, governmental units or affiliates of governmental units are not ATEOs if they are:
  - a. Exempt from (or not subject to) taxation without regard to Section 501(a) or
  - b. Relieved from filing annual returns under Treas. Reg. 1.6033-2(g)(6)See Treas. Reg. 53.4958-2(a)(2)(ii).
- (3) 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 ATEO. See Treas. Reg. 53.4958-2(b)(2).

## **A.4. Effect of Non-Recognition or Revocation**

- (1) An organization is not treated as an ATEO for any period covered by a final determination or adjudication that the organization was not tax-exempt under Section 501(a) as long as the determination or adjudication was not based on inurement or one or more excess benefit transactions. See Treas. Reg. 53.4958-2(a)(5).

- (2) However, the organization may be an ATEO during the above period as a result of the lookback period described in Treas. Reg. 53.4958-2(a)(1). See Treas. Reg. 53.4958-2(a)(5).

**Note:** See also section II.A.2 above for further discussion of the lookback period.

- (3) See example 2 in Treas. Reg. Section 53.4958-2(a)(6) and in section II.A(5)b in the preceding paragraphs which demonstrates revocation and the lookback period.

## **B. Disqualified Persons**

- (1) The next step (after the identification of an ATEO) in reviewing a potential excess benefit transaction is determining if the individual or entity involved is a disqualified person.
- (2) The definition of a disqualified person varies in the Code. For purposes of excess benefit transactions as defined in Section 4958(f), as noted in the following paragraph, the definition of a disqualified person is different than the definition of disqualified person as defined in Section 4946 which applies to private foundations.

### **B.1. Definition**

- (1) A disqualified person as defined in Section 4958(f)(1) is:
  - a. Any person who was, at any time during the 5-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization,
  - b. A member of the family of a disqualified person,
  - c. A 35% controlled entity,
  - d. A person described in a, b, or c above of a related Section 509(a)(3) supporting organization to the ATEO,
  - e. A donor/donor advisor described in Section 4958(f)(7) involved in a transaction with a DAF, or
  - f. An investment advisor defined in Section 4958(f)(8) with respect to a sponsoring organization of a DAF.

See Section 4958(f)(1) and Treas. Reg. 53.4958-3(a)(1).

- (2) Per Section 4958(f)(4), family members are generally determined under Section 4946(d) with one exception. Section 4958 family members will include brothers and sisters (by whole or half-blood) of the individual and their spouses. Treas. Reg. 53.4958-3(b)(1) defines a disqualified person's family members as limited to the following:
  - a. Spouse
  - b. Brothers or sisters (by whole or half-blood)

- c. Spouses of brothers or sisters (by whole or half-blood)
- d. Ancestors
- e. Children and their spouses
- f. Grandchildren and their spouses
- g. Great grandchildren and their spouses

**Note:** For purposes of the above family members, a legally adopted child of an individual is treated as a child of such individual by blood.

(3) Section 4958(f)(3) and Treas. Reg. 53.4958-3(b)(2) define a 35% controlled entity as:

- a. A corporation where disqualified persons own more than 35% of the combined voting power.

**Note:** Combined voting power includes voting power represented by direct or indirect holdings of voting stock but not voting rights held as a director, trustee, or other fiduciary.

- b. A partnership where disqualified persons own more than 35% of the profits interest; and
- c. A trust or estate where disqualified persons own more than 35% of the beneficial interest.

**Note:** A disqualified person who owns 35% of a limited liability company (LLC) interest is treated in the same manner as under Section 7701. See also Treas. Reg. 301.7701-1 to 301.7701-3.

(4) Donor and donor advisors under Section 4958(f)(7) are:

- a. Persons described in Section 4966(d)(2)(A)(iii),
- b. A member of the family of those individuals, or
- c. A 35% controlled entity as defined in Section 4958(f)(3).

(5) Investment Advisors defined in Section 4958(f)(8) are:

- a. Persons (other than employees) compensated by a sponsoring organization for managing the investment of, or providing investment advice with respect to, assets maintained in DAFs owned by the sponsoring organization.
- b. A member of the family of an investment advisor, or
- c. A 35% controlled entity as defined in Section 4958(f)(3).

## **B.2. Substantial Influence**

(1) **Persons who have a substantial influence.** According to Treas. Reg. 53.4958-3(c), a person who holds any of the following powers, responsibilities, or interests is in a position to exercise substantial influence over the affairs of the ATEO:

- a. **Voting members of the governing body.** A voting member of the governing body including any individual serving on the governing body of an organization who is entitled to vote on matters over which the governing body has authority. See Treas. Reg. 53.4958-3(c)(1).
  - b. **Presidents, chief executive officers, or chief operating officers.** A 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 (such as the president, chief executive officer, or chief operating officer). Persons serving as president, chief executive officer (CEO) or chief operating officer (COO) have ultimate responsibility unless the person demonstrates otherwise. If two or more individuals share ultimate responsibility (together or individually), then each individual is in a position of substantial influence. See Treas. Reg. 53.4958-3(c)(2).
  - c. **Treasurers and chief financial officers.** A person who, regardless of title, has ultimate responsibility for managing the finances of the organization (such as the treasurer or chief financial officer). Persons serving as treasurer or chief financial officer have ultimate responsibility unless the person demonstrates otherwise. If two or more individuals share ultimate responsibility (together or individually), then each individual is in a position of substantial influence. See Treas. Reg. 53.4958-3(c)(3).
  - d. **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 ATEO, 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. See Treas. Reg. 53.4958-3(c)(4).
- (2) **Persons who don't have a substantial interest.** According to Treas. Reg. 53.4958-3(d), the following persons are deemed not to be in a position to exercise substantial influence over the affairs of the ATEO:
- a. Tax-exempt organizations described in Section 501(c)(3) and exempt from tax under Section 501(a).
  - b. Certain Section 501(c)(4) organizations, only where an ATEO is described in Section 501(c)(4) and Treas. Reg. 53.4958-2(a)(4), including any other organization so described, and
  - c. Any part or full-time employee of the ATEO, who meet specific criteria in the Code or Treas. Reg., as follows:
    - Receives economic benefits, directly or indirectly from the organization, of less than the amount for a highly compensated employee in Section 414(q)(1)(B)(i),

- Is not described in Treas. Regs. 53.4958-3(b), statutory categories of disqualified persons, or (c), persons having substantial influence, with respect to the organization, and
  - 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 and the four preceding taxable years.
- (3) **Affiliated organizations.** In the case of multiple organizations affiliated by common control or governing documents, the determination of whether a person has substantial influence is made separately for each organization. A person may be a disqualified person regarding transactions with more than one organization. See Treas. Reg. 53.4958-3(f).
- (4) **Case Law.** In *Farr v. Commissioner*, T.C. Memo 2018-2, (2018), aff'd 738 Fed. Appx. 969 (10th Cir. 2018), cert. denied 139 S.Ct. 1263 (2019), the court confirmed that the taxpayer, chief executive officer and member of the board of directors, was a “disqualified person” with respect to the organization for purposes of determining whether the taxpayer was liable for excise taxes arising from excess benefit transactions during the three taxable years at issue. The taxpayer was in position to exercise substantial influence over the organization's affairs during each year.

### **B.3. Facts and Circumstances**

- (1) **Facts and circumstances tending to show substantial influence.** Persons, other than those expressly discussed in the preceding paragraphs, can still exercise substantial influence based on all relevant facts and circumstances. Therefore, they can be disqualified persons. Treas. Reg. 53.4958-3(e)(2) provides factors to help determine if a person has substantial influence over the affairs of an organization. They include, but are not limited to, the following factors:
- a. The person founded the organization,
  - b. The person is a substantial contributor to the organization under Section 507(d)(2)(A), considering only contributions received during the current taxable year and the four preceding taxable years,
  - c. The person's compensation is primarily based on revenues derived from activities of the organization, or of a department or function that the person controls,
  - d. 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,
  - e. 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,

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

(2) **Facts and circumstances tending to show no substantial influence.**

Alternatively, Treas. Reg. 53.4958-3(e)(3) provides factors that tend to show a person doesn't have substantial influence over the affairs of the organization. They include, but are not limited to, the following factors:

- a. The person has taken a bona fide vow of poverty as an employee, agent, or on behalf of a religious organization,
- b. The person is a 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) regarding transactions where the independent contractor won't economically benefit either directly or indirectly (other than from customary fees for professional advice),
- c. The direct supervisor of the person isn't a disqualified person,
- d. The person doesn't 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, or
- e. Any preferential treatment a person receives based on the size of the 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.

- (3) See Treas. Reg. 53.4958-3(g) for 13 examples illustrating the determination of disqualified persons.

## **C. Excess Benefit Transaction**

- (1) After determining a transaction involves an ATEO and a disqualified person, an examiner must evaluate the transaction itself to determine if the disqualified person has received an excess benefit.

### **C.1. Definition**

- (1) An excess benefit transaction is defined in Treas. Reg. 53.4958-4(a)(1) as:
- a. A transaction where an economic benefit is provided by an ATEO,
  - b. Directly or indirectly, to or for the use of any disqualified person, and
  - c. The value of the economic benefit provided by the organization exceeds the value of the consideration (including the performance of services) that the organization received from the disqualified person in exchange for the benefit.



- (2) Treas. Reg. 53.4958-4(a)(1) also provides the following guidance:
- a. In determining whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the ATEO and all entities it controls are considered.
  - b. In determining the reasonableness of compensation paid (or vested, or no longer subject to a substantial risk of forfeiture) in one year, services performed in prior years may be considered.
- (3) The amount that the benefit exceeds the value of the consideration is the excess benefit and the amount that the excise tax is imposed on except for special situations involving DAFs and supporting organizations. See Section 4958(c)(1), (2) and (3).
- Note:** See also section II.C.8, Special Rules for DAFs and section II.C.9, Special Rules for Supporting Organizations, in the following paragraphs.
- (4) The imposition of an excise tax under Section 4960 (Tax on excess tax-exempt organization executive compensation) isn't determinative of whether compensation is an excess benefit transaction under Section 4958 and vice versa. See Notice 2019-09, 2019-04 I.R.B. 403, Q 36.

## **C.2. Date of Occurrence**

- (1) Generally, an excess benefit transaction occurs when the disqualified person receives the economic benefit from the ATEO for federal income tax purposes. See Treas. Reg. 53.4958-1(e)(1).
- (2) **Series of Payments** - When a single contractual arrangement provides for a series of compensation payments 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 regarding these payments is deemed to occur on the last day of the disqualified person's taxable year. However, if a series of payments continue for only part of the taxable year, the excess benefit transaction is deemed to occur on the date of the last payment in the series. See Treas. Reg. 53.4958-1(e)(1).
- (3) **Special Rules** – See Treas. Reg. 53.4958-1(e)(2).
- a. 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.
  - b. 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 (including benefits under a nonqualified deferred compensation plan), the excess benefit transaction occurs when the property, or the rights to future compensation or property, isn't subject to a substantial risk of forfeiture.



- c. However, where the disqualified person elects to include an amount in gross income in the taxable year of transfer under Section 83(b), the rule under Treas. Reg. 53.4958-1(e)(1) applies to the property.
- d. Any excess benefit transaction involving 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.

### C.3. Indirect Benefits

- (1) A transaction, that would be an excess benefit transaction if the ATEO engaged in it directly with a disqualified person, is also an excess benefit transaction when it is accomplished indirectly. An excess benefit transaction can be provided indirectly through a controlled entity or through an intermediary. See Treas. Reg. 53.4958-4(a)(2)(i).
- (2) **Controlled entity** - An ATEO may provide an excess benefit indirectly using one or more entities it controls. For Section 4958 purposes, economic benefits provided by a controlled entity are treated as provided by the ATEO. See Treas. Reg. 53.4958-4(a)(2)(ii)(A). Control is defined in Treas. Reg. 53.4958-4(a)(2)(ii)(B)(1) as follows:
  - a. In the case of a stock corporation, ownership (by vote or value) of more than 50% of the stock,
  - b. In the case of a partnership, ownership of more than 50% of the profit interests or capital interests,
  - c. In the case of a nonstock organization, at least 50% of the directors or trustees are either representatives (including trustees, directors, agents, or employees) of, or directly or indirectly controlled by, an ATEO, or
  - d. In the case of any other entity, ownership of more than 50% of the beneficial interest.

**Note:** For purposes of control, Section 318 (relating to constructive ownership of stock) applies to determining ownership of stock in a corporation. Similar principles apply for purposes of determining ownership of interests in any other entity. See Treas. Reg. 53.4958-4(a)(2)(ii)(B)(2).
- (3) **Intermediary** - An ATEO can also indirectly provide an excess benefit through an intermediary. An intermediary is any person (individual or entity) who participates in a transaction with one or more disqualified persons of an ATEO. See Treas. Reg. 53.4958-4(a)(2)(iii). For Section 4958 purposes, intermediary provided economic benefits are treated as provided by the organization when:
  - a. An ATEO provides an economic benefit to an intermediary, and
  - b. In connection with the receipt of the benefit by the intermediary:

- Evidence of an oral or written agreement, or understanding that the intermediary will provide economic benefits to or for the use of the disqualified person exists, or
- 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.

(4) For examples of indirect economic benefits, see Treas. Reg. 53.4958-4(a)(2)(iv).

#### **C.4. Fair Market Value**

- (1) In determining the value of economic benefits, the value of property, including the right to use property, is its fair market value. See Treas. Reg. 53.4958-4(b)(1)(i).
- (2) Treas. Reg. 53.4958-4(b)(1)(i) defines fair market value as:
  - a. The price at which property, or the right to use property, would change hands between a willing buyer and a willing seller,
  - b. Neither being under any compulsion to buy, sell or transfer property or the right to use property, and
  - c. Both having reasonable knowledge of relevant facts.

#### **C.5. Reasonable Compensation**

**Note:** This section doesn't apply to the special definition of excess benefit transaction for certain transactions involving DAFs and supporting organizations. Please see sections II.C.8 and II.C.9 below for the special rules.

- (1) Reasonable compensation is the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax-exempt) under like circumstances. See Treas. Reg. 53.4958-4(b)(1)(ii)(A).
- (2) The following are relevant factors to consider when determining reasonableness of compensation.
  - a. Section 162 standards for reasonable compensation apply. Consider the aggregate benefits (other than specific disregarded benefits in Treas. Reg. 53.4958-4(a)(4)) provided and the rate at which any deferred compensation accrues.
  - b. A compensation arrangement subject to a cap.
  - c. State or local legislative or agency body or court authorization or approval of a particular compensation package is a factor but isn't determinative of the reasonableness of compensation.
  - d. All economic benefits (regardless of the federal income tax treatment) provided by an ATEO in exchange for the performance of services, except

for disregarded economic benefits in Treas. Reg. 53.4958-4(a)(4), are included.

**Note:** Also see section II.D.2 below for a discussion of disregarded benefits.

(3) Treas. Reg. 53.4958-4(b)(1)(ii)(B) provides examples of economic benefits.

- a. All forms of cash and non-cash compensation including:
  - salary,
  - fees,
  - bonuses,
  - severance payments, and
  - deferred and non-cash compensation.
- b. Unless excludable from gross income as a de minimis fringe benefit under Section 132(a)(4), the payment of liability insurance premiums or the ATEO payment or reimbursement of the following:
  - Any penalty, tax, or expense of correction owed under Section 4958,
  - Any expense not reasonably incurred in a civil proceeding arising out of the performance of services for the ATEO, or
  - Any expense resulting from an act or failure to act where the person has acted willfully and without reasonable cause.
- c. All other compensatory benefits, whether or not included in gross income for income tax purposes, including:
  - Payments to welfare benefit plans such as medical, dental, and life insurance
  - Severance pay
  - Disability benefits
  - Taxable and nontaxable fringe benefits, except those excludable from gross income under Section 132
  - Certain expense allowances or reimbursements (other than expense reimbursements pursuant to an accountable plan) under Treas. Reg. 1.62-2(c)(3)
  - The economic benefit of a below-market loan within the meaning of Section 7872(e)(1)

**Note:** The economic benefit of a below-market loan is the amount deemed transferred to the disqualified person under Section 7872(a) or (b), regardless of whether Section 7872 applies to the loan.

(4) Whether an item is included in the disqualified person's gross income for income tax purposes is made based on the Chapter 1 provisions of the Internal Revenue

Code. The determination is made without regard to whether the item is considered for purposes of determining the reasonableness of compensation under Section 4958. See Treas. Reg. 53.4958-4(b)(1)(ii)(C).

- (5) **Fixed Payment** - In determining reasonableness of a fixed payment under a contract, the facts and circumstances considered are those existing when the parties entered the contract under which the payment was made. See Treas. Reg. 53.4958-4(b)(2)(i).
  - a. 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.
  - b. If property subject to a substantial risk of forfeiture satisfies the definition of fixed payment within Treas. Reg. 53.4958-4(a)(3)(ii), reasonableness is determined at the time the parties entered the contract providing for the property transfer.
  - c. In determining reasonableness, facts and circumstances existing at the date that the payment is questioned aren't considered.
- (6) **Non-Fixed Payment** - In determining reasonableness of a non-fixed payment under a contract, all the facts and circumstances up to the date of payment are considered. See Treas. Reg. 53.4958-4(b)(2)(i).
  - a. If property subject to a substantial risk of forfeiture isn't a fixed payment, reasonableness is determined based on all the facts and circumstances up to and including circumstances as of the date of payment.
  - b. In determining reasonableness, facts and circumstances existing at the date that the payment is questioned aren't considered.
- (7) For several examples of the timing of the reasonableness determination, see Treas. Reg. 53.4958-4(b)(2)(iii).

## **C.6. Intent to Treat Benefit as Compensation**

**Note:** This section doesn't apply to the special definition of excess benefit transactions for certain transactions involving DAFs and supporting organizations. Please see sections II.C.8 and II.C.9 below for the special rules.

- (1) An economic benefit isn't 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. See Treas. Reg. 53.4958-4(c)(1).
- (2) An ATEO (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's contemporaneous with the transfer of the economic benefits under consideration. See Treas. Reg. 53.4958-4(c)(1).

- (3) Such intent to provide an economic benefit as compensation for services isn't required if the economic benefit is excluded from the disqualified person's gross income for income tax purposes based on Chapter 1, Subtitle A of the Internal Revenue Code provisions. 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 Section 401(a), and benefits described in Sections 127 and 137. See Treas. Reg. 53.4958-4(c)(2).
- (4) **Contemporaneous Substantiation** - An ATEO provides contemporaneous written substantiation of its intent to provide an economic benefit as compensation if:
- a. The ATEO reports the benefit as compensation on an original federal tax information return (for example, Form W-2, Wage and Tax Statement, Form 1099-MISC, Miscellaneous Information, Form 1099-NEC, Nonemployee Compensation, or Form 990, Return of Organization Exempt From Income Tax), or
  - b. The ATEO reports the benefit as compensation on an amended federal tax information return filed before the IRS examination starts on the organization or the disqualified person for the taxable year in which the transaction occurred, or
  - c. The recipient disqualified person reports the benefit as income on an original federal tax return (for example, Form 1040, U.S. Individual Income Tax Return), or
  - d. The recipient disqualified person reports the benefit as income on an amended federal tax return filed before the earlier of (1) the start of an IRS audit of the ATEO or the disqualified person for the taxable year when the transaction occurred, or (2) the IRS's first written documentation of a potential excess benefit transaction. See Treas. Reg. 53.4958-4(c)(3)(i)(A).
- (5) **Other Evidence** - Other written contemporaneous evidence may be used to demonstrate that the appropriate decision-making body, or an officer authorized to approve compensation, approved a transfer as compensation for services. This evidence includes, but is not limited to, the following:
- a. An approved written employment contract executed on or before the date of the transfer. See Treas. Reg. 53.4958-4(c)(3)(ii)(A).
  - b. Documentation satisfying the requirements of Treas. Reg. 53.4958-6(a)(3) indicating that an authorized body approved the transfer as compensation for services on or before the date of transfer. See Treas. Reg. 53.4958-4(c)(3)(ii)(B).
  - c. Written evidence in existence on or before the due date of the applicable federal return (including extensions but not amendments) where the ATEO has a reasonable belief that a benefit was nontaxable under Treas. Reg. 53.4958-4(c)(2). See Treas. Reg. 53.4958-4(c)(3)(ii)(C).

- (6) **No Contemporaneous Written Substantiation** - If an ATEO fails to provide contemporaneous written substantiation of its intent to provide an economic benefit as compensation, any services provided by the disqualified person won't be treated as provided in consideration for the economic benefit. See Treas. Reg 53.4958-4(c)(1). Therefore, the economic benefit may be treated as an excess benefit under Section 4958 unless the organization provided the economic benefit in exchange for consideration other than the performance of services.
- (7) **Reasonable Cause** - The organization will be treated as having clearly indicated its intent to provide an economic benefit as compensation for services if an ATEO's failure to report an economic benefit as required under the Internal Revenue Code is due to reasonable cause. See Treas. Regs. 53.4958-4(c)(3)(i)(B) and 301.6724-1. To show reasonable cause, the ATEO must establish that:
  - a. Significant mitigating factors regarding its failure to report exist (See Treas. Reg. 301.6724-1(b)), or
  - b. The failure arose from events beyond the organization's control (See Treas. Reg. 301.6724-1(c)). In addition, the organization must establish that it acted in a responsible manner both before and after the failure occurred. See Treas. Reg. 301.6724-1(d).
- (8) **Theft or Fraud** - An economic benefit that a disqualified person obtains by theft or fraud is never consideration for the performance of services. See Treas. Reg. 53.4958-4(c)(1).

## C.7. Economic Benefits Determined by Revenues

**Note:** This section doesn't apply to the special definition of excess benefit transaction for certain transactions involving DAFs and supporting organizations. Please see section II.C.8 and II.C.9 below for the special rules.

- (1) Revenue-sharing transactions are 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. See Preamble to the Final Regulations under section 4958, T.D. 8978, 2002-7 I.R.B. 500 9 (effective Jan. 22, 2002).
- (2) The final regulations for Section 4958 reserved a separate section governing revenue-sharing transactions. See Treas. Reg. 53.4958-5.
- (3) Until final regulations are published regarding revenue-sharing transactions, these transactions should be evaluated under the general rules set forth in Treas. Reg. 53.4958-4 which define excess benefit transactions that apply to all transactions with disqualified persons regardless of whether the person's compensation is computed by reference to revenues of the organization. See Preamble to the Final Regulations under section 4958, T.D. 8978, 2002-7 I.R.B. 500 9 (effective Jan. 22, 2002).

## C.8. Special Rules for Donor-Advised Funds (DAFs)

- (1) In the case of any donor-advised fund (DAF) described in Section 4966(d)(2), an excess benefit transaction includes any grant, loan, compensation, or other similar payment from such fund to the donor, donor advisor, members of the donor's or donor advisor's families, and 35% controlled entities of such persons. See Section 4958(c)(2)(A).
- (2) The amount of the excess benefit is the entire amount of the grant, loan, compensation, or other similar payment. See Section 4958(c)(2)(B).
- (3) "Other similar payments" include payments in the nature of a grant, loan, or payment of compensation, such as an expense reimbursement. See Staff of Joint Committee on Taxation, Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," JCX-38-06 NO 13 at 347.
- (4) Other similar payments don't include, for example, payments pursuant to bona fide sales or leases of property. See citation above. However, these transactions are still subject to the general rules of Section 4958:
  - a. As donors and donor advisors are disqualified persons with respect to DAFs, they may be subject to Section 4958 taxes if they engage in excess benefit transactions as defined in Section 4958(c)(1). See Section 4958(f)(1)(E).
  - b. As investment advisors are disqualified persons with respect to sponsoring organizations, they may be subject to Section 4958 taxes if they engage in excess benefit transactions as defined in Section 4958(c)(1). See Section 4958(f)(1)(F).
- (5) Transactions that don't meet the special rules for DAFs under Section 4958(c)(2) are still subject to the general rules under Section 4958.

**Note:** See Section II.B.1 above for the definition of a disqualified person with respect to a DAF including the definition of a donor, donor advisor and investment advisor.

**Note:** See TG 3-7, IRC 501(c)(3) Exempt Purposes, Specialty Topics under IRC 170 and 163, for additional discussion of DAFs. TG 3-7 will be published in the future. For a list of all TGs, published and in process, see the cumulative list of Technical Guides located in TG 0 Technical Guide Overview, Exhibit III, starting on page 10.

## C.9. Special Rules for Supporting Organizations

- (1) In the case of any supporting organization described in Section 509(a)(3), an excess benefit transaction includes:
  - a. Any grant, loan, compensation, or other similar payment from a supporting organization to a substantial contributor, members of the substantial contributor's family (as described in Section 4958(f)(4)), or entities 35% controlled by such persons (as defined in Section 4958(f)(3) and modified in Section 4958(c)(3)(B)). See Section 4958(c)(3)(A)(i)(I).

- A substantial contributor is any person who contributed or bequeathed an aggregate of more than \$5,000 to the organization, if such amount is more than 2% of the total contributions and bequests received by the organization before the close of the organization's taxable year when the contribution or bequest is received. In the case of a trust, the creator of the trust is also a substantial contributor. Rules similar to those of Section 507(d)(2)(B) and (C) apply. See Section 4958(c)(3)(C)(i).
  - A substantial contributor doesn't include organizations described in Section 509(a)(1), (2), or (4), or the supporting organization's supported organizations that are described in Section 501(c)(4), 501(c)(5), or 501(c)(6) and that are treated as Section 509(a)(2) organizations by virtue of the last sentence of Section 509(a). See Section 4958(c)(3)(C)(ii).
- b. Loans from any supporting organization to a disqualified person of the supporting organization. See Section 4958(c)(3)(A)(i)(II).
- A disqualified person (defined in Section 4958(f)(1)) includes 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, members of those persons' families (as described in Section 4958(f)(4)), and entities 35% controlled by such persons (as described Section 4958(f)(3)).
  - A disqualified person doesn't include organizations described in Section 509(a)(1), (2), or (4) or the supported organizations that are described in Section 501(c)(4), 501(c)(5), or 501(c)(6) and that are treated as Section 509(a)(2) organizations by virtue of the last sentence of Section 509(a). See Section 4958(c)(3)(C)(ii).
- (2) The amount of the excess benefit in (a) or (b) above is the entire amount of the grant, loan, compensation, or other similar payment. See Section 4958(c)(3)(A)(ii).
- (3) "Other similar payments" include payments in the nature of a grant, loan, or payment of compensation, such as an expense reimbursement. See Staff of Joint Committee on Taxation, Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," JCX-38-06 NO 13 at 358.
- (4) Other similar payments don't include, for example, payments pursuant to bona fide sales or leases of property. See citation above. However, these transactions are still subject to the general rules of Section 4958.
- (5) Transactions that don't meet the special rules for supporting organizations under Section 4958(c)(3) are still subject to the general rules under Section 4958 if the substantial contributor meets the definition of a disqualified person under Section 4958(f).



- (6) Section 4958(c)(3) applies to payments made by a supporting organization to a substantial contributor but not to payments made by a substantial contributor to a supporting organization.

**Note:** See also section II.D.5, Supporting Organizations Arrangements Prior to August 17, 2006, below.

**Note:** See TG 31, 501(c)(3) Foundation Classification – IRC 509(a)(3) Type I Supporting Organizations, TG 32, 501(c)(3) Foundation Classification - IRC 509(a)(3) Type II Supporting Organizations, and TG 33, 501(c)(3) Foundation Classification - IRC 509(a)(3) Type II Supporting Organizations for additional discussion of supporting organizations described in Section 509(a)(3). These TGs will be published in the future. For a list of all TGs, published and in process, see the cumulative list of Technical Guides located in TG 0 Technical Guide Overview, Exhibit III, starting on page 10.

## D. Specific Excess Benefit Transaction Exceptions

**Note:** This section doesn't apply to the special definition of excess benefit transaction for certain transactions involving DAFs and supporting organizations. See sections II.C.8 and II.C.9 above for the special rules.

- (1) The general rules of Section 4958 don't apply to:
- a. Fixed payments under an "initial contract"
  - b. Certain "disregarded benefits"
  - c. Certain payments under Employee Retirement Income Security Act of 1974 (ERISA)
  - d. Existing binding contracts prior to September 13, 1995
  - e. Supporting organizations arrangements prior to August 17, 2006

### D.1. Initial Contract Rule

- (1) Section 4958 doesn't apply to a "fixed payment" made to a person pursuant to an "initial contract." See Treas. Reg. 53.4958-4(a)(3).
- (2) A "fixed payment" is a cash amount 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. See Treas. Reg. 53.4958-4(a)(3)(ii)(A).
- a. A "fixed formula" may incorporate an amount that depends upon future "specified events or contingencies," if no person has discretion when calculating the amount of a payment or deciding whether to make a payment (such as a bonus).
  - b. A "specified event or contingency" may include the amount of revenues generated by (or other objective measure of) one or more activities of the ATEO.

- c. A fixed payment doesn't include any amount paid to a person under a reimbursement or similar arrangement where any person has discretion regarding the amounts incurred or reimbursed.
- (3) An "initial contract" is a binding written contract between an ATEO and a person who wasn't a disqualified person under Section 4958(f)(1) and Treas. Reg. 53.4958-3 immediately prior to entering into the contract. See Treas. Reg. 53.4958-4(a)(3)(iii).
- (4) The initial contract exception doesn't apply to any fixed payment made, under the initial contract, during any taxable year if the person fails to substantially perform the person's obligations under the initial contract during that year. See Treas. Reg. 53.4958-4(a)(3)(iv).
- (5) New Contracts. A binding written contract providing that it may be terminated or canceled by the ATEO (except for substantial non-performance) 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 termination or cancellation, if made, would be effective. See Treas. Reg. 53.4958-4(a)(3)(v).
  - a. If the parties make a "material change" to the contract, it's treated as a new contract as of the date the material change is effective.
  - b. A "material change" includes an extension or renewal of the contract (except for an extension or renewal resulting from the person contracting with the ATEO unilaterally exercising an option expressly granted by the contract), or a more than incidental change to the amount payable under the contract.
  - c. The new contract is tested under Treas. Reg. 53.4958-4(a)(3)(iii) to determine whether it's an "initial contract" which meets the exception from Section 4958 under Treas. Reg. 53.4958-4(a)(3).

## **D.2. Disregarded Benefits**

- (1) The following economic benefits are generally disregarded for Section 4958. See Treas. Reg. 53.4958-4(a)(4).
  - a. Nontaxable Fringe Benefits - An economic benefit that's excluded from income under Section 132 except any liability insurance premium, payment, or reimbursements that must be considered under Treas. Reg. 53.4958-4(b)(1)(ii)(B)(2). See Treas. Reg. 53.4958-4(a)(4)(i).
  - b. Expense Reimbursements paid under an "accountable plan" under Treas. Reg. 1.62-2(c) See Treas. Reg. 53.4958-4(a)(4)(ii).
  - c. Economic benefits provided to volunteers for the organization if the benefit is provided to the public in exchange for a membership fee or contribution of \$75 or less per year. See Treas. Reg. 53.4958-4(a)(4)(iii).
  - d. Economic benefits provided to members of an organization solely due to the payment of a membership fee, or to a donor solely because of a charitable

contribution, regardless of whether the donor is eligible to claim the deduction, if:

- Any non-disqualified person paying a membership fee or making a charitable contribution above a specified amount is given the option of receiving substantially the same benefit; and
  - The disqualified person and a significant number of non-disqualified persons make a payment or charitable contribution of at least the specified amount. See Treas. Reg. 53.4958-4(a)(4)(iv).
- e. Economic benefits provided to a person solely because the person is a member of a charitable class that the ATEO intends to benefit as part of the accomplishment of its exempt purpose. See Treas. Reg. 53.4958-4(a)(4)(v).
- f. Any transfer of an economic benefit to or for the use of a governmental unit, as defined in Section 170(c)(1) if the transfer is for exclusively public purposes. See Treas. Reg. 53.4958-4(a)(4)(vi).

### **D.3. Payment under ERISA**

- (1) Section 4958 doesn't apply to payments made pursuant to, and in accordance with, a final individual prohibited transaction exemption issued by the Department of Labor under Section 408(a) of ERISA regarding a transaction involving a plan that is an ATEO. See Treas. Reg. 53.4958-4(a)(5).

### **D.4. Existing Binding Contracts prior to September 13, 1995**

- (1) Section 4958 doesn't apply to an excess benefit transaction occurring pursuant to a written contract that was binding on September 13, 1995, and at all times thereafter before the transaction occurs. See P.L. 104-168, Section 1311(d)(2) and Treas. Reg. 53.4958-1(f)(2).
- a. Termination or Cancellation - A written binding contract that is terminable or subject to cancellation by the ATEO without the disqualified person's consent 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. See Treas. Reg. 53.4958-1(f)(2).
  - b. Material Change - If a binding written contract is materially changed, it's treated as a new contract entered as of the material change effective date. See Treas. Reg. 53.4958-1(f)(2).
  - c. A "material change" includes an extension or renewal of the contract (except for an extension or renewal resulting from the person contracting with the ATEO unilaterally exercising an option expressly granted by the contract), or a more than incidental change to the amount payable under the contract.

## **D.5. Existing Arrangements with Supporting Organizations Prior to August 17, 2006**

- (1) **Supporting Organization Binding Written Contract** - Any payment made pursuant to a written contract that was binding on August 17, 2006, won't be treated as an excess benefit transaction under Section 4958(c)(3), provided that:
  - a. Such contract was binding at all times after August 17, 2006, and before payment is made,
  - b. The contract isn't modified during such period, and
  - c. The payment under the contract is made on or before August 17, 2007.
- (2) **Supporting Organization, Other Arrangements** - On August 17, 2006, with respect to any arrangement not governed by a binding written contract involving an existing employment relationship or other legal obligation in effect, the IRS won't consider any payment pursuant to such arrangement as an excess benefit transaction under Section 4958(c)(3) provided that:
  - a. The terms of such arrangement aren't modified after August 17, 2006,
  - b. Any services are performed, and any goods are delivered as required by the arrangement no later than December 31, 2006, and
  - c. The payment is made no later than August 17, 2007.
- (3) Termination of the contract or arrangement described above doesn't constitute a modification for this purpose. See Notice 2006-109, 2006-2 C.B. 1121, 2006-51 I.R.B. 1121 December 4, 2006.

## **E. Rebuttable Presumption**

**Note:** This section doesn't apply to the special definition of excess benefit transaction for certain transactions involving DAFs and supporting organizations. Please see the special rules on sections II.C.8 and II.C.9 above.

- (1) Treas. Reg. 53.4958-6 provides rules that enable an organization to establish a rebuttable presumption that a transaction with a disqualified person isn't an excess benefit transaction.
- (2) Payments under a compensation arrangement are presumed to be reasonable and the transfer of property, or the right to use property, is presumed to be at fair market value if all the following conditions are satisfied. See Treas. Reg. 53.4958-6(a).
  - a. **Approval in Advance by an Authorized Body** - The compensation arrangement or the terms of the property transfer are approved in advance by an authorized body of the ATEO, or an entity it controls, composed entirely of individuals who don't have a conflict of interest as to the compensation arrangement or property transfer.

- b. **Comparability** - The authorized body obtained and relied upon appropriate data as to comparability before making its determination.
  - c. **Documentation** - The authorized body adequately documented the basis for its determination concurrently with making that determination.
- (3) **Rebutting the Presumption** - If the above three requirements are satisfied, then 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. See Treas. Reg. 53.4958-6(b).
- a. With respect to any **fixed payment**, rebuttal evidence is limited to evidence relating to facts and circumstances existing on the date the parties enter the contract pursuant to which the payment is made (except in the event of substantial nonperformance).
  - b. With respect to all **other payments** (including non-fixed payments subject to a cap described in Treas. Reg. 53.4958-6(d)(2)), rebuttal evidence may include facts and circumstances up to the date of payment. See Treas. Reg. 53.4958-4(b)(2)(i).
- (4) **Absence of Presumption**
- a. The fact that a transaction between an ATEO and a disqualified person aren't subject to the rebuttable presumption of reasonableness doesn't create any inference that the transaction is an excess benefit transaction. See Treas. Reg. 53.4958-6(e).
  - b. The absence of the rebuttable presumption doesn't exempt or relieve any person from compliance with any federal or state law imposing any obligation, duty, responsibility, or other standard of conduct as to the operation or administration of any ATEO.
- (5) **Reliance Period** - The rebuttable presumption applies to all payments made or transactions completed under a contract, except in the case of non-fixed payments, if the three requirements defined above in section II.E(2) were met when the parties entered the contract. See Treas. Reg. 53.4958-6(f).
- (6) **No Ruling Policy** - The IRS won't issue private letter rulings that any or all the requirements for establishing the rebuttable presumption under Treas. Reg. 53.4958-6 have been satisfied. See Rev. Proc. 2024-3, 2024-1 I.R.B. 143, Section 3.01(131), updated annually.

## **E.1. Requirements for Invoking Rebuttable Presumption**

- (1) **Approval by an authorized body.** An authorized body means:
- a. The ATEO's governing body,
  - b. A committee of the governing body, or
  - c. Other parties authorized by the governing body to act on its behalf by following procedures specified by the governing body to approve

compensation arrangements or property transfers to the extent permitted by state law. See Treas. Reg. 53.4958-6(c)(1)(i).

- (2) An individual isn't included on the authorized body when reviewing a specific compensation arrangement or property transfer involving an individual if:
- a. That individual meets with other members only to answer questions,
  - b. Otherwise recuses himself or herself from the meeting, and
  - c. Isn't present during debate and voting on the compensation arrangement or property transfer. See Treas. Reg. 53.4958-6(c)(1)(ii).

**Note:** The member isn't considered as having a conflict of interest, under this rule, if an authorized body is reviewing a specific compensation arrangement or property transfer involving a member of the authorized body.

- (3) **Conflict of Interest** - A member of the authorized body doesn't have a conflict of interest regarding a compensation arrangement or property transfer only if the member:
- a. Isn't the disqualified person participating in or economically benefiting from the compensation arrangement or property transfer, and isn't a member of the family of the disqualified person under Section 4958(f)(4) and Treas. Reg. 53.4958-3(b)(1),
  - b. Isn't in an employment relationship subject to the direction or control of any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer,
  - c. Doesn't receive compensation or other payments subject to approval by any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer,
  - d. Has no material financial interest affected by the compensation arrangement or property transfer, and
  - e. Doesn't 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. See Treas. Reg. 53.4958-6(c)(1)(iii)
- (4) **Comparability** - An authorized body has appropriate data as to comparability if, given the knowledge and expertise of its members, it has sufficient information to determine whether the compensation is reasonable, or the property transfer is at fair market value as defined in Treas. Reg. 53.4958-4(b). See Treas. Reg. 53.4958-6(c)(2)(i).

- (5) As to comparability, appropriate data in the case of property includes, but is not limited to:
  - a. Current independent appraisals of the value of all property to be transferred
  - b. Offers received as part of an open and competitive bidding process
- (6) In the case of compensation, relevant information includes but is not limited to:
  - a. Compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions
  - b. The availability of similar services in the ATEO's geographic area
  - c. Current compensation surveys compiled by independent firms
  - d. Actual written offers from similar institutions competing for the services of the disqualified person
- (7) **Special rule for compensation paid by small organizations** - For organizations with annual gross receipts of less than \$1 million, the authorized body is considered to have appropriate data as to comparability if it has data on compensation paid for similar services 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. See Treas. Reg. 53.4958-6(c)(2)(ii).
  - a. An ATEO may calculate its annual gross receipts based on its gross receipts average during the three prior taxable years. See Treas. Reg. 53.4958-6(c)(2)(iii).
  - b. The annual gross receipts of all organizations must be aggregated if any ATEO is controlled by or controls another entity. See Treas. Reg. 53.4958-6(c)(2)(iii).
- (8) **Documentation** - For a decision by an authorized body to be documented adequately, the written or electronic records of the authorized body must note:
  - a. The terms of the transaction, and the date it was approved,
  - b. The members of the authorized body who were present during the debate of the approved transaction, and 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 regarding the transaction by anyone who is a member of the authorized body but who had a conflict of interest as to the transaction. See Treas. Reg. 53.4958-6(c)(3)(i).
- (9) **Variances** - The authorized body must record the basis for its determination if the authorized body determines that the reasonable compensation for a specific arrangement, or that the fair market value in a specific property transfer, varies from the range of comparable data obtained. See Treas. Reg. 53.4958-6(c)(3)(ii).

- (10) Concurrently - For a decision by an authorized body to be documented concurrently, records must be prepared by the later of:
- a. The next meeting of the authorized body, or
  - b. 60 days after final action by the authorized body. See Treas. Reg. 53.4958-6(c)(3)(ii).
- (11) Records must be reviewed and approved by the authorized body as reasonable, accurate, and complete within a reasonable time afterwards.

## **E.2. Non-fixed Payments**

- (1) In the case of a non-fixed 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 to invoke the rebuttal presumption under Treas. Reg. 53.4958-6(a) are subsequently satisfied. See Treas. Reg. 53.4958-6(d)(1).
- (2) 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) up to a specified cap, the authorized body may establish a rebuttable presumption as to the non-fixed payment when the employment contract is entered into if:
- a. Before approving the contract, the authorized body obtains appropriate comparability data indicating that a fixed payment of up to a certain amount to the disqualified person would represent reasonable compensation,
  - b. The maximum amount payable under the contract, considering both fixed and non-fixed payments, doesn't exceed the above amount, and
  - c. The requirements for the rebuttable presumption in Treas. Reg. 53.4958-6(a) are satisfied. See Treas. Reg. 53.4958-6(d)(2).

## **F. Taxes on Excess Benefit Transactions**

- (1) After determining that a disqualified person received an excess benefit from an ATEO, an examiner must calculate the tax on the excess benefit transaction.
- (2) Section 4958 imposes initial and additional taxes on excess benefit transactions.
- a. Initial taxes are imposed on the disqualified person and the management of the organization.
  - b. Additional taxes are only asserted on the disqualified person.

**Note:** Because Section 4958(b) doesn't impose additional taxes on the organization manager, a Thorne letter is not required to be issued for Section 4958 excise taxes. See also *Thorne v. Commissioner*, 99 T.C. 67 (1992).



## F.1. Initial Tax on Disqualified Persons

- (1) Section 4958(a)(1) imposes a tax equal to 25% of the excess benefit on each excess benefit transaction between an ATEO and a disqualified person. The initial tax is also sometimes referred to as the "First Tier Tax."
  - a. The tax is imposed on the entire amount of the payment in the case of certain transactions involving DAFs or supporting organizations.

**Note:** See sections II.C.8 and II.C.9 above for the special rules for DAFs and supporting organizations.

**Note:** Also see section II.H below regarding abatement of the 25% tax.
- (2) The tax is paid by the disqualified person who received an excess benefit from the transaction. See Treas. Reg. 53.4958-1(c)(1).
  - a. All the disqualified persons are jointly and severally liable for the tax if more than one disqualified person is liable for the 25% tax. See Section 4958(d)(1) and Treas. Reg. 53.4958-1(c)(1).
  - b. Joint and several liability means that all or a portion of the 25% tax may be assessed against and collected from one or more of the disqualified persons who received an excess benefit from the excess benefit transaction.
  - c. However, the total tax collected must not exceed 100% of the 25% tax.

## F.2. Initial Tax on Organization Managers

- (1) If the 25% initial tax is imposed on an excess benefit with a disqualified person, Section 4958(a)(2) imposes a 10% tax on any organization manager who knowingly participated in the excess benefit transaction. The 10% tax won't be imposed if participation was not willful and due to reasonable cause. See Treas. Reg. 53.4958-1(d)(1).
  - a. The 10% tax is payable by any organization manager who knowingly participated in the excess benefit transaction. See Section 4958(a)(2) and Treas. Reg. 53.4958-1(d)(1).
  - b. If more than one organization manager is liable for the 10% tax, all organization managers are jointly and severally liable for the tax. See Section 4958(d)(1) and Treas. Reg. 53.4958-1(d)(8).
  - c. Joint and several liability means that all or a portion of the 10% tax may be assessed against and collected from one or more of the organization managers who are liable for the 10% tax.
  - d. However, the total tax collected can't exceed 100% of the 10% tax.
  - e. Additionally, the maximum amount of the 10% tax that may be imposed on an organization manager is \$20,000 for each excess benefit transaction. See Section 4958(d)(2).

- (2) If a disqualified person who receives an excess benefit from an excess benefit transaction is also an organization manager who knowingly participated in the excess benefit transaction, and that participation was willful and not due to reasonable cause, this person may be liable for both the 25% tax and the 10% tax. See Treas. Reg. 53.4958-1(a).
- (3) The IRS bears 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), Treas. Reg. 301.7454-2, and Treas. Reg. 53.4958-1(d)(9).
- (4) Where the 25% initial tax imposed on the disqualified person is abated, the 10% tax on the organization manager would also be abated because the assessment of the 10% tax is dependent on the imposition of the 25% tax. See Sections 4958(a)(1) and 4958(a)(2). The abatement of Section 4958(a) taxes is provided for in Section 4962(a) as defined in Section 4963(a).

**Note:** Also see section II.H.2 below for further discussion regarding abatement of Section 4958 taxes.

- (5) **Organizational Manager Defined** - Section 4958(f)(2) defines an organization manager to mean, with respect to any ATEO, any officer, director, or trustee of the organization (or any individual having powers or responsibilities like those of officers, directors, or trustees of the organization). See also Treas. Reg. 53.4958-1(d)(2).
- (6) 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 organizational documents, or
  - b. Regularly exercises authority to make administrative or policy decisions on behalf of the organization. See Treas. Reg. 53.4958-1(d)(2)(i).

**Note:** An individual who isn't an officer, director, or trustee of an ATEO, but who serves on the committee of the governing body of an ATEO that attempts to invoke the rebuttable presumption of reasonableness (See section II.E above) based on the committee's actions is an organization manager. See Treas. Reg. 53.4958-1(d)(2)(ii).

- (7) The following persons aren't officers:
  - a. An independent contractor who acts solely in a capacity as an attorney, accountant, investment manager or advisor.
  - b. A person who has authority merely to recommend administrative or policy decisions, but not to implement them without approval of a superior. See Treas. Reg. 53.4958-1(d)(2)(B).
- (8) **Knowingly Defined** - An organization manager knowingly participates in an excess benefit transaction if the organization manager:
  - a. Has actual knowledge of sufficient facts so that, based solely upon such facts, the transaction would be an excess benefit transaction,

- b. Is aware that the transaction may constitute an excess benefit transaction, and
  - c. Negligently fails to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction, or the person is in fact aware that it's such a transaction. See Treas. Reg. 53.4958-1(d)(4)(i).
- (9) Knowing doesn't mean having reason to know. However, evidence showing that an organization manager had reason to know of a particular fact or rule is relevant in determining whether the organization manager had actual knowledge of such a fact or rule. See Treas. Reg. 53.4958-1(d)(4)(ii).
- (10) Even though a transaction is subsequently determined to be an excess benefit transaction, an organization manager's participation in the transaction usually won't be considered knowing if, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on the professional's reasoned written opinion regarding the elements of the transaction within the professional's expertise. An organization manager may rely on the written opinion of:
  - a. Legal counsel, including in-house counsel,
  - b. Certified public accountants or accounting firms with expertise regarding the relevant tax law matters, and
  - c. Certain independent valuation experts. See Treas. Reg. 53.4958-1(d)(4)(iii).
- (11) A written opinion is reasoned, even though it reaches a conclusion that is later determined to be incorrect, if the opinion addresses itself to the facts and the applicable standards. However, a written opinion isn't reasoned if it does nothing more than recite the facts and express a conclusion. See Treas. Reg. 53.4958-1(d)(4)(iii).
  - a. The absence of a written opinion of an appropriate professional with respect to a transaction doesn't, by itself, give rise to any inference that an organization manager knowingly participated in the transaction. See Treas. Reg. 53.4958-1(d)(4)(iii).
- (12) Even though a transaction is subsequently determined to be an excess benefit transaction, an organization manager's participation in the transaction won't ordinarily be considered knowing if the appropriate authorized body of the ATEO has met the requirements to invoke rebuttable presumption under Treas. Reg. 53.4958-6(a) as to the transaction. See Treas. Reg. 53.4958-1(d)(4)(iv) on the Rebuttable Presumption.

**Note:** See section II.E above for further discussion regarding Rebuttable Presumption.

- (13) **Participation Defined** - Participation includes an affirmative action taken by the organization manager.
- a. It also includes silence or inaction where the organization manager is under a duty to speak or act.
  - b. An organization manager isn't considered to have participated in an excess benefit transaction where the organization manager has opposed the transaction in a manner consistent with fulfilling the organization manager's responsibilities to the organization.
  - c. See Treas. Reg. 53.4958-1(d)(3).
- (14) **Willfully Defined** - Participation by an organization manager is willful if it's voluntary, conscious, and intentional. See Treas. Reg. 53.4958-1(d)(5).
- a. Participation may be willful even without a motive to avoid the restrictions of the law or the incurrence of any tax.
  - b. Participation by an organization manager isn't willful if the manager doesn't know that a transaction is an excess benefit transaction.
- (15) **Reasonable Cause Defined** - Participation by an organization manager is due to reasonable cause if the organization manager exercises responsibility on behalf of the ATEO with ordinary business care and prudence. See Treas. Reg. 53.4958-1(d)(6).

### **F.3. Additional tax on Disqualified Persons**

- (1) If the initial 25% tax is imposed on an excess benefit transaction between an ATEO and a disqualified person, and the excess benefit transaction isn't corrected within the taxable period, an additional excise tax equal to 200% of the excess benefit is imposed on the excess benefit transaction. See Section 4958(b) and Treas. Reg. 53.4958-1(c)(2)(i). The additional tax is also sometimes referred to as the "Second Tier Tax."
- (2) The 200% tax is payable by the disqualified person who received an excess benefit from the excess benefit transaction on which the 25% tax 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. See Section 4958(b) and Treas. Reg. 53.4958-1(c)(2)(i).
- (3) All such disqualified persons are jointly and severally liable for the 200% tax if more than one disqualified person received an excess benefit from an excess benefit transaction. See Section 4958(d)(1) and Treas. Reg. 53.4958-1(c)(2)(i).
  - a. Joint and several liability means that all or a portion of the 200% tax may be assessed against and collected from one or more of the disqualified persons who received an excess benefit from an excess benefit transaction.
  - b. However, the total tax collected must not exceed 100% of the 200% tax.

- (4) A disqualified person must correct the excess benefit transaction during the taxable period to avoid imposition of the 200% tax.
- The taxable period begins when the excess benefit transaction occurs. See Section 4958(f)(5) and Treas. Reg. 53.4958-1(c)(2)(ii).
  - The taxable period ends on the earlier of the following:
    - The date of the mailing of a notice of deficiency to the disqualified person regarding the 25% tax, or
    - The date when the initial 25% tax is assessed on the disqualified person. See Section 4958(f)(5) and Treas. Reg. 53.4958-1(c)(2)(ii).

#### F.4. Statute of Limitations

- (1) The statute of limitations rules that apply to Section 4958 excise taxes are found in Sections 6501(e)(3) and 6501(l).
- (2) **Period of Limitations** - The period of limitations for assessing Section 4958 excise taxes against disqualified persons and organization managers begins:
- When the ATEO files the information return (Form 990, Return of Organization Exempt From Income tax, or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax) for the period when the excess benefit transaction occurred, or
  - When the information return is due, whichever is later.

See Sections 6501(b)(1), 6501(b)(4), and 6501(l)(1). See also Treas. Reg. 301.6501(n)-1(a)(1) and 301.6501(n)-1(c).

**Note:** For a discussion of when a tax-exempt organization should file an information return (Form 990 or Form 990-EZ), see section III.B below for more information.

**Note:** The filing of Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code, by a disqualified person or by an organization manager, reporting an excess benefit transaction with an ATEO, doesn't begin the period of limitations for assessing initial excise taxes against the disqualified person or the organization manager. See Treas. Reg. 301.6501(n)-1(b).

- (3) The Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990EZ, isn't a return and doesn't start the statute. See Treas. Regs. 1.6033-2(g)(1)(iii), 1.6033-2(g)(5) and 1.6033-6(c)(4).
- (4) The period of limitations for assessing Section 4958 excise taxes against disqualified persons and organization managers ends either three years or six years after it begins.
- If an ATEO that engaged in an excess benefit transaction with a disqualified person filed an information return (Form 990 or Form 990-EZ) for the period the excess benefit transaction occurred and reported the excess benefit

transaction on this return or in an attached schedule or statement, the period of limitations for assessing Section 4958 excise taxes against a disqualified person or an organization manager is three years. See Section 6501(a), Treas. Reg. 301.6501(a)-1(a) and Treas. Reg. 301.6501(e)-1(c)(3)(ii).

- b. If an ATEO that engaged in an excess benefit transaction with a disqualified person filed an information return (Form 990 or Form 990-EZ) for the period when the excess benefit transaction occurred but didn't report the excess benefit transaction on this return or in an attached schedule or statement, the period of limitations for assessing Section 4958 excise taxes against a disqualified person or an organization manager is six years. See Section 6501(e)(3) and Treas. Reg. 301.6501(e)-1(c)(3)(ii).

**Note:** Examiners must consult their manager and division counsel before making a six-year statute determination.

- (5) **No Limitations Period** - If an ATEO that engaged in an excess benefit transaction with a disqualified person didn't file the required information return (Form 990 or Form 990-EZ) for the period when the excess benefit transaction occurred, no period of limitations for assessing the related excise taxes against a disqualified person or an organization manager exists. See Section 6501(c)(3) and Treas. Reg. 301.6501(n)-1(b).

- a. As stated above, filing the Form 990-N does not start the statute of limitations period and therefore no limitation period exists.

- (6) **Reporting** - An excess benefit transaction is considered reported on an information return (Form 990 or Form 990-EZ), or in a schedule or statement attached to the information return, if it's disclosed in a manner sufficient to apprise the IRS of the existence and nature of the excess benefit transaction with a disqualified person and, if applicable, the participation by an organization manager. See Treas. Reg. 301.6501(e)-1(c)(3)(ii) and Rev. Rul. 69-247, 1969-1 C.B. 303.

- a. The IRS has the burden of proving that the disclosure of information on an information return (or in a schedule or statement attached to the information return) was insufficient to apprise the IRS of the existence and nature of an excess benefit transaction with a disqualified person and the participation by an organization manager.

- (7) Since the period of limitations for assessing Section 4958 excise taxes against a disqualified person or an organization manager is based on the information return (Form 990 or Form 990-EZ) of the ATEO, it's different from the period of limitations for assessing income taxes against a disqualified person or an organization manager. See Section 6501(a).
- (8) The IRS, disqualified persons and organization managers may agree to extend the period of limitations for assessing Section 4958 excise taxes. See Section 6501(c)(4), Treas. Reg. 301.6501(c)-1(d) and IRM 25.6.22, Extension of Assessment Statute of Limitations by Consent (or its successor IRM).

- (9) Section 4958 excise taxes are payable by the disqualified person and the organization manager. The consent must always be obtained from the person upon whom the tax is imposed even though the period of limitations is determined by the due date of the ATEO's return (Form 990 or Form 990-EZ).
- (10) To extend the period of limitations for assessment, use the taxable year of the disqualified person or organization manager, not the ATEO. Use Form 872, Consent to Extend the Time to Assess Tax, or Form 872-A, Special Consent to Extend the Time to Assess Tax, for this purpose. See IRM 25.6.22.6.12 (or its successor).

## G. Correcting an Excess Benefit Transaction

- (1) An excess benefit transaction is corrected by undoing the excess benefit to the extent possible and taking any additional measures necessary to place the ATEO in a financial position not worse than it would be if the disqualified person were dealing under the highest fiduciary standards. See Section 4958(f)(6) and Treas. Reg. 53.4958-7(a).
- (2) In the case of any correction of an excess benefit transaction involving a DAF described in Section 4958(c)(2), no amount repaid may be held in any DAF. See Section 4958(f)(6).

### G.1. Forms of Correction

- (1) In general, a disqualified person corrects an excess benefit only by making a payment in cash or cash equivalents to the ATEO equal to the correction amount. See Treas. Reg. 53.4958-7(b)(1).
- (2) **Promissory Note** - A cash equivalent doesn't include a promissory note.
- (3) **Anti-Abuse** - A disqualified person won't satisfy the correction requirements if the disqualified person engaged in one or more transactions with the ATEO to circumvent the correction requirements so that the disqualified person effectively transferred property other than cash or cash equivalents. See Treas. Reg. 53.4958-7(b)(2).
- (4) **Nonqualified Deferred Compensation** - The disqualified person may correct the undistributed benefits, by relinquishing any right to receive such benefits and any earnings on those benefits, if an excess benefit transaction results from the vesting of benefits under a nonqualified deferred compensation plan. See Treas. Reg. 53.4958-7(b)(3).
- (5) **Return of Specific Property** - With the agreement of the ATEO, 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 equal to the lesser of the fair market value of the property on the date when it's returned to the ATEO or the fair market value of the property on the date the excess benefit transaction occurred. See Treas. Reg. 53.4958-7(b)(4).

- a. 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 ATEO equal to the difference. See Treas. Reg. 53.4958-7(b)(4)(ii).
- b. Excess Payment - If the payment resulting from the return of the property exceeds the correction amount, the ATEO may make a cash payment to the disqualified person equal to the difference. See Treas. Reg. 53.4958-7(b)(4)(ii).
- c. Nonparticipation - Any disqualified person who received an excess benefit from the excess benefit transaction may not participate in the ATEO's decision whether to accept the return of the specific property. See Treas. Reg. 53.4958-7(b)(4)(iii).

## **G.2. Correction Amount**

- (1) The correction amount equals the sum of the excess benefit and interest on the excess benefit. See Treas. Reg. 53.4958-7(c).
- (2) The amount of interest is determined by multiplying the excess benefit by the appropriate interest rate. See Treas. Reg. 53.4958-7(c).
  - a. Interest should be compounded annually.
  - b. Interest should be computed from the date the excess benefit transaction occurred to the date of correction.
  - c. The interest rate should be at least equal to the applicable federal rate (AFR), compounded annually, for the month when the excess benefit transaction occurred.
  - d. 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).
- (3) If the excess benefit transaction arises under a contract that has been partially performed, it isn't required that the contractual relationship be terminated to correct. However, to avoid future excess benefit transactions, the parties may need to modify the terms of any ongoing contract. See Treas. Reg. 53.4958-7(d).

## **G.3. Correction Where the ATEO is No Longer in Existence or Tax-Exempt**

- (1) When the ATEO that engaged in the excess benefit transaction is no longer in existence, or is no longer tax-exempt, correction should be made under the rules provided in Treas. Reg. 53.4958-7(e). The rules specifically address how to



correct when a Section 501(c)(3) or 501(c)(4) organization ceases to exist or is no longer exempt.

- (2) **Section 501(c)(3) organizations** - The disqualified person must pay the correction amount to another Section 501(c)(3) organization exempt from tax under Section 501(a) if the ATEO that engaged in the excess benefit transaction no longer exists or is no longer described in Section 501(c)(3) and exempt from tax under Section 501(a). Payment to another Section 501(c)(3) organization should be in accordance with the ATEO's dissolution clause in its organizing document provided that:
  - a. The recipient organization must be described in Section 170(b)(1)(A) (other than in Section 170(b)(1)(A)(vii) and (viii)) for at least 60 months before the correction date.
  - b. The disqualified person must not also be a disqualified person as to the recipient organization.
  - c. The recipient organization must not allow the disqualified person to make or recommend any grants or distributions. See Treas. Reg. 53.4958-7(e)(2).
  - d. If the organization or organizations named in the dissolution clause don't satisfy the three requirements above, the examiner should consult their manager for guidance.
- (3) **Section 501(c)(4) organizations** – Where the ATEO no longer exists or is no longer described in Section 501(c)(4), the disqualified person must pay the correction amount to:
  - a. A successor Section 501(c)(4) organization
  - b. If a successor tax-exempt organization doesn't exist, to any Section 501(c)(3) or 501(c)(4) organization meeting the three requirements discussed above for Section 501(c)(3) organizations and under Treas. Reg. 53.4958-7(e)(2) except that the requirement of being described in Section 170(b)(1)(A) doesn't apply if the organization is described in Section 501(c)(4)
- (4) Treas. Reg. Section 53.4958-7(f) provides several examples that illustrate the requirements of correction.

## H. Abatement of Tax on Excess Benefit Transactions

- (1) Under certain circumstances, the initial 25% tax may be abated. See Section 4962 and Treas. Reg. 53.4958-1(c)(2)(iii).
- (2) If the excess benefit is corrected within the correction period, then the additional 200% tax must be abated. See Section 4961 and Treas. Reg. 53.4958-1(c)(2)(iii).

### H.1. Correction Period

- (1) The correction period, defined in Section 4963(e),
  - a. Begins when the excess benefit transaction between an ATEO and a disqualified person occurs, and

- b. Ends 90 days after the notice of deficiency mailing date with respect to the 200% tax. See Treas. Reg. 53.4958-1(c)(2)(iii).
- (2) The correction period can be extended by:
  - a. The period when a Tax Court petition is pending, and
  - b. Any other period that the IRS determines is reasonable and necessary to bring about correction of the excess benefit. See Section 4963(e)(1)(B).
- (3) For the IRS to extend the correction period, the following factors ordinarily should be present:
  - a. The taxpayer is actively seeking in good faith to correct the taxable event.
  - b. Adequate corrective action cannot reasonably be expected to result during the unextended correction period.
  - c. The taxable event appears to have been an isolated occurrence so that it appears unlikely that similar taxable events will occur in the future. See Treas. Reg. 53.4963-1(e)(3).

## H.2. Abatement of Initial Tax

- (1) Any initial 25% tax imposed regarding the excess benefit transaction, including interest, may be abated, not assessed, or refunded if the following three requirements are met:
  - a. Correction of the excess benefit within the correction period defined in Section 4963(e), and
  - b. The excess benefit transaction must be due to "reasonable cause", and
  - c. The excess benefit transaction must not be due to "willful neglect." See Section 4962(a)(1).
- (2) If the 25% tax imposed on the disqualified person is abated, the 10% tax imposed on the organization manager is also abated. The abatement of Section 4958 taxes is provided for in Section 4962(a).

**Note:** See IRM 4.70.17.8.4, Requests for Abatement under IRC 4962, (or its successor) for specific procedures when examining abatement requests.

## H.3. Abatement of Additional Tax

- (1) If the disqualified person corrects the excess benefit transaction during the correction period defined in Section 4963(e), the 200% tax must:
  - a. Not be assessed
  - b. Be abated, if assessed, and
  - c. Be credited or refunded, if collected.

See Section 4961.

- (2) Where a disqualified person makes only partial correction of the excess benefit transaction within the correction period, then only the 200% tax regarding the corrected portion of the excess benefit transaction (including interest, additions to the tax, and additional amounts) is abated, refunded or not assessed. See Treas. Regs. 53.4958-1(c)(2)(iii), 53.4963-1, Sections 4961(a) and 4963.

#### H.4. Reasonable Cause and Not Willful Neglect

- (1) Section 4962 doesn't define reasonable cause or willful neglect. However, Treas. Reg. 53.4958-1(d)(6) defines "due to reasonable cause" as exercising responsibility on behalf of the organization with "ordinary business care and prudence." See Treas. Reg. 53.4941(a)-1(b)(5), 301.6651-1(c) and *United States v. Boyle*, 469 U.S. 241 (1985). Determining "reasonable cause" requires a consideration of all the facts and circumstances. See Treas. Reg. Section 301.6651-1(c).
- (2) "Not willful neglect" means that the receipt of the excess benefit wasn't due to the disqualified person's consciousness, intention, or voluntary failure to comply with Section 4958, and that the noncompliance wasn't due to conscious indifference. See Treas. Reg. 53.4958-1(d)(5) and 53.4941(a)-1(b)(4).
  - a. An act is "willful" if it's "voluntary, conscious, and intentional." See Treas. Reg. 53.4958-1(d)(5) and 53.4941(a)-1(b)(4).
  - b. "Negligence" includes any failure to make a reasonable attempt to comply with the law. See Section 6662(c).
  - c. "Willful neglect" implies failure to exercise the care a reasonable person would observe under the circumstances to see that the standards were observed despite knowledge of the standards or rules in question.
- (3) In *United States v. Boyle*, 469 U.S. 241 (1985), the Supreme Court stated that the term "willful neglect" means "a conscious, intentional failure or reckless indifference."

**Note:** Establishing that the disqualified person didn't know that the excess benefit violated Section 4958 doesn't establish the transaction was not due to willful neglect. Additionally, it does not establish that the transaction was due to reasonable cause. The burden of proof is on the taxpayer to demonstrate that they've established the transaction was due to reasonable cause and not willful neglect. The disqualified person must provide a detailed written explanation.

#### I. Revocation and Section 4958 Special Rules

- (1) Section 4958 doesn't affect the substantive standards for exemption under Section 501(c)(3), Section 501(c)(4), or Section 501(c)(29). These include 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. See Treas. Reg. 53.4958-8(a).

- a. 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.
  - b. For example, transactions that are not subject to Section 4958 because of the initial contract exception described in Treas. Reg. 53.4958-4(a)(3) may, under certain circumstances, jeopardize the organization's exempt status.
- (2) The intermediate sanctions for "excess benefit transactions" may be imposed by the IRS in lieu of (or in addition to) revocation of an organization's tax-exempt status. See H. Rep. No. 506, 104th Cong., 2d Sess. 53, 59 (1996).
- (3) In general, the intermediate sanctions are the sole sanction imposed where the excess benefit doesn't rise to a level that calls into question the exempt status of the organization. In practice, revocation of tax-exempt status, with or without the imposition of excise taxes, would only occur when the organization no longer meets the substantive requirements for tax exemption under Section 501(c)(3). See *Ibid*, note 15.
- (4) In determining whether to continue to recognize the tax-exempt status of an ATEO that engages in one or more excess benefit transactions that violates Section 501(c)(3) prohibition on inurement, consider all relevant facts and circumstances (Treas. Reg. 1.501(c)(3)-1(f)(2)(ii)), including, but not limited to, the following:
  - a. The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction(s) occurred,
  - b. 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,
  - c. Whether the organization has been involved in multiple excess benefit transactions with one or more persons,
  - d. Whether the organization has implemented safeguards that are reasonably expected to prevent excess benefit transactions, and
  - e. 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. See Treas. Reg. 1.501(c)(3)-1(f)(2)(ii)(A)-(E).
- (5) All factors should be considered in combination with each other. Depending on the situation, greater or lesser weight may be assigned to some factors than to others. The safeguard and correction factors will weigh more heavily in favor of continuing to recognize exemption, where the organization discovers the excess benefit transaction(s) and acts before the IRS discovers the excess benefit transaction(s). Further, with respect to the correction factor, correction after the excess benefit transaction(s) are discovered by the IRS, by itself, is never a sufficient basis for continuing to recognize exemption. See Treas. Reg. 1.501(c)(3)-1(f)(2)(iii).

- (6) When an examiner proposes both intermediate sanctions under Section 4958 and revocation of the ATEO's exemption based on the same transaction(s), the examiner should consult their manager. Based on the complexity of the case and relevant facts and circumstances involved, the examiner and manager should consider consulting with counsel.
- (7) Two related court cases, *Farr v. Commissioner*, T. C. Memo 2018-2, (2018), aff'd 738 Fed. Appx. 969 (10th Cir. 2018), cert. denied 139 S.Ct. 1263 (2019) and *Association for Honest Attorneys v. Commissioner*, T.C. Memo 2018-41, (2018), appeal dismissed 2018 WL 4998123 (10th Cir. 2018), illustrate the imposition of Section 4958 excise taxes on disqualified persons (Farr) along with a related revocation of tax-exempt status (*Association for Honest Attorneys*).
  - a. In *Farr v. Commissioner*, the court confirmed that the taxpayer, who was chief executive officer of an ATEO and member of the board of directors, was a "disqualified person" during the three taxable years. Additionally, the court determined that Farr was liable for initial taxes under Section 4958(a)(1) as well as the additional taxes under Section 4958(b) because the transactions were not corrected.
  - b. In *Association for Honest Attorneys v. Commissioner*, the court found that during 2010, 2011, and 2012 petitioner did not, through Ms. Farr or anyone else, engage primarily in the activities described in its articles of incorporation and its bylaws. It also found that during 2010, 2011, and 2012 the net earnings of petitioner inured to the benefit of Ms. Farr, its CEO/board president; petitioner operated primarily for the benefit of private rather than public interests; and more than an insubstantial part of petitioner's activities furthered nonexempt, private purposes. Therefore, the court upheld the IRS's decision to revoke petitioner's tax-exempt status based on its finding that it no longer operated in accordance with Section 501(c)(3).

## **J. Penalties**

- (1) This section discusses the various penalties related to the liabilities of excise taxes under Section 4958.

### **J.1. Section 6684 - Assessable Penalties with Respect to Liability for Tax Under Chapter 42**

- (1) A disqualified person or an organization manager is liable for a penalty of 100% of the applicable Section 4958 excise taxes if the disqualified person or organization manager is liable for Section 4958 excise taxes due to an act that isn't due to reasonable cause, and:
  - a. The person was previously liable for chapter 42 excise taxes (other than Sections 4940 or 4948), or
  - b. The act is both willful and flagrant. See Section 6684 and Treas. Reg. 301.6684-1.

### **J.2. Section 6651 - Failure to File Tax Return or To Pay Tax**

- (1) **Failure to Pay** - If a disqualified person (or an organization manager) who is required to file Form 4720 doesn't file Form 4720 on or before the required due date, including extensions of time, a penalty of 5% of the amount of the correct tax under Section 4958 applies if the failure to file isn't more than one month. See Section 6651(a)(1) and Treas. Reg. 301.6651-1(a)(1).
  - a. For each additional month that the disqualified person (or the organization manager) doesn't file Form 4720, a penalty of 5% per month applies but not to exceed 25% in total.
  - b. The penalty wouldn't apply if the disqualified person (or the organization manager) establishes that the failure to file was due to reasonable cause and not due to willful neglect.
- (2) **Failure to Pay** - If a disqualified person (or an organization manager) who is required to file Form 4720 doesn't pay the excise taxes that should have been reported on Form 4720 on or before the required due date, including extensions of time, a penalty of 1/2% of the amount of the correct tax under Section 4958 applies if the failure to pay isn't more than one month. See Section 6651(a)(2) and Treas. Reg. 301.6651-1(a)(2).
  - a. For each additional month that the disqualified person (or the organization manager) doesn't pay the required excise taxes, a penalty of 1/2% per month applies but not to exceed 25% in total.
  - b. The penalty wouldn't apply if the disqualified person (or the organization manager) establishes that the failure to pay was due to reasonable cause and not due to willful neglect.
- (3) The penalty for the failure to file and the penalty for the failure to pay can't exceed 25% in the aggregate. See Section 6651(c)(1).
- (4) **Fraudulent Failure to File** - If the failure to file Form 4720 is fraudulent, the penalty for failure to file Form 4720 is increased from 5% to 15%, and the maximum penalty is increased from 25% to 75%. See Section 6651(f).
- (5) **Substitute for Return (SFR)** - If a disqualified person (or an organization manager) who is required to file Form 4720 doesn't file Form 4720, and the IRS prepares a substitute Form 4720:
  - a. For purposes of the failure to file penalty, the substitute Form 4720 is disregarded and isn't treated as the return filed by the taxpayer.
  - b. However, for purposes of the failure to pay penalty, the substitute Form 4720 is treated as having been filed by the taxpayer and the tax amount due is considered in calculating the penalty.
  - c. See Section 6651(g) and Treas. Reg. 301.6651-1(g).

## K. Additional Guidance

- (1) This section provides additional resources and court cases relating to Section 4958 issues.

### K.1. Court Cases

- (1) In *Caracci v. C.I.R.*, 456 F.3d 444 (5th Cir., 2006), the Appeals court reversed the Tax Court ruling because the record establishes as a matter of law that the taxpayers didn't receive any "net excess benefit" and therefore weren't liable for the excise taxes assessed. The taxpayers brought action against the Commissioner of Internal Revenue challenging deficiency notices finding that the taxpayers received a "net excess benefit" in the amount of \$18.5 million and assessed over \$250 million in excise taxes under Section 4958(a) and (b). The excess benefit was based on a valuation of assets and liabilities transferred when the agencies converted from exempt to nonexempt status.
- (2) In *Farr v. Commissioner*, T. C. Memo 2018-2, (2018), *aff'd* 738 Fed. Appx. 969 (10th Cir. 2018), *cert. denied* 139 S.Ct. 1263 (2019), the court confirmed that the taxpayer, chief executive officer and member of the board of directors of the ATEO, was a "disqualified person" during the three taxable years. Additionally, the court determined that Farr was liable for initial taxes under Section 4958(a)(1) as well as the additional taxes under Section 4958(b) because the transactions were not corrected.
- (3) In *Vincent J. Fumo v. Commissioner*, T.C. Memo 2021-61, (2021), the court held that Petitioner, a former state legislator, "is a "disqualified person" under Section 4958 with respect to a Section 501(c)(3) organization," although he held no title or position within the organization.
  - a. The court stressed that Treas. Reg. 53.4958-3(e)(2) reads that the facts and circumstances tending to show that a person has substantial influence, "include, but are not limited to," the seven factors listed. The court also noted that when the verb "includes" is used in statutes and regulations, it is "non-exclusive." In other words, the court stated because of the term "include," the facts and circumstances considerations are not limited to only the seven factors listed in the regulation.
  - b. The court found that the petitioner in the role of chief fundraiser was an "unlisted factor" that strongly supported, by analogy with the second listed factor (as substantial contributor to the organization), his status as a disqualified person.
  - c. The judge held that petitioner was "in a position to exercise substantial influence over the affairs of an organization" because he:
    - Founded the organization
    - Was a substantial contributor to the organization



- Had or shared authority to determine a substantial portion of its capital expenditures or operating budget
  - Managed a substantial portion of its activities, assets income or expenses
  - Used his status and position within the state legislature to obtain government funding for the organization
- (4) In *Gloria Ononuju v. Commissioner*, T.C.M. 2021-094 (T.C. 2021), the court ruled that the taxpayer engaged in excess benefit transactions under Section 4958 with American Medical Missionary Care, Inc., an organization exempt under Section 501(c)(3). The court made the following conclusion in its analysis of the facts:

a. Applicable Tax-Exempt Organization

Despite the revocation of the organization's exempt status effective January 1, 2014, it was an applicable tax-exempt organization with respect to Section 4958 because it was described in Section 501(c)(3) during the 5-year look-back period before the date of revocation. See Section 4958(e)(2).

b. Disqualified Person

The taxpayer was held to be a disqualified person because she was the spouse of the president and founder of the organization, which makes her a disqualified person under Section 4958(f)(1)(B). The court chose not to further analyze if the taxpayer was a disqualified person by reason of her status as an officer and director of the organization.

c. Excess Benefit Transactions

The examiner identified multiple payments to the taxpayer from two of the organization's bank accounts totaling \$115,000 during the year under examination. The taxpayer was unable to establish that the payments were compensation for services or that they were used to further the exempt purposes of the organization. The court ruled that \$15,000 in payments paid for health insurance coverage wasn't an excess benefit transaction because the taxpayer's husband was an employee of the organization and therefore the benefit was a nontaxable fringe benefit.

d. Failure to File/Pay Penalties

The court also confirmed that the taxpayer was liable for the failure to file and failure to pay penalties for not filing the Form 4720 or paying the tax due. The court stated that a taxpayer's belief that no return is required, and ignorance of the law isn't sufficient to establish reasonable cause for failure to file a return.

## K.2. Non-precedential Guidance

**Note:** The following Private Letter Rulings (PLR) and Technical Advice Memorandums (TAM) discuss Section 4958 issues. These rulings are based



solely on the facts presented by the taxpayer and applies only to those specific set of facts. Per Section 6110(k)(3), these documents may not be cited as precedent by IRS or other taxpayers. However, the information in these rulings provide the government's position on issues and can assist with developing a fact pattern for a revenue agent's report.

- (1) PLR 202133014 (August 20, 2021) ruled, in part, that the taxpayer's sale of subsidiary shares to Organization at fair market value and taxpayer's restricted grant to Organization of certain assets and the remaining subsidiary shares will not result in an excess benefit transaction under Section 4958(c)(1).
- (2) PLR 201825004 (June 22, 2018) provided, based on the facts presented, the foundation's reclassification to a private foundation and the payments made to the beneficiaries pursuant to the settlement agreement will not constitute an excess benefit transaction under Section 4958.
- (3) PLR 201336020 (September 6, 2013) responds to the taxpayer's request for a ruling about whether a particular person was a disqualified person. The doctor never acted as a department head, didn't manage any substantial part of the hospital's operations, and didn't participate in any management decisions affecting either the hospital or a hospital department. The ruling stated that the doctor, at all times relevant to the transaction, was not a disqualified person to the taxpayer or its affiliates within the meaning of Section 4958(f)(1) at any time on or after the effective date of his employment agreement with the taxpayer.
- (4) PLR 201133013 (August 19, 2011) provides guidance to a taxpayer that is exempt under Section 501(c)(3) with a foundation status of 509(a)(3) but wishes to convert to a private foundation. In part, the ruling provides that the conversion should not give rise to excise taxes under Section 4958 because the supported charity, which will receive funds as part of the conversion, is not a disqualified person and the conversion does not involve the transfer of funds to a disqualified person.
- (5) PLR 201133012 (August 19, 2011) provides guidance to a supported organization where the supporting organization wishes to convert to a private foundation. The taxpayer requested a ruling regarding the effect under Section 4958 on the supported organization or any of its directors, officers or employees who were involved in the conversion and related transactions. Based on the facts, the supported organization is not a disqualified person, nor does the conversion transfer funds to a disqualified person, and therefore, the conversion does not give rise to an excise tax liability under Section 4958.
- (6) TAM 200435020 (August 27, 2004) provides that A and his relatives expended funds of X, and used X assets, in a variety of ways. The ruling provided, in part, that A was liable for excise tax under Section 4958. See also TAMs 200435018, 200435019, 200435021 and 200435022 issued to A's relatives.
- (7) PLR 200421010 (May 21, 2004) is a request that, in part, asks if the participation of T, C, D1 and D2, with S1 and S2, in an arrangement providing for joint use of office space would be an excess benefit transaction under Section 4958. Based on the representations that expenses will be allocated and paid at fair market value to

S1, the participation of T, C, D1 and D2 with S1 and S2 will not result in excess benefit transactions between the parties. The ruling also provides that the joint utilization of common employee services, including secretary, receptionist, accounting staff, administrative assistant, and insurance doesn't constitute an excess benefit transaction under the provided fact pattern.

- (8) PLR 200335037(August 29, 2003) stated that the benefit received by P & Q from grants made to M by B & C were not excess benefit transaction in part because P & Q were not disqualified persons under Section 4958. The ruling also stated that any benefit received by P & Q would be too incidental and tenuous to be quantifiable under Section 4958.
- (9) PLR 200332018 (August 8, 2003) provides M, a private foundation, and N, a supporting organization, created a program to award scholarships to students in State X. In addition, M and N involved State X community foundations in the scholarship program process by allowing the community foundations to participate in the scholarship program selection process. The ruling provides that when a family member of a director or officer of a community foundation is selected as a scholarship recipient by N, it is not an excess benefit transaction if the director or officer recuses him or herself from the selection process.
- (10) PLR 200247055 (November 22, 2002) stated that F, an exempt hospital, is operating a free transportation service that is open to the public, meets a need for patients who are living in remote areas and in need of transportation to the hospital or other facilities in the service area and doesn't restrict the eligibility requirement to certain classes of individuals. Board members or others in a position of authority in relation to F can use the bus service on the same basis as any other member of the public. Under the circumstances in the ruling, the disqualified persons are not receiving an excess benefit from the use of the bus service where the use is to the same level as similarly situated members of the public.
- (11) PLR 200243057 (October 25, 2002) provides an analysis of multiple types of excess benefit transactions between C, a Section 501(c)(3) organization, founded by B. C's purpose was to allow individuals to donate their used vehicles for a tax deduction. C operated on the same premises of F, which was a used car lot owned by D, son of B. Excess benefit transactions included payments for compensation, undocumented loans, rent, and insurance as well as the value of furnishing an automobile and payment more than fair market value for towing.

### **III. Examination Techniques**

- (1) This section will assist examiners in identifying, developing, and resolving Section 4958 issues.

#### **A. Identifying and Developing Section 4958 Issues**

- (1) The following audit steps can help identify and develop issues leading to excise taxes under Section 4958:

- a. Review Form 990 for items that could indicate issues. Information on the Form 990 to consider for possible Section 4958 issues includes:

- Part IV, Line 6: If the organization maintains DAFs, see section II.C.8 above for special rules under Section 4958 for DAFs.

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**Part IV Checklist of Required Schedules**

	Yes	No
<b>6</b> Did the organization maintain any donor advised funds or any similar funds or accounts for which donors have the right to provide advice on the distribution or investment of amounts in such funds or accounts? If "Yes," complete Schedule D, Part I . . . . .		

- Part IV, Line 25a and b: If the organization reported excess benefit transactions, review Schedule L, Transaction with Interested Persons, and examine the transactions to ensure required excise taxes have been reported and correction has been made.
- Part IV, Line 26: Loans to or from disqualified persons should be analyzed.
- Part IV, Line 27: Examine whether any grants or other assistance provided an excess benefit for a disqualified person.
- Part IV, Line 28a – c: Review transactions reported here and on Schedule L for possible excess benefits.

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**Part IV Checklist of Required Schedules (continued)**

	Yes	No
<b>25a</b> <b>Section 501(c)(3), 501(c)(4), and 501(c)(29) organizations.</b> Did the organization engage in an excess benefit transaction with a disqualified person during the year? If "Yes," complete Schedule L, Part I . . . . .		
<b>b</b> Is the organization aware that it engaged in an excess benefit transaction with a disqualified person in a prior year, and that the transaction has not been reported on any of the organization's prior Forms 990 or 990-EZ? If "Yes," complete Schedule L, Part I . . . . .		
<b>26</b> Did the organization report any amount on Part X, line 5 or 22, for receivables from or payables to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons? If "Yes," complete Schedule L, Part II . . . . .		
<b>27</b> Did the organization provide a grant or other assistance to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor or employee thereof, a grant selection committee member, or to a 35% controlled entity (including an employee thereof) or family member of any of these persons? If "Yes," complete Schedule L, Part III . . . . .		
<b>28</b> Was the organization a party to a business transaction with one of the following parties (see the Schedule L, Part IV, instructions for applicable filing thresholds, conditions, and exceptions):		
<b>a</b> A current or former officer, director, trustee, key employee, creator or founder, or substantial contributor? If "Yes," complete Schedule L, Part IV . . . . .		
<b>b</b> A family member of any individual described in line 28a? If "Yes," complete Schedule L, Part IV . . . . .		
<b>c</b> A 35% controlled entity of one or more individuals and/or organizations described in line 28a or 28b? If "Yes," complete Schedule L, Part IV . . . . .		

- Part VI, Line 5: A significant diversion of assets can be an indicator of an excess benefit transaction.

- Part VI, Line 15: This information can provide details on how the organization determines compensation of key employees.

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**Part VI Governance, Management, and Disclosure.** For each "Yes" response to lines 2 through 7b below, and for a "No" response to line 8a, 8b, or 10b below, describe the circumstances, processes, or changes on Schedule O. See instructions. Check if Schedule O contains a response or note to any line in this Part VI ☐

<b>5</b>	Did the organization become aware during the year of a significant diversion of the organization's assets?	<b>5</b>		
<b>15</b>	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?			
<b>a</b>	The organization's CEO, Executive Director, or top management official	<b>15a</b>		
<b>b</b>	Other officers or key employees of the organization	<b>15b</b>		

If "Yes" to line 15a or 15b, describe the process on Schedule O. See instructions.

- Part VII, Column (D): Note compensation for persons listed

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**Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors**

Check if Schedule O contains a response or note to any line in this Part VII ☐

**Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees**

**1a** Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the ☐ Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC/1099-NEC)	(E) Reportable compensation from related organizations (W-2/1099-MISC/1099-NEC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(1)										

- Part VIII, Statement of Revenues: Are there amounts reported for Rents (Line 6) or from sales of assets other than inventory (Line 7) that may be transactions with disqualified persons?

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**Part VIII Statement of Revenue**

Check if Schedule O contains a response or note to any line in this Part VIII ☐

				(A) Total revenue	(B) Related or exempt function revenue	(C) Unrelated business revenue	(D) Revenue excluded from tax under sections 512-514
<b>1a</b> Federated campaigns				<b>1a</b>			
<b>Part VIII</b>	<b>6</b>	<b>a</b>	(i) Real	(ii) Personal			
		<b>b</b>					
		<b>c</b>					
	<b>d</b>	Net rental income or (loss)					
	<b>7</b>	<b>a</b>	(i) Securities	(ii) Other			
		<b>b</b>					
		<b>c</b>					
	<b>d</b>	Net gain or (loss)					

- Part IX, Line 5, Column (A): Is compensation of officers, directors, trustees, and key employees a significant percentage of total expenses on line 25?
- Part IX, Line 6, Column (A): Note compensation to disqualified persons not reported on Line 5 above.
- Part IX, Line 9, Column (A): Are other employee benefits a significant percentage of total expenses on line 25?

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**Part IX Statement of Functional Expenses**

Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).

Check if Schedule O contains a response or note to any line in this Part IX ☐

**Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.**

	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
1 Grants or other assistance to domestic organizations				
5 Compensation of current officers, directors, trustees, and key employees				
6 Compensation not included above to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
7 Other salaries and wages				
8 Pension plan accruals and contributions (include section 401(k) and 403(b) employer contributions)				
9 Other employee benefits				

- Part X, Lines 5 and 6: Note loans and receivables including the beginning and ending balances. Were these also reported on Schedule L?
- Part X, Line 22: Note loans and other liabilities to disqualified persons including the beginning and ending balances. Were these also reported on Schedule L?

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**Part X Balance Sheet**

Check if Schedule O contains a response or note to any line in this Part X ☐

		(A) Beginning of year	(B) End of year
5	Loans and other receivables from any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons		
6	Loans and other receivables from other disqualified persons (as defined under section 4958(f)(1)), and persons described in section 4958(c)(3)(B)		
7	Notes and loans receivable, net		
22	Liabilities: Loans and other payables to any current or former officer, director, trustee, key employee, creator or founder, substantial contributor, or 35% controlled entity or family member of any of these persons		
23	Secured mortgages and notes payable to unrelated third parties		

- Schedule A, Line 12: If the organization is a supporting organization under Section 509(a)(3), see section II.C.9 above for special rules for supporting organizations.



**SCHEDULE A  
(Form 990)**

Department of the Treasury  
Internal Revenue Service

**Public Charity Status and Public Support**

Complete if the organization is a section 501(c)(3) organization or a section 4947(a)(1) nonexempt charitable trust.

Attach to Form 990 or Form 990-EZ.

Go to [www.irs.gov/Form990](http://www.irs.gov/Form990) for instructions and the latest information.

OMB No. 1545-0047

**2022**

**Open to Public  
Inspection**

Name of the organization

Employer identification number

**Part I Reason for Public Charity Status.** (All organizations must complete this part.) See instructions.

The organization is not a private foundation because it is: (For lines 1 through 12, check only one box.)

- 1** ☐ A church, convention of churches, or association of churches described in **section 170(b)(1)(A)(i).**
- 12** ☐ An organization organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more publicly supported organizations described in **section 509(a)(1)** or **section 509(a)(2).** See **section 509(a)(3).** Check the box on lines 12a through 12d that describes the type of supporting organization and complete lines 12e, 12f, and 12g.
- a** ☐ **Type I.** A supporting organization operated, supervised, or controlled by its supported organization(s), typically by giving the supported organization(s) the power to regularly appoint or elect a majority of the directors or trustees of the supporting organization. **You must complete Part IV, Sections A and B.**
- b** ☐ **Type II.** A supporting organization supervised or controlled in connection with its supported organization(s), by having control or management of the supporting organization vested in the same persons that control or manage the supported organization(s). **You must complete Part IV, Sections A and C.**
- c** ☐ **Type III functionally integrated.** A supporting organization operated in connection with, and functionally integrated with, its supported organization(s) (see instructions). **You must complete Part IV, Sections A, D, and E.**
- d** ☐ **Type III non-functionally integrated.** A supporting organization operated in connection with its supported organization(s) that is not functionally integrated. The organization generally must satisfy a distribution requirement and an attentiveness requirement (see instructions). **You must complete Part IV, Sections A and D, and Part V.**
- e** ☐ Check this box if the organization received a written determination from the IRS that it is a Type I, Type II, Type III functionally integrated, or Type III non-functionally integrated supporting organization.
- f** Enter the number of supported organizations . . . . .
- g** Provide the following information about the supported organization(s).

(i) Name of supported organization	(ii) EIN	(iii) Type of organization (described on lines 1–10 above (see instructions))	(iv) Is the organization listed in your governing document?		(v) Amount of monetary support (see instructions)	(vi) Amount of other support (see instructions)
			Yes	No		

- Schedule L: Organizations are required to report transactions with interested parties including excess benefit transaction, loans, grants, assistance, and business transactions.

**SCHEDULE L  
(Form 990)**

Department of the Treasury  
Internal Revenue Service

**Transactions With Interested Persons**

Complete if the organization answered "Yes" on Form 990, Part IV, line 25a, 25b, 26, 27, 28a, 28b, or 28c, or Form 990-EZ, Part V, line 38a or 40b.

Attach to Form 990 or Form 990-EZ.

Go to [www.irs.gov/Form990](http://www.irs.gov/Form990) for instructions and the latest information.

OMB No. 1545-0047

**2022**

**Open to Public  
Inspection**

Name of the organization

Employer identification number

**Part I Excess Benefit Transactions** (section 501(c)(3), section 501(c)(4), and section 501(c)(29) organizations only).

Complete if the organization answered "Yes" on Form 990, Part IV, line 25a or 25b, or Form 990-EZ, Part V, line 40b.

1	(a) Name of disqualified person	(b) Relationship between disqualified person and organization	(c) Description of transaction	(d) Corrected?	
				Yes	No

**Part II Loans to and/or From Interested Persons.**

Complete if the organization answered "Yes" on Form 990-EZ, Part V, line 38a or Form 990, Part IV, line 26; or if the organization reported an amount on Form 990, Part X, line 5, 6, or 22.

(a) Name of interested person	(b) Relationship with organization	(c) Purpose of loan	(d) Loan to or from the organization?		(e) Original principal amount	(f) Balance due	(g) In default?		(h) Approved by board or committee?		(i) Written agreement?	
			To	From			Yes	No	Yes	No	Yes	No

**Part III Grants or Assistance Benefiting Interested Persons.**

Complete if the organization answered "Yes" on Form 990, Part IV, line 27.

(a) Name of interested person	(b) Relationship between interested person and the organization	(c) Amount of assistance	(d) Type of assistance	(e) Purpose of assistance
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**Part IV Business Transactions Involving Interested Persons.**

Complete if the organization answered "Yes" on Form 990, Part IV, line 28a, 28b, or 28c.

(a) Name of interested person	(b) Relationship between interested person and the	(c) Amount of transaction	(d) Description of transaction	(e) Sharing of organization's
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- Schedule J: Organizations report additional compensation information for officers, directors, trustees, key employees, and highly compensated employees that could be indicators of Section 4958 issues.

**SCHEDULE J**  
(Form 990)Department of the Treasury  
Internal Revenue Service

Name of the organization

**Compensation Information**

For certain Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

Complete if the organization answered "Yes" on Form 990, Part IV, line 23. Attach to Form 990.

Go to [www.irs.gov/Form990](http://www.irs.gov/Form990) for instructions and the latest information.

OMB No. 1545-0047

**2022****Open to Public Inspection**

Employer identification number

**Part I Questions Regarding Compensation**Yes ☐ No ☐

- b. Review salaries paid to those controlling the organization and to other key employees. To determine if they're reasonable, consider factors such as:
- Duties performed
  - Amount and type of responsibility
  - Time devoted to duties
  - Special knowledge and experience
  - Individual ability
  - Previous training
  - Compensation paid in prior years
  - Prevailing economic conditions
  - Living conditions of the particular locality
  - The type of activities carried out by the organization and its size
- c. Reconcile salaries the organization paid to employees to wages on Forms W-2, Wage and Tax Statement of the employees. What was included in taxable income?
- d. Request copies of employment contracts or compensation packages as deemed pertinent. Check the date and the specific compensation the organization intended to pay.
- e. Review disbursements. Look for payment of expenses to or for the benefit of an officer or employee that aren't reported as wages on Forms W-2.

- f. Consider the status of the recipients to determine who meets the various criteria of an insider, an outsider, or a disqualified person with respect to the organization.
- g. Review other compensation amounts, including fringe benefits. Determine if they're excludable from the recipient's gross income under Section 132 or includible under Section 61. Look closely at reimbursements such as travel expenses. Was the payment made under a non-accountable plan? If so, determine if the amounts paid meet the ordinary and necessary requirements of Section 162. Was the amount included on Forms W-2?
- h. Analyze loans between the organization and disqualified persons. Are these bona fide loans? Are the terms of the loan being adhered to?
- i. Determine if any sales or exchanges of property occurred. If so, were any insiders, disqualified persons, foundation managers involved? Was the sale or exchange at fair market value?
- j. Analyze the composition of the organization's assets. Did an insider, disqualified person, foundation manager have personal use of any of them? For example, did any of them use a vehicle for both personal and business travel? If used for personal use, was an amount included on the Forms W-2?
- k. Examine fund-raising agreements to determine if they're at arm's length. Consider the method of raising funds and whether this income is subject to unrelated business income tax. Does the fund-raiser exercise control over the organization in any way?
- l. Determine if any entities are related to the exempt organization. Analyze the structure of any transactions between the related entities and the exempt organization. Are they at arm's length, at fair market value, exclusive?
- m. Use the Lead Sheet, M. Excess Benefit Transactions Lead Sheet, available on the Exempt Organization Resources Knowledge Base under the Compliance Tools Book to assist in developing Section 4958 issues. The lead sheet is also included in the exhibits below.

## **A.1. Determining the Value of an Excess Benefit Transaction**

- (1) One of the most difficult audit issues is determining if an excess benefit transaction has occurred. Determining the value of the transaction, itself, will help decide if the transaction meets the criteria for an excess benefit transaction.
  - a. In general, excess benefit transactions involve the transfer of property or payments for services.
  - b. If the issue is property (including the right to use property), Treas. Reg. 53.4958-4(b)(1)(i) notes that the value is fair market value for purposes of Section 4958.
  - c. If the issue is compensation, the value is the amount that would ordinarily be paid for like services by like enterprises under like circumstances, otherwise



known as “reasonable compensation.” Section 162 standards apply in determining reasonableness of compensation. See Treas. Reg. 53.4958-4(b)(1)(ii)(A).

- (2) To determine a property’s fair market value, the examiner may want to consider a referral to Engineering. Request Engineering help as early in the issue development as possible. See IRM 4.70.16.4, Requesting Technical Assistance from Specialists (or its successor).
- (3) To determine if an excess benefit transaction has occurred, take into account all consideration and benefits exchanged between a disqualified person and the ATEO as well as any entities it controls. However, generally economic benefits that are excluded from income under Section 132 are disregarded for purposes of Section 4958. See Treas. Reg. 53.4958-4(a)(4).
- (4) Examples of economic benefits included in determining the value of services rendered and whether the compensation is reasonable are:
  - a. Cash and non-cash compensation (salary, fees, bonuses, severance payments, deferred compensation)
  - b. Payment of liability insurance premiums
  - c. Other payments on behalf of the disqualified person (penalties, tax expenses, civil proceeding expenses, expenses resulting from an act or failure to act)
  - d. Other compensatory benefits (expense allowances or reimbursements paid under a non-accountable plan, such as travel or auto expenses)
  - e. Foregone or below-market interest on loans

See Treas. Reg. 53.4958-4(b)(1)(ii)(b).

## **A.2. Factors for determining a bona-fide loan**

- (1) When an ATEO transfers money to a disqualified person and indicates it’s a loan, we must first determine whether the transfer is a bona-fide loan. Generally, whether the transfer of funds from one party to another is a loan, or some other kind of transfer, such as a gift, dividend, or compensation, depends on the intent of the parties.
- (2) The courts have provided factors to consider when analyzing loans. In *Vinikoor v. Commissioner*, T.C. Memo 1998-152, the Tax Court identified the following nine factors to consider for analyzing loans:
  - a. the existence or absence of loan documents
  - b. whether interest was charged
  - c. security or collateral
  - d. a fixed maturity date
  - e. whether a demand for payment was ever made

- f. any actual payment
  - g. the purported borrower's ability to repay the loan
  - h. evidence in the lender's and borrower's books and records that the transfer was treated as a loan and
  - i. how the transaction was reported for tax purposes
- (3) The factors listed above aren't exclusive, and no one factor is controlling. For example, in *Vinikoor*, the promissory notes had no amortization schedule and no minimum payment.
  - (4) All the relevant facts and circumstances must be considered when evaluating whether a bona-fide loan exists. For example, consider whether a schedule for payments was created, actual repayments were made, and any consequences if the repayment schedule wasn't honored. In addition, the organization's records and returns should reflect the indebtedness.
  - (5) Another factor to consider is whether the organization received any other economic benefit. The value received by the disqualified person must exceed the value, or consideration, paid by the organization.
  - (6) Loan proceeds may not be the only economic benefit that the disqualified person received. If the disqualified person hasn't been paying interest, or paid below-market interest, the disqualified person has received a measurable economic benefit from the organization in the form of forgone interest. The forgone interest transfers occur annually regardless of whether any actual funds change hands.
  - (7) Even if transfers of funds were bona-fide loans, an organization providing loans to disqualified persons may still constitute inurement because it serves a private rather than a public interest. See *Treas. Reg. 1.501(c)(3)-1(d)(ii)*. In *Founding Church of Scientology v. United States*, 412 F.2d 1197 (Ct. Cl. 1969), the court held, "Indeed, the very existence of a private source of loan credit from an organization's earnings may itself amount to inurement of benefit." Examiners should consider whether the organization's exempt purpose is furthered by the loans. If not, then the examiner should consider whether the loans constitute inurement that would justify proposing revocation.
  - (8) In *Lowry Hospital Association v. Commissioner*, 66 T.C. 850, 857-859 (1976), which involved an exempt hospital founded by Dr. Lowry, the court held that the hospital didn't qualify as tax-exempt under Section 501(c)(3) because some of the net earnings inured to the benefit of the founding physician. The court noted, "While the interest rate received by the petitioner on the unsecured loans was roughly equivalent to the interest rate it was receiving or could have received on passbook deposits from the local bank at the time the loan was made, the nursing home loans represented a substantially greater risk." The court concluded that the exempt hospital executed loans that weren't in its own best interest or made on an arm's-length basis.

### **A.3. Other Section 4958 Issues**

- (1) Though not all-inclusive, the list below shows examples of transactions between an ATEO and disqualified person that could raise Section 4958 issues:
  - a. Exempt organization's payment of a disqualified person's personal expenses
  - b. Disqualified person's use of the exempt organization's vehicles for personal reasons
  - c. Disqualified person's use of the exempt organization's real property for personal reasons
  - d. Disqualified person's lease of property to the exempt organization in exchange for rent
  - e. Whether amounts the disqualified person received from the exempt organization are loans
  - f. Whether amounts the disqualified person received from the exempt organization are loan repayments
  - g. Exempt organization's payment of personal expenses for a disqualified person's family members
  - h. Exempt organization's payments to a for-profit corporation owned by the disqualified person
  - i. Disqualified person embezzled funds from an exempt organization
  - j. Exempt organization and disqualified person revenue-sharing arrangements
  - k. Exempt organization's transfer of assets to or from a for-profit organization controlled by the disqualified person

### **B. Required Returns**

- (1) Generally, an ATEO must file either Form 990, Return of Organization Exempt From Income Tax or Form 990-EZ, Short Form Return of Organization Exempt From Income Tax.
  - a. An ATEO that engaged in an excess benefit transaction with a disqualified person should report the excess benefit transaction and the amount of the initial 25% tax imposed on the disqualified person on an information return (Form 990 or Form 990-EZ) for the period when the excess benefit transaction occurred, as required by the form and the applicable instructions. See Sections 6033(b)(11), 6033(b)(12), 6033(b)(13) and 6033(f) and Treas. Reg. 1.6033-2.
  - b. If an organization manager knowingly participated in an excess benefit transaction between an ATEO and a disqualified person, the ATEO should also report the excess benefit transaction and the amount of the initial 10% tax imposed on the organization manager on an information return (Form 990 or Form 990-EZ) for the period when the excess benefit transaction occurred,

as required by the form and the applicable instructions. See Sections 6033(b)(11), 6033(b)(12), 6033(b)(13) and 6033(f). See also Treas. Reg. 1.6033-2.

(2) Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC

- a. A disqualified person, who engaged in an excess benefit transaction and is liable for the initial 25% tax, is required to file Form 4720 to report the excess benefit transaction and pay the excise tax on or before the 15<sup>th</sup> day of the fifth month after the end of the disqualified person's tax year. See Section 6011(a), Treas. Reg. 53.6011-1(b) and Treas. Reg. 53.6071-1(f).
- b. An organization manager who knowingly participated in an excess benefit transaction is liable for the 10% tax and required to file Form 4720 to report and pay the excise tax on or before the 15th day of the fifth month after the end of the organization manager's tax year. See Section 6011(a), Treas. Reg. 53.6011-1(b) and Treas. Reg. 53.6071-1(f).

(3) Substitute Form 4720/4720-A

- a. If a disqualified person (or an organization manager) who is required to file Form 4720 doesn't file Form 4720, the IRS may prepare a substitute Form 4720 (4720-A). See Section 6020(b) and Treas. Reg. 301.6020-1(b).
- b. Beginning with tax year 2020, Form 4720 has been revised to identify whether the filer is the exempt organization or an individual. Accordingly, for tax years after 2019, an examiner preparing Form 4720 to report individual excise tax liability during an examination will no longer convert Form 4720 to "Form 4720-A." The examiner will, instead, complete Form 4720 identifying the filer as an individual as described in the instructions for the Forms 4720. See the instructions to the Form 4720 for further information.
- c. A substitute Form 4720 prepared by the IRS is a valid Form 4720 for all legal purposes. See Section 6020(b)(2) and Treas. Reg. 301.6020-1(b)(2).
- d. See IRM 20.1.2 (or its successor), the penalty handbook for failure to file and failure to pay penalties and the specific procedures that must be followed when preparing deficiency notices in substitute for return situations.
- e. The failure to pay penalty shouldn't be computed with respect to both the initial and additional excise tax amounts. Per Section 6651(a)(1), the penalty for failure to file applies only to "the amount required to be shown as tax on such return." Per Section 6651(a)(2), as applicable here, the penalty for failure to pay applies to "the amount shown as tax on any return." The additional tax under Section 4958(b) isn't a tax that is reported on any tax return. The Form 4720, which includes a line item for reporting Section 4958(a)(1) initial taxes, doesn't include a line item to report Section 4958(b) additional taxes. As such, Section 6651(a)(1) and Section 6651(a)(2) penalties should be computed based only on the initial (Section 4958(a)(1)) tax.

## C. Practical Example

- (1) The example below provides a case scenario and illustrates how the issues were resolved.

### C.1. Case Facts

- (1) Orchid Charity is tax-exempt under Section 501(c)(3) and classified as a public charity described in Section 509(a)(2).
- (2) Mr. Hosta, Orchid's President, has exclusive signature authority over Orchid's checking account
- (3) Orchid is on a calendar year and timely filed its Forms 990 each year.
- (4) It was selected for examination for its 2020 tax year. Review of the Form 990 shows the following:
  - a. The Treasurer's brother was paid compensation of \$50,000.
  - b. An independent contractor was paid \$25,000 for professional services.
  - c. An outstanding loan to Mr. Hosta of \$10,000 from 2010.
- (5) Mr. Hosta used Orchid's checking account to make purchases and cash withdrawals totaling \$41,000 during the 2020 tax year.
  - a. \$10,000 was paid to his son's private school for tuition
  - b. \$25,000 was paid for cruise tickets for him and his wife
  - c. \$2,000 was paid for genealogical testing for him and immediate family members
  - d. \$4,000 dollars was withdrawn by him with no explanation
  - e. Mr. Hosta claims the purchases and cash withdrawals were compensation and repayment of a loan.
  - f. Neither Orchid nor Mr. Hosta were able to supply any reasonable business purpose for the purchases and withdrawals. The amounts weren't reported as compensation on either Form W-2 or Form 1099 and they weren't included on the organization's Forms 941, Employer's Quarterly Federal Tax Return. Mr. Hosta didn't report them on his personal income tax return. Promissory notes payable weren't executed. Nor were any interest payments made.
  - g. The examiner determined these transactions should be treated as excess benefit transactions. The transactions are between an ATEO and a disqualified person. In addition, they appear to be of a personal nature and weren't clearly treated as compensation. Orchid has no documentation to support that these were valid business expenses or that they, in any way, further its exempt purposes. Therefore, all elements of an excess benefit transaction have been met.

- (6) Orchid's books and records reflect a loan to Mr. Hosta in the amount of \$10,000.
- a. The loan appeared on the books on June 15, 2010, and the loan amount has remained unchanged.
  - b. The \$10,000 is still reported as a loan receivable on the Form 990.
  - c. No payments, interest or principal, have been received on the loan.
  - d. The examiner asked for a loan agreement or other documentation reflecting the terms between Orchid and Mr. Hosta. Both stated that it was an oral agreement but have no explanation as to why principal or interest repayments haven't been made.
  - e. The examiner determined the loan should be treated as an excess benefit transaction. The organization has included this loan on the books as a receivable. However, the alleged loan has no other standard characteristics of a loan conducted at arm's length such as periodic principal and interest payments or a written loan document explaining terms.
- (7) As shown on the return, Orchid paid the treasurer's brother \$50,000 in compensation.
- a. Per discussions with Orchid and written documentation of employment terms, the brother has significant duties and works 8 hours per day four days a week.
  - b. Before setting his compensation, the organization considered amounts paid for comparable work by other similarly situated organizations.
  - c. The compensation has been reported on a W-2, 990 and 941 each year as well as on the brother's personal income tax return.
  - d. Based on the facts, the examiner determined the payments to the brother are reasonable compensation and not an excess benefit. An exempt organization is treated as clearly indicating its intent to treat an economic benefit as compensation if it provides written substantiation that is contemporaneous with the transfer of the particular benefit. In this case, Orchid has provided sufficient written substantiation for the compensation paid.
- (8) Orchid purchased a used car for \$5,000 in 2020 from a body shop owned by the former vice president.
- a. The written purchase agreement details the year, make, model and condition of the vehicle.
  - b. The fair market value price is around \$6,000.
  - c. When the examiner reviewed operations, it appeared that the car is used frequently for exempt activities and isn't used for personal reasons.

- d. The purchase was recorded on EO's books and Form 990.
- e. The examiner determined this wasn't an excess benefit transaction because the car was purchased at arm's length and was used by the organization for exempt activities.

## C.2. Statute of Limitations Considerations

### (1) Purchases and Cash Withdrawals

- a. Since the purchases and cash withdrawals occurred during the 2020 year, the statute of limitations on those transaction is May 15, 2024, which is 3 years after the filing of the 2020 Form 990 by Orchid.

**Note:** See II.F.5, Statute of Limitations above for discussion on how the statute is determined.

### (2) Loan

- a. Section 4958 excise taxes can't be assessed against the initial loan since the initial transaction occurred in the 2010 tax year, and the statute of limitations has expired for that period.
- b. However, any unpaid interest in the 2020 tax year would be within the statute of limitations.

## C.3. Excise Tax Calculations

- (1) The below worksheet lists the excess benefit transactions in this example. This spreadsheet shows the initial taxes on the disqualified person of 25% as well as the 10% tax on the disqualified person in his capacity as an organization manager. It also shows the additional tax of 200% to be assessed on the disqualified person if correction isn't made.

Excess Benefit Transactions				Section 4958(a)(1)	Section 4958(a)(2)	Section 4958(b)
Date	Check #	Transaction	Amount	25%	10%	200%
1/12/2020	204	Mr. Hosta's son's tuition	\$ 10,000.00	\$ 2,500.00	\$ 1,000.00	\$ 20,000.00
4/30/2020	516	Cruise for Mr. Hosta & Spouse	\$ 25,000.00	\$ 6,250.00	\$ 2,500.00	\$ 50,000.00
6/15/2020	606	Genealogy Testing	\$ 2,000.00	\$ 500.00	\$ 200.00	\$ 4,000.00
7/1/2020		Cash Withdrawal	\$ 4,000.00	\$ 1,000.00	\$ 400.00	\$ 8,000.00
1/1/2020		Interest on loan	\$ 411.38	\$ 102.85	\$ 41.14	\$ 822.76
		<b>Totals</b>	<b>\$ 41,411.38</b>	<b>\$ 10,352.85</b>	<b>\$ 4,141.14</b>	<b>\$ 82,822.76</b>
		Interest	657.18	#		
		<b>Correction Amount</b>	<b>\$ 42,068.56</b>			
		# Calculate at AFR from EBT dates until correction date				

## C.4. Revenue Agent Report

- (1) An initial examination report or formal examination report may be issued. See IRM 4.70.14, Resolving the Examination, (or its successor) for requirements for each report.
- (2) See the following sample forms that may be required in the examination report, showing the initial taxes under Section 4958(a)(1) and organization manager taxes under Section 4958(a)(2) using the scenario above and assuming the taxpayer has corrected the transaction.

<b>Exempt Organizations - Report of Examination</b> <i>(Proposed Tax Changes)</i>					
1. Form No. 4720		2. Area Office		3. Date of Report 9/10/2021	
4. Name and Address of Taxpayer Mr. Hosta Address			5. Name and Address of Private Foundation or Other Exempt Organization <i>(if different from Item 4)</i> Orchid Charity Orchid Address		
6. Social Security Number or Employer Identification Number  Mr. Hosta's SSN		7. Tax Period(s) Ended 12/31/2020		8. Private Foundation's or other Exempt Organization's Employer Identification Number <i>(if different from Item 6)</i>  Orchid's EIN	
				9. Tax Period(s) Ended 12/31/20	
10. Report Preparer's Name Revenue Agent				11. Agreement Secured <i>(Check one.)</i> Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with <i>(Name and Title)</i> Mr. Hosta				13. Agreement Date	
14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4958(a)(1)	2020	10,352.85			
4958(a)(2)	2020	4,141.14			
15. Remarks See explanation on Form 886-A.					
16. Attachments Form 886-A and 870-E					



## Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Mr. Hosta		Employer ID No. Mr. Hosta SSN	Schedule or Exhibit	
Name of Exempt Organization (if different from taxpayer) Orchid Charity				
		<b>Taxable Years Ended</b>		
		12/31/2020	12/31/2020	
Internal Revenue Code Section for Proposed Adjustment		4958(a)(1)	4958(a)(2)	
1. Adjustments	Excess Benefit Transactions	41,411.38	41,411.38	
2.	Total Adjustments	41,411.38	41,411.38	
3.	Amount reported on return or as previously adjusted			
4.	Total amount as corrected	41,411.38	41,411.38	
5.	Applicable tax rate %	25	10	
6.	Initial tax liability as corrected (line 4 x line 5)	10,352.85	4,141.14	
7.	Initial tax liability reported			
8.	Increase or (decrease) in tax	10,352.85	4,141.14	
9.	Additional tax (minimum)			
10.	Penalties (Code section _____)			

Explanation of Adjustments

Assessment of applicable IRC 4958 taxes. See Form 886-A for further explanation.



Form 870-E (Rev. 1-2004)	Department of the Treasury-Internal Revenue Service <b>Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment</b>	Date received by Internal Revenue Service
Name of Taxpayer, Address (Number, street, city or town) State, ZIP Code Mr. Hosta Address		Social Security or Employer Identification Number Mr. Hosta's SSN
In regards to:	Name of Private Foundation or Other Exempt Organization Orchid Charity	

Increase (Decrease) in Tax and Penalties			
Taxable Year Ended	Internal Revenue Code Section	Amount of Tax	Penalty
12/31/2020	4958(a)(1)	10,352.85	
12/31/2020	4958(a)(2)	4,141.14	

### Consent to Assessment and Collection

I consent to the immediate assessment and collection of any deficiencies (increase in tax and penalties) against (1) the exempt organization named above, or (2) me, as a manager of a private foundation or other exempt organization named above, or (3) me, as a disqualified person with respect to the exempt organization named above, and accept any overassessment (decrease in tax and penalties) shown above, plus any interest provided by law. I understand that by signing this waiver, I will not be able to contest these years in the United States Tax Court, unless additional deficiencies are determined for these years.

Disqualified Person's, Foundation or Organization Manager's Signature	Date
Taxpayer's Representative's Signature	Date

Corporate/Trust/Partnership Organization Name

Authorized Official	Signature	Title	Date
Authorized Official	Signature	Title	Date

Form **870-E** (Rev. 1-2004)

Catalog Number 16898M

Department of the Treasury-Internal Revenue Service  
www.irs.gov

- (3) See the below sample forms that may be required in the examination report, showing the initial taxes under Section 4958(a)(1), organization manager taxes under Section 4958(a)(2) and additional taxes under Section 4958(b) using the scenario above and assuming the taxpayer has NOT corrected the transaction.

<b>Exempt Organizations - Report of Examination</b> <i>(Proposed Tax Changes)</i>					
1. Form No. 4720		2. Area Office		3. Date of Report 9/10/2021	
4. Name and Address of Taxpayer Mr. Hosta Address			5. Name and Address of Private Foundation or Other Exempt Organization (If different from Item 4) Orchid Charity Orchid Address		
6. Social Security Number or Employer Identification Number  Mr. Hosta's SSN		7. Tax Period(s) Ended 12/31/2020		8. Private Foundation's or other Exempt Organization's Employer Identification Number (If different from Item 6)  Orchid's EIN	
9. Tax Period(s) Ended 12/31/20					
10. Report Preparer's Name Revenue Agent				11. Agreement Secured (Check one.) Yes <input type="checkbox"/> No <input type="checkbox"/>	
12. Findings Discussed with (Name and Title) Mr. Hosta				13. Agreement Date	
14a. Summary of Proposed Adjustments				14b. Penalty	
Internal Revenue Code Section (1)	Period Covered by Examination (2)	Amount of Tax (3)	Additional Tax (4)	Internal Revenue Code Section (1)	Amount (2)
4958(a)(1)	2020	10,352.85			
4958(a)(2)	2020	4,141.14			
4958(b)	2020	82,522.76			
15. Remarks See explanation on Form 886-A.					
16. Attachments Form 886-A and 870-E					

## Exempt Organizations Excise Tax Audit Changes

(Chapter 41, Chapter 42, and Section 170(f)(10)(F) Excise Taxes)

Name of Taxpayer Mr. Hosta	Employer ID No. Mr. Hosta SSN	Schedule or Exhibit
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Name of Exempt Organization (if different from taxpayer)  
Orchid Charity

		Taxable Years Ended		
		12/31/2020	12/31/2020	12/31/2020
Internal Revenue Code Section for Proposed Adjustment		4958(a)(1)	4958(a)(2)	4958(b)
1. Adjustments	Excess Benefit Transactions	41,411.38	41,411.38	41,411.38
2.	Total Adjustments	41,411.38	41,411.38	41,411.38
3.	Amount reported on return or as previously adjusted			
4.	Total amount as corrected	41,411.38	41,411.38	41,411.38
5.	Applicable tax rate %	25	10	200
6.	Initial tax liability as corrected (line 4 x line 5)	10,352.85	4,141.14	82,822.76
7.	Initial tax liability reported			
8.	Increase or (decrease) in tax	10,352.85	4,141.14	82,822.76
9.	Additional tax (minimum)			
10.	Penalties (Code section _____)			

### Explanation of Adjustments

Assessment of applicable IRC 4958 taxes. See Form 886-A for further explanation.

[illegible]

Form 870-E (Rev. 1-2004)	Department of the Treasury-Internal Revenue Service <b>Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment</b>	Date received by Internal Revenue Service
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Name of Taxpayer, Address (Number, street, city or town) State, ZIP Code Mr. Hosta Address	Social Security or Employer Identification Number Mr. Hosta's SSN
--	--

In regards to:	Name of Private Foundation or Other Exempt Organization Orchid Charity
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Increase (Decrease) in Tax and Penalties			
Taxable Year Ended	Internal Revenue Code Section	Amount of Tax	Penalty
12/31/2020	4958(a)(1)	10,352.85	
12/31/2020	4958(a)(2)	4,141.14	
12/31/2020	4958(b)	82,822.76	

### Consent to Assessment and Collection

I consent to the immediate assessment and collection of any deficiencies (increase in tax and penalties) against (1) the exempt organization named above, or (2) me, as a manager of a private foundation or other exempt organization named above, or (3) me, as a disqualified person with respect to the exempt organization named above, and accept any overassessment (decrease in tax and penalties) shown above, plus any interest provided by law. I understand that by signing this waiver, I will not be able to contest these years in the United States Tax Court, unless additional deficiencies are determined for these years.

Disqualified Person's, Foundation or Organization Manager's Signature	Date
Taxpayer's Representative's Signature	Date

Corporate/Trust/Partnership Organization Name			
Authorized Official	Signature	Title	Date
Authorized Official	Signature	Title	Date

## IV. Exhibits

### A. Exhibit 1: Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC

- (1) As stated above, a disqualified person who engages in an excess benefit transaction under Section 4958 is required to file Form 4720 to report the transactions and initial taxes under Section 4958(a)(1).
- (2) Additionally, an organization manager must file the Form 4720 to report the tax under Section 4958(a)(2).
- (3) Below are highlighted sections of the Form 4720, pages 1, 5 and 6 which include items that must be completed when reporting excise taxes under IRC 4958.

#### a. Form 4720, page 1

Form <b>4720</b>		Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code (Sections 170(f)(10), 664(c)(2), 4911, 4912, 4941, 4942, 4943, 4944, 4945, 4955, 4958, 4959, 4960, 4965, 4966, 4967, and 4968) Go to <a href="http://www.irs.gov/Form4720">www.irs.gov/Form4720</a> for instructions and the latest information.		OMB No. 1545-0047 <b>2022</b>
Department of the Treasury Internal Revenue Service		For calendar year 2022 or other tax year beginning , 2022, and ending , 20		
Name of organization, entity, or person subject to tax		EIN or SSN		
Number, street, and room or suite no. (or P.O. box if mail is not delivered to street address)		<input type="checkbox"/> Amended return		
City or town, state or province, country, and ZIP or foreign postal code		Check box for type of annual return: <input type="checkbox"/> Form 990 <input type="checkbox"/> Form 990-EZ <input type="checkbox"/> Form 990-PF <input type="checkbox"/> Other <input type="checkbox"/> Form 5227		
				<b>Yes</b> <b>No</b>
<b>A</b> Is the organization a foreign private foundation within the meaning of section 4948(b)? . . . . .				
Show conversion rate to U.S. dollars. See instructions . . . . .				
<b>B</b> <b>Entity (other than the organization) or person subject to tax:</b> Are you required to file Form 4720 with respect to more than one organization in the current tax year? See instructions . . . . .				
If "Yes," attach a list showing the name and EIN for each organization with respect to which you will file Form 4720 for the current tax year.				
<b>Part I Taxes on Organization</b> (Sections 170(f)(10), 664(c)(2), 4911(a), 4912(a), 4942(a), 4943(a), 4944(a)(1), 4945(a)(1), 4955(a)(1), 4959, 4960(a), 4965(a)(1), 4966(a)(1), and 4968(a))				
1	Tax on undistributed income—Schedule B, line 4 . . . . .	1		
2	Tax on excess business holdings—Schedule C, line 7 . . . . .	2		
3	Tax on investments that jeopardize charitable purpose—Schedule D, Part I, column (f) . . . . .	3		
4	Tax on taxable expenditures—Schedule E, Part I, column (h) . . . . .	4		
5	Tax on political expenditures—Schedule F, Part I, column (f) . . . . .	5		
6	Tax on excess lobbying expenditures—Schedule G, line 4 . . . . .	6		
7	Tax on disqualifying lobbying expenditures—Schedule H, Part I, column (e) . . . . .	7		
8	Tax on premiums paid on personal benefit contracts . . . . .	8		
9	Tax on being a party to prohibited tax shelter transactions—Schedule J, Part I, column (h) . . . . .	9		
10	Tax on taxable distributions—Schedule K, Part I, column (f) . . . . .	10		
11	Tax on a charitable remainder trust's unrelated business taxable income. Attach statement . . . . .	11		
12	Tax on failure to meet the requirements of section 501(r)(3)—Schedule M, Part II, line 2 . . . . .	12		
13	Tax on excess executive compensation—Schedule N . . . . .	13		
14	Tax on net investment income of private colleges and universities—Schedule O . . . . .	14		
15	<b>Total</b> (add lines 1–14) . . . . .	15		
<b>Part II Taxes on a Manager, Self-Dealer, Disqualified Person, Donor, Donor Advisor, or Related Person</b> (Sections 4912(b), 4941(a), 4944(a)(2), 4945(a)(2), 4955(a)(2), 4958(a), 4965(a)(2), 4966(a)(2), and 4967(a))				
Name and address of related organization; city or town, state or province, country, ZIP or foreign postal code		Employer identification number		
1	Tax on self-dealing—Schedule A, Part II, column (d); and Part III, column (d) . . . . .	1		
2	Tax on investments that jeopardize charitable purposes—Schedule D, Part II, column (d) . . . . .	2		
3	Tax on taxable expenditures—Schedule E, Part II, column (d) . . . . .	3		
4	Tax on political expenditures—Schedule F, Part II, column (d) . . . . .	4		
5	Tax on disqualifying lobbying expenditures—Schedule H, Part II, column (d) . . . . .	5		
6	<b>Tax on excess benefit transactions—Schedule I, Part II, column (d); and Part III, column (d) . . . . .</b>	<b>6</b>		
7	Tax on being a party to prohibited tax shelter transactions—Schedule J, Part II, column (d) . . . . .	7		
8	Tax on taxable distributions—Schedule K, Part II, column (d) . . . . .	8		



b. Form 4720, page 5, Schedule I, Part I

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**SCHEDULE G—Tax on Excess Lobbying Expenditures (Section 4911)**

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**SCHEDULE I—Initial Taxes on Excess Benefit Transactions (Section 4958)**

**Part I Excess Benefit Transactions and Tax Computation**

(a) Transaction number	(b) Date of transaction	(c) Correction made?		(d) Description of transaction
		Yes	No	
1				
2				
3				
4				
5				
(e) Amount of excess benefit		(f) Initial tax on disqualified persons (25% of col. (e))		(g) Tax on organization managers (if applicable) (lesser of \$20,000 or 10% of col. (e))

Form **4720** (2022)

c. Form 4720, page 6, Schedule I, Parts II and III

Form 4720 (2022) Page **6**

**SCHEDULE I—Initial Taxes on Excess Benefit Transactions (Section 4958) Continued**

**Part II Summary of Tax Liability of Disqualified Persons and Proration of Payments**

(a) Names of disqualified persons liable for tax	(b) Trans. no. from Part I, col. (a)	(c) Tax from Part I, col. (f), or prorated amount	(d) Disqualified person's total tax liability (add amounts in col. (c)) (see instructions)

**Part III Summary of Tax Liability of 501(c)(3), (c)(4) & (c)(29) Organization Managers and Proration of Payments**

(a) Names of 501(c)(3), (c)(4) & (c)(29) organization managers liable for tax	(b) Trans. no. from Part I, col. (a)	(c) Tax from Part I, col. (g), or prorated amount	(d) Manager's total tax liability (add amounts in col. (c)) (see instructions)

**SCHEDULE J—Taxes on Being a Party to Prohibited Tax Shelter Transactions (Section 4965)**

**Part I Prohibited Tax Shelter Transactions (TST) and Tax Imposed on the Tax-Exempt Entity (see instructions)**

## A.1. Completing Form 4720, Specific Instructions

**Note:** The instructions below are specific to reporting excess benefit transactions under Section 4958 and do not necessarily apply to other Chapter 42 taxes. See Instructions for Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the IRC, for full instructions on completing the Form 4720.

- (1) On the top of page 1 of the Form 4720, the disqualified person or manager must complete the name, address, SSN, type of return and questions A and B.
  - a. A disqualified person or manager filing a separate Form 4720 enters his or her name, address, and taxpayer identification number at the top of the form. The name and address of the related tax-exempt organization is not entered here, instead it is entered in Part II as discussed below.
  - b. The person must also check "Other" in the box for type of annual return filed.
  - c. In answering Question A, the person answers "Yes" or "No" depending on whether the related organization, identified in Part II, is a foreign private foundation under Section 4948(b).
  - d. Finally, the person must check "Yes" to Question B if the person is reporting and paying excise tax relating to more than one organization on the Form 4720. If "Yes," the person must attach a list with the name and EIN for each organization.

<b>Form 4720</b> Department of the Treasury Internal Revenue Service	<b>Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code</b> (Sections 170(f)(10), 664(c)(2), 4911, 4912, 4941, 4942, 4943, 4944, 4945, 4955, 4958, 4959, 4960, 4965, 4966, 4967, and 4968) Go to <a href="http://www.irs.gov/Form4720">www.irs.gov/Form4720</a> for instructions and the latest information.	OMB No. 1545-0047  <div style="font-size: 2em; font-weight: bold;">2022</div>									
For calendar year 2022 or other tax year beginning _____, 2022, and ending _____, 20											
Name of organization, entity, or person subject to tax		EIN or SSN									
Number, street, and room or suite no. (or P.O. box if mail is not delivered to street address)		<input type="checkbox"/> Amended return									
City or town, state or province, country, and ZIP or foreign postal code		Check box for type of annual return: <input type="checkbox"/> Form 990 <input type="checkbox"/> Form 990-EZ <input type="checkbox"/> Form 990-PF <input checked="" type="checkbox"/> Other									
		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="width: 80%;"></th> <th style="width: 10%; text-align: center;">Yes</th> <th style="width: 10%; text-align: center;">No</th> </tr> <tr> <td><b>A</b> Is the organization a foreign private foundation within the meaning of section 4948(b)? Show conversion rate to U.S. dollars. See instructions . . . . .</td> <td style="text-align: center;"></td> <td style="text-align: center;"></td> </tr> <tr> <td><b>B</b> Entity (other than the organization) or person subject to tax: Are you required to file Form 4720 with respect to more than one organization in the current tax year? See instructions . . . . . If "Yes," attach a list showing the name and EIN for each organization with respect to which you will file Form 4720 for the current tax year.</td> <td style="text-align: center;"></td> <td style="text-align: center;"></td> </tr> </table>		Yes	No	<b>A</b> Is the organization a foreign private foundation within the meaning of section 4948(b)? Show conversion rate to U.S. dollars. See instructions . . . . .			<b>B</b> Entity (other than the organization) or person subject to tax: Are you required to file Form 4720 with respect to more than one organization in the current tax year? See instructions . . . . . If "Yes," attach a list showing the name and EIN for each organization with respect to which you will file Form 4720 for the current tax year.		
	Yes	No									
<b>A</b> Is the organization a foreign private foundation within the meaning of section 4948(b)? Show conversion rate to U.S. dollars. See instructions . . . . .											
<b>B</b> Entity (other than the organization) or person subject to tax: Are you required to file Form 4720 with respect to more than one organization in the current tax year? See instructions . . . . . If "Yes," attach a list showing the name and EIN for each organization with respect to which you will file Form 4720 for the current tax year.											
<b>Part I Taxes on Organization</b> (Sections 170(f)(10), 664(c)(2), 4911(a), 4912(a), 4942(a), 4943(a), 4944(a)(1), 4945(a)(1),											

- (2) On Part II, Taxes on a Manager, Self-Dealer, Disqualified Person, Donor, Donor Advisor, or Related Person, the disqualified person or manager reports information on the related tax-exempt organization and the amount of tax due under Section 4958(a)(1) and (a)(2).
- The person enters the name, address, and employer identification number of the tax-exempt organization with respect to the tax owed under Section 4958 as a disqualified person.
  - On Line 6, the person enters the tax on the excess benefit transactions under Section 4958. They must enter the sum of:
    - Taxes owed as a disqualified person, from Schedule I, Part II, column (d), and
    - Tax owed as an organization manager who knowingly participated in a transaction that was an excess benefit transaction, from Schedule I, Part III, column (d).

15 Total (add lines 1–14) . . . . .		15
<b>Part II Taxes on a Manager, Self-Dealer, Disqualified Person, Donor, Donor Advisor, or Related Person</b> (Sections 4912(b), 4941(a), 4944(a)(2), 4945(a)(2), 4955(a)(2), 4958(a), 4965(a)(2), 4966(a)(2), and 4967(a))		
Name and address of related organization; city or town, state or province, country, ZIP or foreign postal code		Employer identification number
1	Tax on self-dealing—Schedule A, Part II, column (d); and Part III, column (d) . . . . .	1
2	Tax on investments that jeopardize charitable purposes—Schedule D, Part II, column (d) . . . . .	2
3	Tax on taxable expenditures—Schedule E, Part II, column (d) . . . . .	3
4	Tax on political expenditures—Schedule F, Part II, column (d) . . . . .	4
5	Tax on disqualifying lobbying expenditures—Schedule H, Part II, column (d) . . . . .	5
6	Tax on excess benefit transactions—Schedule I, Part II, column (d); and Part III, column (d) . . . . .	6
7	Tax on being a party to prohibited tax shelter transactions—Schedule J, Part II, column (d) . . . . .	7
8	Tax on taxable distributions—Schedule K, Part II, column (d) . . . . .	8
9	Tax on prohibited benefits—Schedule L, Part II, column (d); and Part III, column (d) . . . . .	9
10	Total—Add lines 1 through 9 . . . . .	10
<b>Part III Tax Payments</b>		

- (3) The disqualified person or organization manager calculates the excise taxes on Schedule I, Initial Taxes on Excess Benefit Transactions (Section 4958) on pages 5 and 6 of the Form 4720.
- (4) In Part I of Schedule I, Excess Benefit Transactions and Tax Computation, the person:
- Enters the date of each transaction in column (b),
  - If, when the return is filed, the disqualified person has corrected, in whole or part, any acts or transactions resulting in liability for tax under Chapter 42, they will answer “Yes,” in column (c) and provide the following information separately for each transaction:
    - A detailed description of any correction made
    - The date of each correction
    - For partial correction, an explanation stating why complete correction hasn’t been made

- c. For any acts or transactions, the disqualified persons have not corrected, they must check "No" in column (c) and provide the following information separately for each transaction:
- Detailed explanation of why correction hasn't been made
  - Explanation of what steps are being taken to make the correction.
- d. Lists each transaction in column (d),
- e. Enters the amount of the excess benefit in column (e),
- f. Enters the tax on the excess benefit for disqualified persons, computed in Part II, in column (f) and
- g. Enters the tax on the excess benefit for organization managers, computed in Part III, in column (g).

SCHEDULE I—Initial Taxes on Excess Benefit Transactions (Section 4958)				
Part I Excess Benefit Transactions and Tax Computation				
(a) Transaction number	(b) Date of transaction	(c) Correction made?		(d) Description of transaction
		Yes	No	
1				
2				
3				
4				
5				
(e) Amount of excess benefit		(f) Initial tax on disqualified persons (25% of col. (e))		(g) Tax on organization managers (if applicable) (lesser of \$20,000 or 10% of col. (e))

Form 4720 (2022)

- (5) In Part II, Summary of Tax Liability of Disqualified Persons and Proration of Payments, of the Schedule I, the disqualified person liable for initial taxes under Section 4958(a)(1) enters:
- The names of all disqualified person involved in the transaction,
  - The transaction number from the list of transactions in Schedule I, Part I,
  - The tax to be paid by each disqualified person, and
- Note:** If more than one disqualified person took part in an excess benefit transaction, each is individually liable for the entire tax on the transaction. But the disqualified persons who are liable for the tax may prorate the payment among themselves.
- The total of the tax liability from column (c) for each disqualified person.

**SCHEDULE I—Initial Taxes on Excess Benefit Transactions (Section 4958) Continued**

<b>Part II Summary of Tax Liability of Disqualified Persons and Proration of Payments</b>			
(a) Names of disqualified persons liable for tax	(b) Trans. no. from Part I, col. (a)	(c) Tax from Part I, col. (f), or prorated amount	(d) Disqualified person's total tax liability (add amounts in col. (c)) (see instructions)

- (6) In Schedule I, Part III, Summary of Tax Liability of 501(c)(3), (c)(4) & (c)(29) Organization Managers and Proration of Payments, the organization manager who knowingly took part in the excess benefit transactions listed in Schedule I, Part I enters:

- The names of all organization managers who took part in the transaction,
- The transaction number from the list of transactions in Schedule I, Part I,
- The tax to be paid by each organization manager,

**Note:** If more than one manager knowingly took part in an excess benefit transaction, each is individually liable for the entire tax in connection with the transaction. But the managers liable for the tax may prorate the payment among themselves.

- The total of the tax liability reported in column (c) for each organization manager.

<b>Part III Summary of Tax Liability of 501(c)(3), (c)(4) &amp; (c)(29) Organization Managers and Proration of Payments</b>			
(a) Names of 501(c)(3), (c)(4) & (c)(29) organization managers liable for tax	(b) Trans. no. from Part I, col. (a)	(c) Tax from Part I, col. (g), or prorated amount	(d) Manager's total tax liability (add amounts in col. (c)) (see instructions)

**SCHEDULE I Taxes on Being a Party to Prohibited Tax Shelter Transactions (Section 4065)**

## B. Exhibit 2: Excess Benefit Transactions Lead Sheet

This lead sheet can be used to assist in working cases that may involve excess benefit transactions under Section 4958. The lead sheet, M. Excess Benefit Transactions Lead Sheet, can be found on the Exempt Organizations Resources Knowledge Base on the Resources and Job Aids shelf in the Compliance Tools Book, Lead Sheets Chapter and Technical Lead Sheets page under the Other Related Resources box on the right of the page.

Excess Benefit Transaction Lead Sheet				
Tax Period	Per Return	Per Exam	Adjustment	Reference
<b>Conclusion:</b>				
<p><i>The following techniques are not intended to be all-inclusive nor are they mandatory steps to be followed. Judgment should be used in selecting the techniques that apply to each taxpayer.</i></p>				
<b>Audit Steps:</b>				<b>Workpaper Reference</b>
<p>An excess benefit transaction (EBT) is a transaction in which an economic benefit is provided by an applicable tax-exempt organization (ATEO), directly or indirectly, to or for the use of a disqualified person (DP), and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization. If an IRC 4958 excess benefit transaction has been identified during the exam, determine the following:</p>				
1. Identify the basis of the EBT (for example, loans, assets used for collateral, exchange of compensation and other compensatory benefits).				
2. Identify the ATEOs and DPs involved in the EBT.				
3. Determine the date the EBT occurred.				
4. Determine the reasonableness, value and timing of the consideration received in EBTs.				

<b>Excess Benefit Transaction Lead Sheet</b>	
5. Apply the protections and semi-safe harbor rules of Section 4958	
6. Compute the applicable taxes: a. IRC 4958(a)(1) 1 <sup>st</sup> Tier 25% Tax b. IRC 4958(a)(2) Organization Manager 10% tax c. IRC 4958(b) 2 <sup>nd</sup> Tier 200% tax d. IRC 4958(d)(1) Joint and Severally Liable	
7. Identify all organization managers that may be jointly and severally liable for the Section 4958(a)(2) tax. See Section 4958(d)(1) and Treas. Reg. 53.4958-1(d)(8).	
8. Consider the maximum aggregate amount of 10% tax (i.e., \$20,000) that may be imposed on all organization managers who knowingly participated in an EBT for each EBT. See Section 4958(d)(2).	
9. Determine the taxable period of the EBT. See Section 4958(f)(5) and Treas. Reg. 53.4958-1(c)(2)(ii).	
10. Determine whether participation by an organization manager is due to reasonable cause. a. Document organization manager's activities concerning the EBT b. Determine if organization manager exercised ordinary business care and prudence. See Treas. Reg. 53.4958-1(d)(6).	
11. Consider the "exceptions" to Section 4958: a. Fixed payments under an "initial contract" b. Certain "disregarded benefits" c. Certain payments under ERISA d. Existing Binding Contracts prior to September 13, 1995 e. Existing Arrangements with Supporting Organizations Prior to August 17, 2006	
12. Verify that the value of economic benefits for purposes of Section 4958, the value of property, including the right to use the property, is its fair market value. See Treas. Reg. 53.4958-4(b)(1)(i).	
13. Determine the <i>reasonableness of compensation</i> . Consider all <i>economic benefits</i> provided by the ATEO in exchange for the performance of services included, except for disregarded economic benefits under Treas. Reg. 53.4958-4(b)(1)(ii)(B).	
14. Review written contemporaneous evidence that may be used to demonstrate that the appropriate decision-making body, or an officer authorized to approve compensation, approved a transfer as compensation (for e.g., employment contracts).	



Excess Benefit Transaction Lead Sheet	
15. Determine whether an ATEO's failure to report an economic benefit as required under the Internal Revenue Code is due to reasonable cause; the organization will be treated as having clearly indicated its intent to provide an economic benefit as compensation for services.	
16. If the ATEO establishes a rebuttable presumption, as described in Treas. Reg. 53.4958-6(a), determine if the following requirements are satisfied: <ul style="list-style-type: none"> <li>a. The arrangement is approved by the organization's board (authorized body);</li> <li>b. The board relies on appropriate data as to the comparability of the compensation or fair market value of the consideration; and,</li> <li>c. Contemporaneous documentation is made of the determination of the board or committee.</li> </ul>	
17. To rebut the presumption established by the ATEO: <ul style="list-style-type: none"> <li>a. Developed sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body.</li> <li>b. With respect to any <b>fixed payment</b>, limit the rebuttal evidence to the facts and circumstance existing on the date the parties enter into the contract pursuant to which the payment is made.</li> <li>c. With respect to all <b>other payments</b> (including non-fixed payments subject to a cap), rebuttal evidence may include facts and circumstances up to and including the date of payment. See Treas. Reg. 53-4958-6(b).</li> </ul>	
18. Verify whether the EBT was corrected by the DP; consider the following: <ul style="list-style-type: none"> <li>a. Determine the correction method</li> <li>b. Gather and review source documentation to support correction</li> <li>c. Determine correction amount. See Treas. Reg. 53.4958-7(c)</li> <li>d. Determine correction period. See IRC 4963 and Treas. Reg. 53.4963-1</li> <li>e. Document explanations for any uncorrected EBT</li> </ul>	
19. Consider the circumstances in which the 25% tax may be abated; and, where the 200% tax must be abated. See Sections 4961 and 4962 and Treas. Reg. 53.4958-1(c)(2)(iii).	
20. In initiating and conducting any inquiry or examination into whether an EBT has occurred between a Church and a DP, be sure to follow the procedures set forth in Section 7611. See Treas. Reg. 53.4958-8(b).	



Excess Benefit Transaction Lead Sheet	
21. Determine the statute of limitations applicable to Section 4958 excise taxes and complete and secure any necessary agreement to extend the period of limitations for assessment using Form 872 (Consent to Extend the Time to Assess Tax). Be sure to use the taxable period of the DP or organization manager, not the taxable period of the ATEO. See Sections 6501(e)(3) and 6501(l).	
22. Secure delinquent/substitute returns (Forms 4720), as applicable. a. Determine whether applicable penalties should be assessed. b. Consider reasonable cause as appropriate.	
23. Determine whether the organization's tax-exempt status should be revoked. Factors to consider: a. The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the EBT, b. The size and scope of the EBT(s) (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes, c. Whether the organization has been involved in multiple EBT's with one or more persons, d. Whether the organization has implemented safeguards that are reasonably calculated to prevent EBT's, and e. Whether the EBT has been corrected, or the organization has made good faith efforts to seek correction from the DP(s) who benefited from the EBT.	
24. If both intermediate sanctions under Section 4958 and revocation of the ATEO's exemption is proposed based on the same transaction(s), you should consult with TEGE Division Counsel regarding the Section 4958 issues.	
<b>Facts:</b> <i>(Document the relevant facts.)</i>	
<b>Law:</b> <i>(Tax Law, Regulations, court cases, and other authorities)</i>	
IRC Section: 4958	
Specific citations:	
<b>Taxpayer Position:</b> <i>(If applicable)</i>	