

Publication 557

Tax-Exempt Status for Your Organization

(Rev. January 2025)

For use in preparing

2025 Returns

Volume 7 of 8



Get forms and other information faster and easier at:

- [IRS.gov](https://www.irs.gov) (English)
- [IRS.gov/Korean](https://www.irs.gov/Korean) (한국어)
- [IRS.gov/Spanish](https://www.irs.gov/Spanish) (Español)
- [IRS.gov/Russian](https://www.irs.gov/Russian) (Русский)
- [IRS.gov/Chinese](https://www.irs.gov/Chinese) (中文)
- [IRS.gov/Vietnamese](https://www.irs.gov/Vietnamese) (Tiếng Việt)



Publication 557 (Rev 1 2025) Catalog Number 39343U
Department of the Treasury **Internal Revenue Service** www.irs.gov

Visit the Accessibility
Page on [IRS.gov](https://www.irs.gov)

This page is intentionally left blank

These include employees:

1. Who haven't completed 3 years of service,
2. Who haven't attained age 21,
3. Who are seasonal or less than half-time employees,
4. Who aren't in the plan and who are included in a unit of employees covered by a collective bargaining agreement if the class of benefits involved was the subject of good faith bargaining, or
5. Who are nonresident aliens and who receive no earned income from the employer that has United States sourced income.

Highly compensated individual. A highly compensated individual is one who:

1. Owned 5% or more of the employer at any time during the current year or the preceding year,
2. Received more than \$125,000 in compensation from the employer for the preceding year (the amount is annualized for inflation. Go to IRS.gov, and search "Pension Plan Limitation" for the year), and
3. Was among the top 20% of employees by compensation for the preceding year.

However, the employer can choose not to have (3) apply.

Aggregation rules. The employer can choose to treat two or more plans as one plan for purposes of meeting the nondiscrimination requirements.

Employees of controlled groups of corporations, trades, or businesses under common control, or members of an affiliated service group, are treated as employees of a single employer. Leased employees are treated as employees of the recipient.

One employee. A trust created to provide benefits to one employee won't qualify as a voluntary employees' beneficiary association under section 501(c)(9).

Supplemental Unemployment Benefit Trusts (501(c)(17))

A trust or trusts forming part of a written plan (established and maintained by an employer, the employees, or both) providing solely for the payment of supplemental unemployment compensation benefits must file the application for recognition of exemption on Form 1024. The trust must be a valid, existing trust under local law and must be evidenced by an executed document.

A conformed copy of the plan of which the trust is a part should be attached to the application.

To be complete, an application must include a copy of the document (such as the trust instrument) by which the organization was created; a full description of the benefits available to participants and the terms and conditions of eligibility for benefits (usually contained in a plan document); and, if providing benefits pursuant to a collective bargaining agreement, a copy of that agreement.

Note. Under section 4976, the reversion of funds from a section 501(c)(17) organization to the employer who created the supplemental unemployment benefit trust may subject the employer to a 100% penalty excise tax on the amount of the reversion.

Notice requirement. An organization won't be considered tax exempt under this section unless the organization gives notice to the

IRS that it is applying for recognition of exempt status. The organization gives notice by filing Form 1024. If the notice isn't given by 15 months after the end of the month in which the organization was created, the organization won't be exempt for any period before such notice is given. An extension of time for filing the notice is granted under the same procedures as those described for section 501(c)(3) organizations in chapter 3 under *Application for Recognition of Exemption*.

Types of payments. You must show that the supplemental unemployment compensation benefits will be benefits paid to an employee because of the employee's involuntary separation from employment (whether or not the separation is temporary) resulting directly from a reduction-in-force, discontinuance of a plant or operation, or other similar conditions. In addition, sickness and accident benefits

(but not vacation, retirement, or death benefits) may be included in the plan if these are subordinate to the unemployment compensation benefits.

Diversion of funds. It must be impossible under the plan (at any time before the satisfaction of all liabilities with respect to employees under the plan) to use or to divert any of the corpus or income of the trust to any purpose other than the payment of supplemental unemployment compensation benefits (or sickness or accident benefits to the extent just explained).

Discrimination in benefits. Neither the terms of the plan nor the actual payment of benefits can be discriminatory in favor of the company's officers, stockholders, supervisors, or highly paid employees. However, a plan isn't discriminatory merely because benefits bear a uniform relationship to compensation or the rate of compensation.

Prohibited transactions and exemption. If your organization is a supplemental unemployment benefit trust and has received a denial of exemption because it engaged in a prohibited transaction, as defined by section 503(b), it can file a claim for exemption in any tax year following the tax year in which the notice of denial was issued. It must file the claim on Form 1024. The organization must include a written declaration that it won't knowingly again engage in a prohibited transaction. An authorized principal officer of your organization must make this declaration under the penalties of perjury.

If your organization has satisfied all requirements as a supplemental unemployment benefit trust described in section 501(c)(17), it will be notified in writing that it has been recognized as exempt. However, the organization will be exempt only for those tax years after the tax year in which the claim for exemption

(Form 1024) is filed. Tax year in this case means the established annual accounting period of the organization or, if the organization has not established an annual accounting period, the calendar year. For more information about the requirements for re-establishing an exemption previously denied, contact the IRS.

501(c)(12) - Local Benevolent Life Insurance Associations, Mutual Irrigation and Telephone Companies, and Like Organizations

Each of the following organizations apply for recognition of exemption from federal income tax by filing Form 1024.

1. Benevolent life insurance associations of a purely local character and like organizations.

2. Mutual ditch or irrigation companies and like organizations.
3. Mutual or cooperative telephone companies and like organizations.

A like organization is an organization that performs a service comparable to that performed by any one of the above organizations.

The information to be provided upon application by each of these organizations is described in this section. For information as to the procedures to follow in applying for exemption, see chapter 1.

General requirements. These organizations must use their income solely to cover losses and expenses, with any excess being returned to members or retained to cover future losses and expenses. They must collect at least 85% of their income from members for the sole purpose of meeting losses and expenses.

Mutual character. These organizations, other than benevolent life insurance associations, must be organized and operated on a mutual or cooperative basis. They are associations of persons or organizations, or both, banded together to provide themselves a mutually desirable service approximately at cost and on a mutual basis. To maintain the mutual characteristic of democratic ownership and control, they must be so organized and operated that their members have the right to choose the management, to receive services at cost, to receive a return of any excess of payments over losses and expenses, and to share in any assets upon dissolution.

The rights and interests of members in the annual savings of the organization must be determined in proportion to their business with the organization. Upon dissolution, gains from the sale of appreciated assets must be distributed to all persons who were members during the period the assets were owned by

the organization in proportion to the amount of business done during that period. The bylaws mustn't provide for forfeiture of a member's rights and interest upon withdrawal or termination.

Membership. Membership of a mutual organization consists of those who join the organization to obtain its services, and have a voice in its management. In a stock company, the stockholders are members. However, a mutual life insurance organization can't have policyholders other than its members.

Losses and expenses. In furnishing services substantially at cost, an organization must use its income solely for paying losses and expenses. Any excess income not retained in reasonable reserves for future losses and expenses belongs to members in proportion to their patronage or business done with the organization.

If such patronage refunds are retained in reasonable amounts for purposes of expanding and improving facilities, retiring capital indebtedness, acquiring other assets, and unexpected expenses, the organization must maintain records sufficient to reflect the equity of each member in the assets acquired with the funds.

Distributions of proceeds. The cooperative may distribute the unexpended balance of collections or assessments remaining on hand at the end of the year to members or patrons prorated on the basis of their patronage or business done with the cooperative. Such distribution represents a refund in the costs of services rendered to the member.

The 85% Requirement

All of the organizations listed above must submit evidence with their application that they receive 85% or more of their gross income from their members for the sole purpose of meeting losses and expenses.

Nevertheless, certain items of income are excluded from the computation of the 85% requirement if the organization is a mutual or cooperative telephone or electric company.

Mutual or cooperative telephone

company. A mutual or cooperative telephone company will exclude from the computation of the 85% requirement any income received or accrued from:

1. A nonmember telephone company for the performance of communication services involving the completion of long distance calls to, from, or between members of the mutual or cooperative telephone company;
2. Qualified pole rentals;
3. The sale of display listings in a directory furnished to its members; or

4. The prepayment of a loan created in 1987, 1988, or 1989, under section 306A, 306B, or 311 of the Rural Electrification Act of 1936;
5. Grants, contributions, and assistance provided under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or by local, state, or regional governmental entities for disasters or emergencies; and certain grants or contributions provided by a government entity for electric, communications, broadband, Internet, or other utility facilities or services. This is effective for taxable years beginning after December 31, 2017.

Mutual or cooperative electric company.

A mutual or cooperative electric company will exclude from the computation of the 85% requirement any income received or accrued from:

1. Qualified pole rentals;

2. Any provision or sale of electric energy transmission services or ancillary service if the services are provided on a nondiscriminatory open access basis under an open-access transmission tariff approved or accepted by the Federal Energy Regulatory Commission (FERC) or under an independent transmission provider agreement approved or accepted by FERC (other than income received or accrued directly or indirectly from a member);
3. The provision or sale of electric energy distribution services or ancillary services if the services are provided on a nondiscriminatory open-access basis to distribute electric energy not owned by the mutual or electric cooperative company:
 - a. To end-users who are served by distribution facilities not owned by the company or any of its

members (other than income received or accrued directly or indirectly from a member), or

b. Generated by a generation facility not owned or leased by the company or any of its members and which is directly connected to distribution facilities owned by the company or any of its members (other than income received or accrued directly or indirectly from a member),

4. Any nuclear decommissioning transaction,
5. Any asset exchange or conversion transaction; or
6. Grants, contributions, and assistance provided under the Robert T. Stafford Disaster Relief and Emergency Assistance Act or by local, state, or regional governmental entities for

disasters or emergencies; and certain grants or contributions provided by a government entity for electric, communications, broadband, Internet, or other utility facilities or services. This is effective for taxable years beginning after December 31, 2017.

An electric cooperative's sale of excess fuel at cost in the year of purchase isn't income for purposes of determining compliance with the 85% requirement.

Qualified pole rental. The term qualified pole rental means any rental of a pole (or other structure used to support wires) if the pole (or other structure) is used:

1. By the telephone or electric company to support one or more wires that are used by the company in providing telephone or electric services to its members, and

2. Pursuant to the rental to support one or more wires (in addition to wires described in (1)) for use in connection with the transmission by wire of electricity or of telephone or other communications.

The term rental, for this purpose, includes any sale of the right to use the pole (or other structure).

The 85% requirement is applied on the basis of an annual accounting period. Failure of an organization to meet the requirement in a particular year precludes exemption for that year, but has no effect upon exemption for years in which the 85% requirement is met.

Gain from the sale or conversion of the organization's property isn't considered an amount received from members in determining whether the organization's income consists of amounts collected from members.

Because the 85% income test is based on gross income, capital losses can't be used to reduce capital gains for purposes of this test.

Example. The books of an organization reflect the following for the calendar year.

Collections from members	\$2,400
Short-term capital gains	600
Short-term capital losses	400
Other income	None
Gross income (\$2,400 + \$600 = \$3000)	100%
Collected from members (\$2,400)	80%

Since amounts collected from members don't constitute at least 85% of gross income, the organization isn't entitled to exemption from federal income tax for the year.

Voluntary contributions in the nature of gifts aren't taken into account for purposes of the 85% computation.

Other tax-exempt income besides gifts is considered as income received from other than members in applying the 85% test.

If the 85% test isn't met, your organization, if classifiable under this section, won't qualify for exemption as any other type of organization described in this publication.

Tax treatment of donations. Donations to an organization described in this section aren't deductible as charitable contributions on the donor's federal income tax return.

Government grants. In the past, government grants were not treated as income but as contributions to capital. Under the Tax Cuts & Jobs Act, P.L. No. 115-97, section 13312, section 118 was amended so that government grants may no longer be treated as capital contributions.

In 2019, P.L. No. 116-94 amended section 501(c)(12) to exclude from the 85% requirement certain government grants for assistance to mutual and cooperative telephone and electric companies.

Local Life Insurance Associations

A benevolent life insurance association or an organization seeking recognition of exemption on grounds of similarity to a benevolent life insurance association must submit evidence upon

applying for recognition of exemption that it will be of a purely local character, that its excess funds will be refunded to members or retained in reasonable reserves to meet future losses and expenses, and that it meets the 85% income requirement. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and

maintains investments from which more than 15% of its income is derived, it won't be entitled to exemption.

To establish that your organization is of a purely local character, it should show that its activities will be confined to a particular community, place, or district irrespective of political subdivisions. If the activities of an organization are limited only by the borders of a state, it can't be purely local in character. A benevolent life insurance association that doesn't terminate membership when a member moves from the local area in which the association operates will qualify for exemption if it meets the other requirements.

A copy of each type of policy issued by your organization should be included with the application for recognition of exemption.

Organizations similar to local benevolent life insurance companies. These organizations include those that, in addition to paying death benefits, also provide for the

payment of sick, accident, or health benefits. However, an organization that pays only sick, accident, or health benefits, but not life insurance benefits, isn't an organization similar to a benevolent life insurance association and shouldn't apply for recognition of exemption, as described in this section.

Burial and funeral benefit insurance organization. This type of organization can apply for recognition of exemption as an organization similar to a benevolent life insurance company if it establishes that the benefits are paid in cash and if it isn't engaged directly in the manufacture of funeral supplies or the performance of funeral services. An organization that provides its benefits in the form of supplies and service isn't a life insurance company.

Such an organization can seek recognition of exemption from federal income tax, however, as a mutual insurance company other than life.

Mutual or Cooperative Associations

Mutual ditch or irrigation companies, mutual or cooperative telephone companies, and like organizations need not establish that they are of a purely local character. They can serve noncontiguous areas.

Like organization. A like organization is a cooperative or mutual organization that performs a service similar to mutual ditch, irrigation, telephone, or electric companies. Examples include the following: cooperatives that provide protection of river banks to prevent erosion, water and sewer services, cable television, satellite, television, cellular phone services, two-way radio service, or natural gas services.

501(c)(13) - Cemetery Companies

If your organization wishes to obtain recognition of exemption from federal income tax as a cemetery company or a corporation chartered solely for the purpose of the disposal of human bodies by burial or cremation, it must file an application on Form 1024. For the procedure to follow to file an application, see Application, Approval, and Appeal Procedures in chapter 1.

A nonprofit mutual cemetery company that seeks recognition of exemption should submit evidence with its application that it is owned and operated exclusively for the benefit of its lot owners who hold lots for bona fide burial purposes and not for purposes of resale. A mutual cemetery company that also engages in charitable activities, such as the burial of paupers, will be regarded as operating within this standard. The fact that a mutual cemetery company limits its membership to a particular class of individuals, such as

members of a family, won't affect its status as mutual so long as all the other requirements of section 501(c)(13) are met.

If your organization is a nonprofit corporation chartered solely for the purpose of the disposal of human bodies by burial or cremation, you should show that it isn't permitted by its charter to engage in any business not necessarily incident to that purpose. Operating a mortuary isn't permitted. However, selling monuments, markers, vaults, and flowers solely for use in the cemetery is permitted if the profits from these sales are used to maintain the cemetery as a whole.

How income can be used. You should show that your organization's earnings are or will be used only in one or more of the following ways.

1. To pay the ordinary and necessary expenses of operating, maintaining,

and improving the cemetery or crematorium.

2. To buy cemetery property.
3. To create a fund that will provide a source of income for the perpetual care of the cemetery or a reasonable reserve for any ordinary or necessary purpose.

No part of the net earnings of your organization can inure to the benefit of any private shareholder or individual.

Ordinary and necessary expenses in connection with the operation, management, maintenance, and improvement of the cemetery are permitted, as are reasonable fees for the services of a manager.

Buying cemetery property. Payments can be made to amortize debt incurred to buy land, but can't be in the nature of profit distributions.

You must show the method used to finance the purchase of the cemetery property and that the purchase price of the land at the time of its sale to the cemetery wasn't unreasonable.

Except for holders of preferred stock (discussed later), no person can have any interest in the net earnings of a tax-exempt cemetery company or crematorium.

Therefore, if property is transferred to the organization in exchange for an interest in the organization's net earnings, the organization won't be exempt so long as that interest remains outstanding.

An equity interest in the organization is an interest in the net earnings of the organization. However, an interest in the organization that isn't an equity interest may still be an interest in the organization's net earnings. For example, a bond issued by a cemetery company that provides for a fixed rate of interest and also provides for

additional interest payments based on the income of the organization is considered an interest in the net earnings of the organization. Similarly, a convertible debt obligation issued after July 7, 1975, is considered an interest in the net earnings of the organization.

Perpetual care organization. A perpetual care organization, including, for example, a trust organized to receive, maintain, and administer funds that it receives from a nonprofit tax-exempt cemetery under state law and contracts, can apply for recognition of exemption on Form 1024, even though it doesn't own the land used for burial. However, the income from these funds must be devoted exclusively to the perpetual care and maintenance of the nonprofit cemetery as a whole. Also, no part of the net earnings can inure to the benefit of any private shareholder or individual.

In addition, a perpetual care organization not operated for profit, but established as a civic enterprise to maintain and administer funds, the income of which is devoted exclusively to the perpetual care and maintenance of an abandoned cemetery as a whole, may qualify for exemption.

Care of individual plots. When funds are received by a cemetery company for the perpetual care of an individual lot or crypt, a trust is created that is subject to federal income tax. Any trust income that is used or permanently set aside for the care, maintenance, or beautification of a particular family burial lot or mausoleum crypt isn't deductible in computing the trust's taxable income.

Common and preferred stock. A cemetery company that issues common stock can qualify for exemption only if no dividends may be paid.

The payment of dividends must be legally prohibited either by the corporation's charter or by applicable state law.

Generally, a cemetery company or crematorium isn't exempt if it issues preferred stock. However, it can still be exempt if the preferred stock was issued before November 28, 1978, or was issued after that date under a written plan adopted before that date. The adoption of the plan must be shown by the acts of the responsible officers and appear on the official records of the organization.

The preferred stock issued either before November 28, 1978, or under a plan adopted before that date, must meet all the following requirements.

1. The preferred stock entitles the holders to dividends at a fixed rate that isn't more than the greater of the legal rate of interest in the state of incorporation or 8% a year on the

value of the consideration for which the stock was issued.

2. The organization's articles of incorporation require:
 - a. That the preferred stock be retired at par as rapidly as funds become available from operations, and
 - b. That all funds not required for the payment of dividends on or for the retirement of preferred stock be used by the company for the care and improvement of the cemetery property.

Tax treatment of donations. Donations to exempt cemetery companies, corporations chartered solely for human burial purposes, and perpetual care funds (operated in connection with such exempt organizations) are deductible as charitable contributions on the donor's federal income tax return.

However, a donor can't deduct a contribution made for the perpetual care of a particular lot or crypt. Payments made to a cemetery company or corporation as part of the purchase price of a burial lot or crypt, whether irrevocably dedicated to the perpetual care of the cemetery as a whole or earmarked for the care of a particular lot, are also not deductible.

501(c)(14) - Credit Unions and Other Mutual Financial Organizations

If your organization wants to obtain recognition of exemption as a credit union without capital stock, organized and operated under state law for mutual purposes and without profit, it must file the application for recognition of exemption on Form 1024.

Federal credit unions organized and operated in accordance with the Federal Credit Union Act, as amended, are instrumentalities of the

United States and, therefore, are exempt under section 501(c)(1). They are included in a group exemption letter issued to the National Credit Union Administration. They aren't discussed in this publication.

State-chartered credit unions and other mutual financial organizations file applications for recognition of exemption from federal income tax under section 501(c)(14). The other mutual financial organizations must be corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit to provide reserve funds for, and insurance of, shares or deposits in:

1. Domestic building and loan associations,
2. Cooperative banks (without capital stock) organized and operated for mutual purposes and without profit,

3. Mutual savings banks (not having capital stock represented by shares), or
4. Mutual savings banks described in section 591(b).

Similar organizations, formed before September 1, 1957, that provide reserve funds for (but not insurance of shares or deposits in) one of the types of savings institutions described in (1), (2), or (3) above may be exempt from tax if 85% or more of the organization's income is from providing reserve funds and from investments. There is no specific restriction against the issuance of capital stock for these organizations.

Building and loan associations, savings and loan associations, mutual savings banks, and cooperative banks, other than those described in this section, aren't exempt from tax.

However, certain corporations organized and operated in conjunction with farmers' cooperatives can be exempt under section 521.

State-Chartered Credit Unions

Your organization must show on its application that it is formed under a state credit union law, the state and date of incorporation, and that the state credit union law with respect to loans, investments, and dividends, if any, your organization is operated in compliance with.

Other Mutual Financial Organizations

Every other organization included in this section must show in its application the state in which the organization is incorporated and the date of incorporation; the character of the organization; the purpose for which it was organized; its actual activities; the sources of its receipts and the disposition thereof; whether any of its income may be credited to

surplus or may benefit any private shareholder or individual; whether the law relating to loans, investments, and dividends is being complied with; and, in general, all facts relating to its operations that affect its right to exemption.

The application must include detailed information showing either that the organization provides both reserve funds for and insurance of shares and deposits of its member financial organizations or that the organization provides reserve funds for shares or deposits of its members and 85% or more of the organization's income is from providing reserve funds and from investments. There should be attached a conformed copy of the articles of incorporation or other document setting forth the permitted powers or activities of the organization; the bylaws or other similar code of regulations;

and the latest annual financial statement showing the receipts, disbursements, assets, and liabilities of the organization.

501(c)(19) - Veterans' Organizations

A post or organization of past or present members of the Armed Forces of the United States must file Form 1024 to apply for recognition of exemption from federal income tax. You should follow the general procedures outlined in chapter 1. The organization must also meet the qualifications described in this section.

Examples of groups that qualify for exemption are posts or auxiliaries of the American Legion, Veterans of Foreign Wars, and similar organizations.

To qualify for recognition of exemption, your application should show:

1. That the post or organization is organized in the United States or any of its possessions;
2. That at least 75% of the members are past or present members of the U.S. Armed Forces and that at least 97.5% of all members of the organization are past or present members of the U.S. Armed Forces, cadets (including only students in college or university ROTC programs or at armed services academies) or spouses, widows, widowers, ancestors, or lineal descendants of any of those listed here; and
3. That no part of net earnings inure to the benefit of any private shareholder or individual.

In addition to these requirements, a veterans' organization must also be operated exclusively for one or more of the following purposes.

1. To promote the social welfare of the community (that is, to promote in some way the common good and general welfare of the people of the community).
2. To assist disabled and needy war veterans and members of the U.S. Armed Forces and their dependents and the widows and orphans of deceased veterans.
3. To provide entertainment, care, and assistance to hospitalized veterans or members of the U.S. Armed Forces.
4. To carry on programs to perpetuate the memory of deceased veterans and members of the U.S. Armed Forces and to comfort their survivors.
5. To conduct programs for religious, charitable, scientific, literary, or educational purposes.

6. To sponsor or participate in activities of a patriotic nature.
7. To provide insurance benefits for its members or dependents of its members or both.
8. To provide social and recreational activities for its members.

Auxiliary unit. An auxiliary unit or society of a veterans' organization can apply for recognition of exemption provided that the veterans' organization (parent organization) meets the requirements explained earlier in this section. The auxiliary unit or society must also meet all the following additional requirements.

1. It is affiliated with, and organized in accordance with, the bylaws and regulations formulated by the parent organization.
2. At least 75% of its members are either past or present members of the U.S.

Armed Forces, spouses of those members, or related to those members within two degrees of kinship (grandparent, brother, sister, and grandchild represent the most distant allowable relationship).

3. All of its members either are members of the parent organization, spouses of a member of the parent organization, or related to a member of such organization within two degrees of kinship.
4. No part of its net earnings inure to the benefit of any private shareholder or individual.

Trusts or foundations. Trusts or foundations for a veterans' organization can also apply for recognition of exemption provided that the parent organization meets the requirements explained earlier. The trust or foundation must also meet all the following qualifications.

1. The trust or foundation is in existence under local law and, if it is organized for charitable purposes, has a dissolution provision similar to charitable organizations. (See Articles of Organization in chapter 3 of this publication.)
2. The corpus or income can't be diverted or used other than for:
 - a. The funding of a veterans' organization, described in this section;
 - b. Religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals; or
 - c. An insurance set aside.
3. The trust income isn't unreasonably accumulated and, if the trust or foundation isn't an insurance set aside, a substantial portion of the income is

in fact distributed to the parent organization or for the purposes described in item 2(b).

4. It is organized exclusively for one or more of the purposes listed earlier in this section that are specifically applicable to the parent organization.

Tax treatment of donations. Donations to war veterans' organizations are deductible as charitable contributions on the donor's federal income tax return. At least 90% of the organization's membership must consist of war veterans.

The term war veterans means persons, whether or not present members of the U.S. Armed Forces, who have served in the U.S. Armed Forces during a period of war (including the Korean and Vietnam conflicts, the Persian Gulf war, and later declared wars).

501(c)(21) - Black Lung Benefit Trusts

If your organization wishes to obtain recognition of exemption as a black lung benefit trust, it must file the application for recognition of exemption on Form 1024 and include a copy of its trust instrument. The general procedures to follow for obtaining recognition are discussed in chapter 1 of this publication. This section describes the additional (or specific) information to be provided upon application.

Requirements. A black lung benefit trust that is established in writing, created or organized in the United States, and contributed to by any person (except an insurance company) will qualify for tax-exempt status if it meets both of the following requirements. The trust must be irrevocable and there can be no right or possibility or reversion of the corpus or income of the trust

to the coal mine operator or other creator, except that the creator may recover excess contributions.

1. Its only purpose is:
 - a. To satisfy in whole or in part the liability of that person (generally, the coal mine operator contributing to the trust) for, or with respect to, claims for compensation arising under federal or state statutes for disability or death due to pneumoconiosis,
 - b. To pay the premiums for insurance that covers only that liability,
 - c. To pay the administrative and other incidental expenses of that trust (including legal, accounting, actuarial, and trustee expenses) in connection with the operation

of the trust and processing of black lung claims against such person arising under federal or state statutes, and

- d. To pay accident and health benefits or insurance premiums and other administrative expenses for retired coal miners and their spouses. The amount of assets available for such use is generally limited to 110% of the present value of the liability for black lung benefits.

2. No part of its assets can be used for, or diverted to, any purposes other than:

- a. The purposes described in 1,
- b. Payments into the Black Lung Disability Trust Fund or into the general fund of the U.S. Treasury (other than in satisfaction of any

tax or other civil or criminal liability of the person who established or contributed to the trust),

- c. Investment in public debt securities of the U.S., obligations of a state or local government that aren't in default as to principal or interest, or time or demand deposits in a bank or an insured credit union located in the United States. (These investments are restricted to the extent that the trustee determines that a portion of the assets isn't currently needed for the purposes described in 1.)

An annual information return is required of exempt trusts described in section 501(c)(21). Formerly, Form 990-BL, Information and Initial Excise Tax Return for Black Lung Benefit Trusts and Certain Related

Persons, was used for this purpose. However, Form 990-BL is a historical form beginning with tax year 2021. Section 501(c)(21) trusts can no longer file Form 990-BL and will file Form 990 to meet their annual filing obligation. A trust that normally has gross receipts in each tax year of no more than \$50,000 is excepted from this filing requirement. However, it must submit an annual electronic notice, Form 990-N (*e-Postcard*).

Excise taxes. See Chapter 5 for information on the excise tax that may be imposed on the organization.

Tax treatment of donations. Contributions by a taxpayer (generally, the coal mine operator) to a black lung benefit trust are deductible for federal income tax purposes under section 192. The deduction is limited, and any excess contributions are subject to an excise tax of 5%. Form 6069, Return of Certain Excise Taxes on Mine Operators,

Black Lung Trusts, and Other Persons Under Sections 4951, 4952, and 4953, is used to compute the allowable deduction and any excise tax liability. The form doesn't have to be filed if there is no excise tax liability. For more information about these contributions, see Form 6069 and its instructions.

501(c)(2) - Title-Holding Corporations for Single Parent Corporations

If your organization wants to obtain recognition of exemption from federal income tax as a corporation organized to hold title to property, collect income from that property, and turn over the entire amount less expenses to a single parent organization that is exempt from income tax, it must file its application on Form 1024. The information to submit upon application is described in this section.

For a discussion of the procedures for obtaining recognition of exemption, see chapter 1, Application Procedures.

You must show that your organization is a corporation. If you are in doubt as to whether your organization qualifies as a corporation for this purpose, contact your IRS office.

A title-holding corporation will qualify for exemption only if there is effective ownership and control over it by the distributee exempt organization. For example, the distributee organization may control the title-holding corporation by owning its voting stock or possessing the power to select nominees to hold its voting stock.

Corporate charter. The corporate charter must confine the purposes and powers of your organization to holding title to property, collecting income from the property, and turning the income over to an exempt organization.

If the charter authorizes your organization to engage in activities that go beyond these limits, its exemption may not be recognized even if its actual operations are so limited. If your organization's original charter doesn't limit its powers, you can amend the charter to conform to the required limits and submit evidence with your application that the charter has been amended.

Payment of income. You must show that your corporation is required to turn over the entire income from the property, less expenses, to one or more exempt organizations.

Actual payment of the income is required. A mere obligation to use the income for the exempt organization's benefit, or the fact that such organization has control over the income, doesn't satisfy this requirement.

Expenses. Expenses may reduce the amount of income required to be turned over to the tax-exempt organization for which your

organization holds property. The term expenses (for this purpose) includes not only ordinary and necessary expenses paid or incurred, but also reasonable additions to depreciation reserves and other reserves that would be proper for a business corporation holding title to and maintaining property.

In addition, the title-holding corporation can retain part of its income each year to apply to debt on property to which it holds title. This transaction is treated as if the income had been turned over to the exempt organization and the latter had used the income to make a contribution to the capital of the title-holding corporation that in turn applied the contribution to the debt.

Waiver of payment of income. Generally, there is no payment of rent when the occupant of property held by your title-holding corporation is the exempt organization for which your corporation holds the title.

In this situation, the statutory requirement that income be paid over to the exempt organization is satisfied if your corporation turns over whatever income is available.

Application for recognition of exemption.

In addition to the information required by Form 1024, the title-holding corporation must furnish evidence that the organization for which title is held has obtained recognition of exempt status. If that organization has not been specifically notified in writing by the IRS that it is exempt, the title-holding corporation must submit the necessary application and supporting documents to enable the IRS to determine whether the organization for which title is held qualifies for exemption. A copy of a ruling or determination letter issued to the organization for which title is held will be proof that it qualifies for exemption.

However, until the organization for which title is held obtains recognition of exempt status or proof is submitted to show that it qualifies, the title-holding corporation can't obtain recognition of exemption.

Tax treatment of donations. Donations to an exempt title-holding corporation generally aren't deductible as charitable contributions on the donor's federal income tax return.

501(c)(25) - Title-Holding Corporations or Trusts for Multiple Parent Corporations

If your organization wants to obtain recognition of exemption from federal income tax as an organization organized for the exclusive purpose of acquiring, holding title to, and collecting income from real property, and turning over the entire amount less expenses to member organizations exempt from income tax, it should file its application on Form 1024.

For a discussion of the procedures for obtaining recognition of exemption, see chapter 1, Application Procedures.

Who can control the organization.

Organizations recognized as exempt under this section can have up to 35 shareholders or beneficiaries, in contrast to title-holding organizations recognized as exempt under section 501(c)(2), which can have only one controlling parent organization.

Organizational requirements. A section 501(c)(25) organization must be either a corporation or a trust. Only one class of stock is permitted in the case of a corporation. In the case of a trust, only one class of beneficial interest is allowed.

Organizations eligible to acquire or hold interests in this type of title-holding organization are qualified pension, profit-sharing, or stock bonus plans, governmental

plans, governments and their agencies and instrumentalities, and charitable organizations.

The articles of incorporation or trust instrument must include provisions showing that the corporation or trust is organized to meet the requirements of the statute, including compliance with the limitations on membership and classes of stock or beneficial interest, and compliance with the income distribution requirements. The organizing document must permit the organization's shareholders or beneficiaries to dismiss the organization's investment advisor, if any, upon a vote of the shareholders or beneficiaries holding a majority interest in the organization.

The organizing document must permit the shareholders or beneficiaries to terminate their interests by at least one of the following methods.

1. By selling or exchanging their stock or beneficial interest to any organization described in section 501(c)(25)(C), provided that the sale or exchange doesn't cause the number of shareholders or beneficiaries to exceed 35.
2. By having their stock or beneficial interest redeemed by the section 501(c)(25) organization upon 90 days notice.

If state law prevents a corporation from including in its articles of incorporation the above provisions, such provisions must instead be included in the bylaws of the corporation.

A 501(c)(25) organization can be organized as a nonstock corporation if its articles of incorporation or bylaws provide members with the same rights as described above.

Subsidiaries. A wholly owned subsidiary won't be treated as a separate corporation, and all assets, liabilities, and items of income, deduction, and credit will be treated as belonging to the section 501(c)(25) organization. Subsidiaries shouldn't apply separately for recognition of exemption.

Tax treatment of donations. Donations to an exempt title-holding corporation generally aren't deductible as charitable contributions on the donor's federal income tax return.

Unrelated Business Income

In general, the receipt of unrelated business income by a section 501(c)(25) organization will subject the organization to loss of exempt status since the organization can't be exempt from taxation if it engages in any business other than that of holding title to real property and collecting the income from the property.

However, exempt status generally won't be affected by the receipt of debt-financed income that is treated as unrelated business taxable income solely because of section 514.

Under section 514(c)(9), certain shareholders or beneficiaries aren't subject to unrelated debt-financed income tax under section 514 on their investments through the organization. These shareholders are generally schools, colleges, universities, or supporting organizations of such educational institutions. Organizations other than these will take into account as gross income from an unrelated trade or business their pro rata share of income that is treated as unrelated debt-financed income because section 514(c)(9) doesn't apply. These organizations will also take their pro rata share of the allowable deductions from unrelated taxable income.

Real property. Real property can include personal property leased in connection with real property, but only if the rent from the personal property isn't more than 15% of the total rent for both the real property and the personal property.

Real property acquired after June 10, 1987, can't include any interest as a tenant in common (or similar interest) or any indirect interest.

501(c)(26) State-Sponsored High-Risk Health Coverage Organizations

A state-sponsored organization established to provide medical care to high-risk individuals applies on Form 1024 for recognition of exemption from federal income tax under section 501(c) (26).

To qualify for exemption, the organization must be a membership organization established by a state exclusively to provide coverage for medical care on a nonprofit basis to high-risk individuals who are state residents. It can provide coverage either by issuing insurance itself or by entering into an arrangement with a health maintenance organization (HMO).

The state must determine the composition of membership in the organization. No part of the net earnings of the organization can inure to the benefit of any private shareholder or individual.

High-risk individuals. These are individuals, their spouses, and qualifying children, who, because of a pre-existing medical condition:

1. Can't get medical care coverage for that condition through insurance or an HMO, or

2. Can get coverage for that condition only at a rate that is substantially higher than the rate for the same coverage from the state-sponsored organization.

501(c)(27) - Qualified Workers' Compensation State-Sponsored Organizations

501(c)(27)(A) -- Pre-June 1, 1996, Organizations. A state-sponsored workers' compensation reinsurance organization applies on Form 1024 for recognition of exemption from federal income tax under section 501(c)(27).

To qualify for exemption, any membership organization must meet all the following requirements.

1. It was established by a state before June 1, 1996, exclusively to reimburse

its members for losses under workers' compensation acts.

2. The state requires that the membership consist of all persons who issue insurance covering workers' compensation losses in the state and all persons and government entities who self-insure against those losses.
3. It operates as a nonprofit organization by returning surplus income to its members or workers' compensation policyholders on a periodic basis and by reducing initial premiums in anticipation of investment income.

501(c)(27)(B) -- Organizations formed after December 31, 1997. Any organization (including a mutual insurance company) can qualify for exemption if it meets all of the following requirements.

1. It is created by state law and is organized and operated under state law exclusively to:
 - a. Provide workmen's compensation insurance which is required by state law or state law must provide significant disincentives if employers fail to purchase such insurance, and
 - b. Provide related coverage which is incidental to workmen's compensation insurance.
2. It provides workmen's compensation insurance to any employer in the state (for employees in the state or temporarily assigned out-of-state) which seeks such insurance and meets other reasonable requirements relating to the insurance.
3. The state makes a financial commitment to such organization

either by extending its full faith and credit to the initial debt of the organization or by providing the initial operating capital of the organization.

4. The assets of the organization revert to the state upon dissolution or the organization isn't permitted to dissolve under state law.
5. The majority of the board of directors or oversight body of such organization are appointed by the chief executive officer or other executive branch official of the state, by the state legislature, or by both.

501(c)(29) - CO-OP Health Insurance Issuers

This includes a qualified nonprofit health insurance issuer which has received a loan or grant under the CO-OP Program under this section of the Code.

Guidance for Section 501(c)(29) Qualified Nonprofit Health Insurance Issuers

Section 501(c)(29), added to the Code by section 1322(h)(1) of the Affordable Care Act, provides for the exemption of qualified nonprofit health insurance issuers (QNHIIs) that have received a loan or grant under the Centers for Medicare and Medicaid Services (CMS)

CO-OP program for periods that they meet both the requirements of section 1322 of the Affordable Care Act and of any loan agreement with CMS. The CO-OP program provides loans and repayable grants to foster the creation of member governed QNHIIs that will operate with a strong consumer focus and offer qualified health insurance plans. Notice 2011-23, 2011-13 I.R.B. 588, discussed requirements for tax exemption for QNHIIs described in Internal Revenue Code section 501(c)(29).

The Notice provides guidance on the annual filing requirement for organizations that intend to apply for recognition of section 501(c)(29) status and modified and superseded by Rev. Proc. 2022-8. Under Rev. Proc. 2022-8, an organization applying for recognition of exemption from federal income tax under section 501(c)(29) applies on Form 1024. Rev. Proc. 2015-17, 2015-7 I.R.B. 599, sets out the procedures for issuing determination letters on the exempt status of QNHIIIs and provides guidance on the effective date of exempt status. [Rev. Proc. 2015-17](#), supplemented by current year issued revenue procedures also apply to exemptions from federal income tax under section 501(c)(29) applies on Form 1024.

General Requirements for Exemption under 501(c)(29) and Annual Filing Requirement

In general, section 501(c)(29) applies to certain organizations receiving loans or

repayable grants under the CO-OP program. An organization will qualify for exemption under section 501(c)(29) only if:

- The organization has received a loan or a repayable grant under the CO-OP program and is in compliance with all requirements of the CO-OP program and any agreement with CMS;
- The organization has applied for recognition of exemption;
- No part of the organization's net earnings inures to the benefit of any private shareholder or individual, except that the organization is required by section 1322(c)(4) of the Affordable Care Act to use its profits to lower premiums, improve benefits or improve the quality of health care delivered to its members;
- No substantial part of the organization's activities involves attempts to influence legislation; and

- The organization doesn't participate or intervene in political campaigns. See Rev. Proc. 2015-17 for complete instructions for filing exemption applications.

Additional Guidance for Prospective 501(c)(29) Organizations

An organization claiming exempt status under section 501(c)(29) that intends to file an application for recognition of exemption should begin by filing Form 990, Return of Organization Exempt from Income Tax, and indicate on its return that it has not yet received a determination letter. In addition to the general information required on Form 990, these organizations must report certain information regarding required reserves.

5.

Excise Taxes

Introduction

An excise tax may be imposed on certain tax-exempt organizations.

Topics

This chapter discusses:

- Prohibited tax shelter transactions
- Excess benefit transactions
- Excess business holdings
- Taxable distributions of sponsoring organizations
- Taxes on prohibited benefits distributed from donor advised funds
- Excise taxes on private foundations
- Excise taxes on section 501(c)(21) black lung benefit trusts

- Excise Tax on Failure To Meet the Community Health Needs Assessment Requirements of Hospitals
- Excise tax on excess tax-exempt organization executive compensation
- Excise tax on net investment income of private colleges and universities

Useful Items

You may want to see:

Forms (and Instructions)

- ☐ **4720** Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code

See chapter 6 for more information about getting Form 4720.

Prohibited Tax Shelter Transactions

Section 4965 imposes an excise tax on:

- Certain tax-exempt entities that are party to prohibited tax shelter transactions, and
- Any entity manager who approves or otherwise causes the entity to be a party to a prohibited tax shelter transaction and knows or has reason to know that the transaction is a prohibited tax shelter transaction.

Additionally, section 6033 provides new disclosure requirements on a tax-exempt entity that is a party to a prohibited tax shelter transaction.

Tax-exempt entities. Tax-exempt entities that are subject to section 4965 include:

1. Entities described in section 501(c), including but not limited to the following common types of entities:
 - a. Instrumentalities of the United States described in section 501(c)(1);

- b. Churches, hospitals, museums, schools, scientific research organizations, and other charities described in section 501(c)(3);
- c. Civic leagues, social welfare organizations, and local associations of employees described in section 501(c) (4);
- d. Labor, agricultural, or horticultural organizations described in section 501(c)(5);
- e. Business leagues, chambers of commerce, trade associations, and other organizations described in section 501(c)(6);
- f. Voluntary employees' beneficiary associations (VEBAs) described in section 501(c)(9);
- g. Credit unions described in section 501(c)(14);

- h. Insurance companies described in section 501(c)(15); and
 - i. Veterans' organizations described in section 501(c)(19).
- 2. Religious or apostolic associations or corporations described in section 501(d).
- 3. Entities described in section 170(c), including states, possessions of the United States, the District of Columbia, political subdivisions of states and political subdivisions of possessions of the United States (but not including the United States).
- 4. Indian tribal governments within the meaning of section 7701(a)(40).

Entity manager. An entity manager is any person with authority or responsibility similar to that exercised by an officer, director,

or trustee, and, for any act, the person that has authority or responsibility with respect to the prohibited transaction.

Prohibited tax shelter transaction. A prohibited tax shelter transaction is any listed transaction, within the meaning of section 6707A(c)(2), and any prohibited reportable transactions. A prohibited reportable transaction is a confidential transaction within the meaning of Regulations section 1.6011-4(b)(3), and a transaction with contractual protection within the meaning of Regulations section 1.6011-4(b)(4). See the Instructions for Form 8886-T for more information on listed transactions and prohibited reportable transactions.

Subsequently listed transaction. Any transaction to which the tax-exempt entity is a party and is later determined to be a listed transaction after the entity has become a party to it, is a subsequently listed transaction.

Entity Level Tax

Section 4965(a)(1) imposes an entity level excise tax on any tax-exempt entity described in 1, 2, 3, or 4 above that becomes a party to a prohibited tax shelter transaction or is a party to a subsequently listed transaction (defined earlier). The excise tax imposed on a tax-exempt entity applies to tax years in which the entity becomes a party to the prohibited tax shelter transaction and any subsequent tax years. The amount of the excise tax depends on whether the tax-exempt entity knew or had reason to know that the transaction was a prohibited tax shelter transaction at the time it became a party to the transaction.

To figure and report the excise tax imposed on a tax-exempt entity for being a party to a prohibited tax shelter transaction, file Form 4720.

For more information about this excise tax, including information about how it is figured, see the Instructions for Form 4720.

Manager Level Tax

Section 4965(a)(2) imposes an excise tax on any tax-exempt entity manager who approves or otherwise causes the entity to be a party to a prohibited tax shelter transaction and knows (or has reason to know) that the transaction is a prohibited tax shelter transaction. The excise tax, in the amount of \$20,000, is assessed for each approval or other act causing the organization to be a party to the prohibited tax shelter transaction. To report this tax, file Form 4720.

Excess Benefit Transactions

Excise tax on excess benefit

transactions. A disqualified person who benefits from an excess benefit transaction, such as compensation, fringe benefits, or

contract payments from certain section 501(c)(3), 501(c)(4), or 501(c)(29) organizations, must correct the transaction and may have to pay an excise tax under section 4958. A manager of the organization may also have to pay an excise tax under section 4958. These taxes are reported on Form 4720.

The excise taxes are imposed if an applicable tax-exempt organization provides an excess benefit to a disqualified person and that benefit exceeds the value of the benefit received in exchange.

There are three taxes under section 4958. Disqualified persons are liable for the first two taxes and certain organization managers are liable for the third tax.

Taxes imposed on excess benefit transactions don't apply to a transaction under a written contract that was binding on September 13, 1995, and at all times thereafter before the transaction occurred.

Tax on Disqualified Persons

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

See definition of disqualified person, later at *Disqualified person*.

Additional tax on the disqualified person.

If the 25% tax is imposed 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 any disqualified person involved.

If a disqualified person makes a payment of less than the full correction amount, the 200% tax is imposed only on the unpaid portion of the correction amount.

If more than one disqualified person received an excess benefit from an excess benefit transaction, all such disqualified persons are jointly and severally liable for the taxes.

To avoid the 200% tax, a disqualified person must correct the excess benefit transaction during the taxable period. The 200% tax is abated (refunded if collected) if the excess benefit transaction is corrected within a 90-day correction period beginning on the date a statutory notice of deficiency is issued.

Taxable period. The taxable period means the period beginning with the date on which the excess benefit transaction occurs and ending on the earlier of:

- The date a notice of deficiency was mailed to the disqualified person for the initial tax on the excess benefit transaction, or
- The date on which the initial tax on the excess benefit transaction for the disqualified person is assessed.

Tax on Organization Managers

If tax is imposed on a disqualified person for any excess benefit transaction, an excise tax equal to 10% of the excess benefit is imposed on an organization manager who knowingly participated in an excess benefit transaction, unless such participation wasn't willful and was due to reasonable cause. This tax can't exceed \$20,000 (\$10,000 for transactions entered in a tax year beginning before August 18, 2006), for each transaction. There is also joint and several liability for this tax. A person can be liable for both the tax paid by the disqualified person and the organization manager tax for a particular excess benefit transaction.

Organization manager. An organization manager is any officer, director, or trustee of an applicable tax-exempt organization, or any individual having powers or responsibilities similar to officers, directors, or trustees of the organization, regardless of title.

An organization manager isn't considered to have participated in an excess benefit transaction where the manager has opposed the transaction in a manner consistent with the fulfillment of the manager's responsibilities to the organization. For example, a director who votes against giving an excess benefit would ordinarily not be subject to the 10% tax.

A person participates in a transaction knowingly if the person:

- Has actual knowledge of sufficient facts so that, based solely upon those facts, such transaction would be an excess benefit transaction;
- Is aware that such a transaction under these circumstances may violate the provisions of federal tax law governing excess benefit transactions; and

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

Knowing doesn't mean having reason to know. The organization manager ordinarily won't be considered knowing if, after full disclosure of the factual situation to an appropriate professional, the organization manager relied on the professional's reasoned written opinion on matters within the professional's expertise or if the manager relied on the fact that the requirements for the rebuttable presumption of reasonableness have been satisfied. Participation by an organization manager is willful if it is voluntary, conscious, and intentional.

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

Excess Benefit Transaction

An excess benefit transaction is a transaction in which an economic benefit is provided by an applicable tax-exempt organization, directly or indirectly, to or for the use of any disqualified person, and the value of the economic benefit provided by the organization exceeds the value of the consideration (including the performance of services) received for providing such benefit. The excess benefit transaction rules apply to all transactions with disqualified persons, regardless of whether the amount of the benefit provided is determined in whole or in part by the revenues of one or more activities of the organization.

To determine whether an excess benefit transaction has occurred, all consideration and benefits exchanged between a disqualified person and the applicable tax-exempt organization, and all entities it controls, are taken into account. For purposes of determining the value of economic benefits, the value of property, including the right to use property, is the fair market value. Fair market value is the price at which property, or the right to use property, would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy, sell, or transfer property or the right to use property, and both having reasonable knowledge of relevant facts.

Donor advised fund transactions occurring after August 17, 2006. For a donor advised fund, an excess benefit transaction includes a grant, loan, compensation, or other similar payment from the fund to a:

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

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

Supporting organization transactions occurring after July 25, 2006. For any supporting organization, defined in section 509(a)(3), an excess benefit transaction includes grants, loans, compensation, or other similar payment provided by the supporting organization to a:

- Substantial contributor,

- Family member of a substantial contributor,
- 35% controlled entity of a substantial contributor, or
- 35% controlled entity of a family member of a substantial contributor.

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

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

Excess benefit transaction rules generally don't apply to transactions between a supporting organization and its supported

organization described in section 501(c)(4), (5), or (6) in furtherance of charitable purposes.

Date of Occurrence

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

In the case of benefits provided to a qualified pension, profit-sharing, or stock bonus plan, the transaction occurs on the date the benefit is vested. In the case of the transfer of property subject to a substantial risk of forfeiture, or in the case of rights to future compensation or property, the transaction

occurs on the date the property, or the rights to future compensation or property, isn't subject to a substantial risk of forfeiture.

Where the disqualified person elects to include an amount in gross income in the tax year of transfer under section 83(b), the excess benefit transaction occurs on the date the disqualified person receives the economic benefit for federal income tax purposes.

Correcting the excess benefit. An excess benefit transaction is corrected by undoing the excess benefit to the extent possible, and by taking any additional measures necessary to place the organization in a financial position not worse than what it would have been if the disqualified person were dealing under the highest fiduciary standards.

A disqualified person corrects an excess benefit by making a payment in cash or cash equivalents, excluding payment by a promissory note, equal to the correction amount to the applicable tax-exempt

organization. The correction amount equals the excess benefit plus the interest on the excess benefit. The interest rate can be no lower than the applicable federal rate, compounded annually, for the month the transaction occurred.

A disqualified person can, with the agreement of the applicable tax-exempt organization, make a payment by returning the specific property previously transferred in the excess transaction. In this case, the disqualified person is treated as making a payment equal to the lesser of:

- The fair market value of the property on the date the property is returned to the organization, or
- The fair market value of the property on the date the excess benefit transaction occurred.

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

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

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

Applicable Tax-Exempt Organization

An applicable tax-exempt organization is a section 501(c)(3), 501(c)(4), or 501(c)(29) organization that is tax-exempt under section

501(a), or was such an organization at any time during a 5-year period ending on the day of the excess benefit transaction.

An applicable tax-exempt organization doesn't include:

1. A private foundation as defined in section 509(a),
2. A governmental entity that is:
 - a. Exempt from (or not subject to) taxation without regard to section 501(a), or
 - b. Not required to file an annual return, or
3. A foreign organization, recognized by the IRS or by treaty, that receives substantially all of its support (other than gross investment income) from sources outside the United States.

An organization isn't treated as a section 501(c)(3), 501(c)(4), or 501(c)(29) organization for any period covered by a final determination that the organization wasn't tax-exempt under section 501(a), but only if the determination wasn't based on private inurement or one or more excess benefit transactions.

Disqualified Person

A disqualified person is:

- Any person (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,
- A family member of an individual described in (1), and
- A 35% controlled entity.

For donor advised funds, sponsoring organizations, and certain supporting organizations occurring after August 17, 2006. The following persons will be considered disqualified persons along with certain family members and 35% controlled entities associated with them.

- Donors of donor advised funds,
- Investment advisors of sponsoring organizations, and
- Disqualified persons of a section 509(a)(3) supporting organization that supports the applicable tax-exempt organization.

For certain supporting organization transactions occurring after July 25, 2006. Substantial contributors to supporting organizations will also be considered disqualified persons with respect to the supporting organizations, along with their family members and 35% controlled entities.

Investment advisor. Investment advisor means for any sponsoring organization, any person compensated by such organization (but not an employee of such organization) for managing the investment of, or providing investment advice for, assets maintained in donor advised funds owned by such sponsoring organization.

Substantial contributor. In general, a substantial contributor means any person who contributed or bequeathed an aggregate of more than \$5,000 to the organization, if that amount is more than 2% of the total contributions and bequests received by the end of the organization's tax year in which the contribution or bequest is received. A substantial contributor includes the grantor of a trust.

Family members. Family members of a disqualified person include a disqualified person's spouse, brothers or sisters (whether by whole or half-blood), spouses of brothers

or sisters (whether by whole or half-blood), ancestors, children (including a legally adopted child), grandchildren, great grandchildren, and spouses of children, grandchildren, and great grandchildren (whether by whole or half-blood).

35% controlled entity. A 35% controlled entity is:

1. A corporation in which disqualified persons own more than 35% of the total combined voting power,
2. A partnership in which such persons own more than 35% of the profits interest, or
3. A trust or estate in which such persons own more than 35% of the beneficial interest.

In determining the holdings of a business enterprise, any stock or other interest owned directly or indirectly shall apply.

Persons having substantial influence.

Among those who are in a position to exercise substantial influence over the affairs of the organization are, for example, voting members of the governing body, and persons holding the power of:

- Presidents, chief executives, or chief operating officers;
- Treasurers and chief financial officers; or
- Persons with a material financial interest in a provider-sponsored organization.