Internal Revenue
bulletin

Bulletin No. 2001–8
February 20, 2001

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2001–9, page 652.

LIFO; price indexes; department stores. The December 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, December 31, 2000.

T.D. 8914, page 653.

Final regulations under section 988 of the Code relate to when a currency will be considered hyperinflationary. These final regulations are intended to prevent distortions associated with the computation of income and expense arising from section 988 transactions denominated in hyperinflationary currencies.

EMPLOYEE PLANS

T.D. 8928, page 685.

Final regulations provide guidance on various issues arising under the COBRA continuation coverage requirements for group health plans. The issues include those related to business reorganizations, employer withdrawals from multiemployer plans, health flexible spending arrangements, and counting employees for purposes of the exception under the COBRA continuation coverage provisions for plans of small employers.

REG–209461–79, page 712.

Partial withdrawal of, and amendments to, the notices of proposed rulemaking that relate to the tax treatment of cafeteria plans under section 125 of the Code.

EXEMPT ORGANIZATIONS

T.D. 8920, page 654.
REG–246256–96, page 713.

Temporary and proposed regulations under section 4958 of the Code add details to the definitions and rules of section 4958. Section 4958 imposes excise taxes on excess benefit transactions between a section 501(c)(3) or 501(c)(4) organization (except a private foundation) and a person with substantial influence over the affairs of the organization.

Announcement 2001–20, page 716.

A list is provided of organizations that no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

EMPLOYMENT TAX

Announcement 2001–16, page 715.

This announcement provides guidance to federally recognized Indian tribal governments about their Federal Unemployment Tax Act (FUTA) obligations for 2000. Recent legislation changed how FUTA applies to Indian tribal governments. As of December 21, 2000, federally recognized Indian tribal governments are exempt from FUTA. The new law contains a transition rule which eliminates an Indian tribal government's 2000 liability for FUTA taxes for services performed before December 21, 2000, if certain requirements are met. Because the due date for the 2000 Form 940 used to report FUTA tax liability is January 31, 2001, this announcement is made to provide Indian tribal governments options in filing their Forms 940.

(Continued on the next page)

Finding Lists begin on page ii.
Announcements of Disbarments and Suspensions begin on page 717.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

T.D. 8935, page 702.
REG–103320–00, page 714.

Temporary and proposed regulations under section 6103 of the Code set forth the requirements and conditions under which the Service can make disclosures of returns and return information to the designee of a taxpayer pursuant to written or nonwritten requests.

Rev. Proc. 2001–18, page 708.

Last known address. This procedure explains how a taxpayer is to inform the Service of a change of address. When so informed, the Service will update the taxpayer's address of record to the new address. The Service uses the taxpayer's address of record for the various notices that are required to be sent to a taxpayer's "last known address" under the Code and for refunds of overpayments of tax. Rev. Proc. 90–18 amplified and superseded.

Announcement 2001–15, page 715.

This announcement advises persons required to file information returns that the mandatory use of Form W-9, *Request for Taxpayer Identification Number and Certification*, (Rev. December 2000) by U.S. persons has been delayed until July 1, 2001. However, foreign persons may not use a Form W-9 after December 31, 2000.

Announcement 2001–17, page 716.

The Service announces the availability of new Form 8875, *Taxable REIT Subsidiary Election*. This form is used by both an eligible corporation and a REIT to jointly elect to have the corporation treated as a taxable REIT subsidiary.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The December 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, December 31, 2000.

Rev. Rul. 2001–9

The following Department Store Inventory Price Indexes for December 2000 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, December 31, 2000.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Dec. 1999	Dec. 2000	Percent Change from Dec. 1999 to Dec. 2000[1]
1. Piece Goods	512.9	489.0	-4.7
2. Domestics and Draperies	619.5	614.5	-0.8
3. Women's and Children's Shoes	631.0	647.4	2.6
4. Men's Shoes	887.4	901.8	1.6
5. Infants' Wear	650.0	631.7	-2.8
6. Women's Underwear	561.6	567.2	1.0
7. Women's Hosiery	325.0	342.9	5.5
8. Women's and Girls' Accessories	526.2	533.8	1.4
9. Women's Outerwear and Girls' Wear	393.5	381.8	-3.0
10. Men's Clothing	610.1	584.0	-4.3
11. Men's Furnishings	626.0	618.3	-1.2
12. Boys' Clothing and Furnishings	506.4	487.8	-3.7
13. Jewelry	924.8	910.2	-1.6
14. Notions	768.3	795.1	3.5
15. Toilet Articles and Drugs	981.7	984.4	0.3
16. Furniture and Bedding	688.5	692.8	0.6
17. Floor Coverings	602.7	628.7	4.3
18. Housewares	786.9	769.3	-2.2
19. Major Appliances	234.9	229.6	-2.3
20. Radio and Television	63.2	57.1	-9.7
21. Recreation and Education[2]	95.3	91.8	-3.7
22. Home Improvements[2]	129.3	129.3	0.0
23. Auto Accessories[2]	107.3	108.2	0.8
Groups 1 - 15: Soft Goods	596.7	589.8	-1.2
Groups 16 - 20: Durable Goods	445.6	433.9	-2.6
Groups 21 - 23: Misc. Goods[2]	102.1	100.0	-2.1
Store Total[3]	540.2	531.7	-1.6

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

Section 988.—Treatment of Certain Foreign Currency Transactions

26 CFR 1.988–1: Certain definitions and special rules.

T.D. 8914

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Definition of Hyperinflationary Currency for Purposes of Section 988

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning when a currency will be considered hyperinflationary for purposes of section 988. These final regulations are intended to prevent distortions associated with the computation of income and expense arising from section 988 transactions denominated in hyperinflationary currencies.

DATES: The effective date of this regulation is February 14, 2000.

FOR FURTHER INFORMATION CONTACT: John W. Rogers III of the Office of Associate Chief Counsel (International) at (202) 622-3870.

SUPPLEMENTARY INFORMATION:

Background

This document contains final Income Tax Regulations (26 CFR part 1) under section 988 of the Internal Revenue Code (Code). On March 17, 1992, the IRS and Treasury published final regulations (57 F.R. 9172) relating to the taxation of section 988 transactions, including, inter alia, transactions denominated in hyperinflationary currencies. Also on March 17, 1992, proposed regulations were published (57 F.R. 9217) relating to the treatment of certain financial instruments denominated in hyperinflationary currencies. The proposed regulations did not separately define hyperinflationary currency. Rather, they simply made reference to the definition in the final regulations, §1.988–1(f).

T.D. 8860 (2000–5 I.R.B. 437) (65 F.R. 2026) (January 13, 2000) finalized the proposed regulations relating to the treatment of financial instruments denominated in hyperinflationary currencies. Also in that issue of the Bulletin was a notice of proposed rulemaking (REG–116567–99, 2000–5 I.R.B. 463) regarding a proposed change in the period of years that are considered in determining whether a currency is hyperinflationary for purposes of section 988 (base period). The notice of proposed rulemaking also provided notice of a public hearing on the proposed regulations. No requests to speak were received, and the public hearing was canceled. This Treasury decision finalizes the proposed regulations relating to the change in base period, with certain minor changes.

Explanation of Provisions

As set out in the notice of proposed rulemaking, the term hyperinflationary currency, as defined in §1.988–1(f), utilizes the definition in §1.985–1(b)(2)(ii)(D). This definition was developed in the context of the Dollar Approximate Separate Transactions Method (DASTM) regulations, §1.985–3, and generally considers the cumulative effects of inflation over the base period in determining whether a currency is hyperinflationary. In §1.985–1(b)(2)(ii)(D), the base period consists of the thirty-six calendar month period immediately preceding the first day of the current calendar year. Use of this base period is generally appropriate in the context of DASTM because a qualified business unit needs to know in advance if it is subject to §1.985–3 calculations.

However, failure to take the current year's inflation into account for purposes of computing foreign currency gain or loss under section 988 may lead to distortions in income and expense because inflation may rise dramatically in a single year. Accordingly, the IRS and Treasury believe that for purposes of section 988, it is more appropriate to consider the cumulative inflation rate over the thirty-six month period ending on the last day of the taxpayer's (or the qualified business unit's) current taxable year. This change in the base period, however, applies only for the purposes of section 988 and not for the purpose of determining whether a taxpayer (or QBU) is subject to the provisions of §1.985–3.

Summary of Comments

One comment was received in connection with the proposed change in the measurement of the base period under section 988. This comment relates to the application of the rule to regulated investment companies (RICs). The commenter stated that sections 852(a) and 4982 effectively require a RIC to distribute essentially all of its income during the calendar year in which it is earned. Thus, the commenter concluded that RICs need to know before the end of their tax year whether a particular currency is hyperinflationary. The Treasury and IRS recognize that the revised definition of base period could present an administrative burden for RICs. Accordingly, the final regulation provides that RICs are not subject to the revised base period standard of these final regulations.

A similar exclusion from the revised base period standard has been made for REITs due to their similar distribution requirements. The regulation has also been amended to provide that the Service may by notice provide that the revised base period standard shall not apply to any section 988 transaction of an entity with distribution requirements similar to that of RICs and REITs.

In addition, the regulation was amended to provide that generally accepted accounting principles may not apply to alter the base period outlined in paragraph (f)(1)(ii)(A) of this section. This change is intended to clarify that the last sentence of §1.985–1(b)(2)(ii)(D) may not be used to alter the base period for purposes of section 988.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive

Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required.

Drafting Information

The principal author of these regulations is John W. Rogers III of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department also participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. In §1.988–1, paragraph (f) is revised to read as follows:

§1.988–1 Certain definitions and special rules

* * * * *

(f) *Hyperinflationary currency*—(1) *Definition*—(i) *General rule*. For purposes of section 988, a hyperinflationary currency means a currency described in §1.985–1(b)(2)(ii)(D). Unless otherwise provided, the currency in any example used in §§1.988–1 through 1.988–5 is not a hyperinflationary currency.

(ii) *Special rules for determining base period*. In determining whether a currency is hyperinflationary under §1.985–1(b)(2)(ii)(D) for purposes of this paragraph (f), the following rules will apply:

(A) The base period means the thirty-six calendar month period ending on the last day of the taxpayer's (or qualified business unit's) current taxable year. Thus, for example, if for 1996, 1997, and 1998, a country's annual inflation rates are 6 percent, 11 percent, and 90 percent, respectively, the cumulative inflation rate for the three-year base period is 124% [((1.06 x 1.11 x 1.90) - 1.0 = 1.24) x 100 = 124%]. Accordingly, assuming the QBU has a calendar year as its taxable year, the currency of the country is hyperinflationary for the 1998 taxable year. This change in the §1.985–1(b)(2)(ii)(D) base period shall not apply to any section 988 transaction of an entity described in section 851 (regulated investment company (RIC)) or section 856 (real estate investment trust (REIT)). The Service may, by notice, provide that the foregoing change in the §1.985–1(b)(2)(ii)(D) base period does not apply to any section 988 transaction of an entity with distribution requirements similar to a RIC or REIT.

(B) The last sentence of §1.985–1(b)(2)(ii)(D) shall not apply to alter the base period for purposes of this paragraph (f) in determining whether a currency is hyperinflationary for purposes of section 988. Accordingly, generally accepted accounting principles may not apply to alter the base period for purposes of this paragraph (f). (2) *Effective date*. Paragraph (f)(1) of this section shall apply to transactions entered into after February 14, 2000.

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Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

Approved November 29, 2000.

Jonathan Talisman,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 29, 2000, 8:45 a.m., and published in the issue of the Federal Register for January 3, 2001, 66 F.R. 279)

Section 4958.—Taxes on Excess Benefit Transactions

26 CFR 53.4958–1T: Taxes on excess benefit transactions (temporary).

T.D. 8920

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 53, 301, and 602

Excise Taxes on Excess Benefit Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

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

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

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

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

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

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

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

Background

Section 4958 was added to the Code by the Taxpayer Bill of Rights 2, Public Law 104–168 (110 Stat. 1452), enacted July 30, 1996. The section 4958 excise taxes generally apply to excess benefit transactions occurring on or after September 14, 1995. The IRS notified the general public of the new section 4958 excise taxes in Notice 96–46 (1996–2 C.B. 212), which also solicited comments on the new law.

On August 4, 1998, a notice of proposed rulemaking (REG–246256–96) on page 713 of this Bulletin clarifying certain definitions and rules contained in section 4958 was published in the **Federal Register** (63 F.R. 41486). The IRS received numerous written comments responding to this notice, including a comment from the public on the collections of information estimates contained therein.

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

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

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

Explanation of Provisions

Additional Taxes on Disqualified Person

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

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

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

Correction

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Tax Paid by Organization Managers: Reliance on Advice of Counsel

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

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

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

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

Date of Occurrence

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

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

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

Any excess benefit transaction with respect to benefits under a deferred compensation plan which vest during any taxable year of the disqualified person is deemed to occur on the last day of the disqualified person's taxable year.

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

Definition of Applicable Tax-Exempt Organization

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

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

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

Definition of Disqualified Person

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

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

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

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

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

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

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

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

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

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

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

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

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

Definition of Excess Benefit Transaction

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

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

Economic Benefit Provided Directly or Indirectly

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

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

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

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

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

Initial Contract Exception

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

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

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

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

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

4958 to the extent the contract allows for subsequent discretion to be exercised (which may be subject to influence by the disqualified person) when calculating the amount of a payment or deciding whether to make a payment. The temporary regulations include eleven examples to illustrate the application of the initial contract rule.

Certain Economic Benefits Disregarded for Purposes of Section 4958

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

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

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

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

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

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

Insurance or Indemnification of Excise Taxes

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

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

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

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

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

Timing Rules for Determining Reasonableness

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

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

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

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

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

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

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

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

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

Section 4958(c)(2) describes a second type of excess benefit transaction: "any transaction in which the amount of any economic benefit provided to or for the use of a disqualified person is determined in whole or in part by the revenues of 1 or more activities of the organization . . .", if the transaction results in inurement under section 501(c)(3) or (4). However, a revenue-sharing transaction is treated as an excess benefit transaction under this special statutory rule only "[t]o the extent provided in regulations prescribed by the Secretary . . . ."

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

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

Numerous comments were received with respect to revenue-sharing transactions. Some commentators did not believe a different standard from that applied to all other transactions (fair market value) should apply, and that the value of consideration provided by a disqualified person in a revenue-sharing transaction should be taken into account in determining the excess benefit in these transactions. Others objected to the revenue-sharing transaction standard of the proposed regulations, and requested that it be replaced by a standard based on approaches the IRS has taken in prior unpublished rulings. Some commentators requested guidance as to the meaning of *proportional benefits* or other concepts incorporated in the proposed regulations standard. Others requested that existing contractual arrangements not be subject to this section of the final regulations, or that the effect of the final rules for existing arrangements be phased in. In addition, several commentators requested that the final regulations clarify whether the rebuttable presumption of reasonableness is available for revenue-sharing transactions. In sum, commentators offered multiple, often conflicting, suggestions and recommendations to address the many issues raised with respect to revenue-sharing transactions.

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

Rebuttable Presumption that a Transaction is not an Excess Benefit Transaction

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

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

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

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

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

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

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

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

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

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

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

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

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

Special Rules

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

Additional Issues

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

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

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

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

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

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

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no preceding notice of proposed rulemaking is required for this temporary regulation, the provisions of the Regulatory Flexibility Act do not apply. Pursuant to section

7805(f) of the Internal Revenue Code, this temporary regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on business.

Drafting Information

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

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Amendments to the Regulations

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

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

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

Authority: 26 U.S.C. 7805.

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

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

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

(ii) Reasonable compensation.
(A) In general.
(B) Items included in determining the value of compensation for purposes of determining reasonableness under section 4958.
(C) Inclusion in compensation for reasonableness determination does not govern income tax treatment.
(2) Timing of reasonableness determination.
(i) In general.
(ii) Treatment as a new contract.
(iii) Examples.
(c) Establishing intent to treat economic benefit as consideration for the performance of services.
(1) In general.
(2) Nontaxable benefits.
(3) Contemporaneous substantiation.
(i) Reporting of benefit.
(ii) Other evidence of contemporaneous substantiation.
(iii) Failure to report due to reasonable cause.
(4) Examples.

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

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

(a) In general.
(b) Rebutting the presumption.
(c) Requirements for invoking rebuttable presumption.
(1) Approval by an authorized body.
(i) In general.
(ii) Individuals not included on authorized body.
(iii) Absence of conflict of interest.
(2) Appropriate data as to comparability.
(i) In general.
(ii) Special rule for compensation paid by small organizations.
(iii) Application of special rule for small organizations.
(iv) Examples.
(3) Documentation.
(d) No presumption with respect to non-fixed payments until amounts are determined.
(1) In general.
(2) Special rule for certain non-fixed payments subject to a cap.
(e) No inference from absence of presumption.
(f) Period of reliance on rebuttable presumption.

§53.4958–7T Correction (temporary).

(a) In general.
(b) Form of correction.
(1) Cash or cash equivalents.
(2) Anti-abuse rule.
(3) Special rule relating to nonqualified deferred compensation.
(4) Return of specific property.
(i) In general.
(ii) Payment not equal to correction amount.
(iii) Disqualified person may not participate in decision.
(c) Correction amount.
(d) Correction where contract has been partially performed.
(e) Correction in the case of an applicable tax-exempt organization that has ceased to exist, or is no longer tax-exempt.
(1) In general.
(2) Section 501(c)(3) organizations.
(3) Section 501(c)(4) organizations.
(f) Examples.

§53.4958–8T Special rules (temporary).

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

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

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

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

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

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

amount (as described in §53.4958–7T(c)). The tax imposed by section 4958(b) is payable by any disqualified person who received an excess benefit from the excess benefit transaction on which the initial tax was imposed by section 4958(a)(1). With respect to any excess benefit transaction, if more than one disqualified person is liable for the tax imposed by section 4958(b), all such persons are jointly and severally liable for that tax.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(C) Independent valuation experts who—

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(2) *Organizations described in section 501(c)(3)*. An organization is described in

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

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

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

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

(4) *Effect of non-recognition or revocation of exempt status*. An organization is not described in paragraph (a)(2) or (3) of this section during any period covered by a final determination or adjudication that the organization is not exempt from tax under section 501(a) as an organization described in section 501(c)(3) or (4), so long as that determination or adjudication is not based upon participation in inurement or one or more excess benefit transactions. However, the organization may be an applicable tax-exempt organization for that period as a result of the five-year lookback rule described in paragraph (a)(1) of this section.

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

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

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

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

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

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

(i) Spouse;

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

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

(iv) Ancestors;

(v) Children;

(vi) Grandchildren;

(vii) Great grandchildren; and

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(i) The person founded the organization;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(2) *Timing of reasonableness determination*—(i) *In general*. The facts and cir-

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) The compensation arrangement or the terms of the property transfer are approved in advance by an authorized body of the applicable tax-exempt organization (or an entity controlled by the organization with the meaning of §53.4958–4T(a)(2)(ii)(B)) composed entirely of individuals who do not have a conflict of interest (within the meaning of paragraph (c)(1)(iii) of this section) with respect to the compensation arrangement or property transfer, as described in paragraph (c)(1) of this section;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

§53.4958–7T Correction (temporary).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

§53.4958–8T Special rules (temporary).

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

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

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

§53.4963–1 [Amended]

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

PART 301—PROCEDURE AND ADMINISTRATION

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

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

§301.6213–1 [Amended]

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

§301.6501(e)–1 [Amended]

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

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

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

§301.6501(n)–1 [Amended]

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

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

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

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

§301.7422–1 [Amended]

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

§301.7454–2 [Amended]

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

§301.7611–1 [Amended]

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

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

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

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

* * * * *

Application to Section 4958

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

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

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

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

§602.101 OMB control numbers.

* * * * *

(b) * * *

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

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 19, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 9, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 10, 2001, 66 F.R. 2144)

Section 4980B.—Failure to Satisfy Continuation Coverage Requirements of Group Health Plans

26 CFR 54.4980B–1: COBRA in general.

T.D. 8928

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 54

Continuation Coverage Requirements Applicable to Group Health Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance on certain issues that arise in connection with the COBRA continuation coverage requirements applicable to group health plans. The regulations in this document supplement final COBRA regulations published on February 3, 1999, in the **Federal Register**. The regulations will generally affect sponsors and administrators of, and participants in, group health plans, and they provide plan sponsors and plan administrators with guidance necessary to comply with the law.

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

Applicability dates: For dates of applicability, see the discussion under the heading "Effective Date" in this preamble.

FOR FURTHER INFORMATION CONTACT: Yurlinda Mathis at 202-622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) imposes continuation coverage requirements on group health plans in certain situations. This document contains amendments to the COBRA health care continuation coverage regulations in 26 CFR part 54. Proposed regulations interpreting COBRA were published in the **Federal Register** on June 15, 1987 (52 F.R. 22716). On February 3, 1999, final COBRA regulations (T.D. 8812, 1999–1 C.B. 533) were published in the **Federal Register** (64 F.R. 5160) (the 1999 final regulations), and a notice of proposed rulemaking (REG–121865–98, 1999–1 C.B. 577) was published the same day (64 F.R. 5237) for certain issues not addressed in the final regulations (the 1999 proposed regulations). A public hearing was held on June 8, 1999. In addition, written comments responding to the notice of proposed rulemaking and to the final regulations were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation and Summary of Comments

Small Employer Plan Exception

Group health plans maintained by an employer that had fewer than 20 employees on a typical business day in the previous calendar year are not subject to COBRA. The 1999 proposed regulations relating to plans maintained by an employer with fewer than 20 employees in the previous calendar year are adopted as final regulations without change. Unlike the 1987 proposed regulations, the 1999 proposed regulations use a full-time equivalency method in counting part-time employees for purposes of determining if an employer had fewer than 20 employees. Several commenters expressed disapproval of this approach or inquired why it was being considered.

The 1987 proposed regulations contained rules about how to count part-time employees. An example can be used to illustrate how the 1987 rules were proposed to apply. In a calendar year two employers each employ 15 full-time employees and 12 part-time employees. Each part-time employee works 15 hours per week. Each employer has six typical business days each week. One employer schedules all 12 of the part-time employees to work two-and-a-half hours each typical business day per week. The other employer staggers the schedule of the part-time employees so that they each work seven-and-a-half hours on two typical business days per week, so that four part-time employees work on each typical business day. Under the 1987 proposed regulations, the part-time employees of the first employer counted as 12 employees whereas the part-time employees of the second employer counted only as four employees. In the following calendar year, a group health plan maintained by the first employer would have been subject to COBRA (because the first employer employed 27 employees on a typical business day in the preceding calendar year) but a group health plan maintained by the second employer would not have been subject to COBRA (because the second employer employed only 19 employees on a typical business day in the preceding calendar year).

The exception for employers with fewer than 20 employees reflects Congress' judgment that the costs and administrative burden associated with COBRA should not be imposed on small employers and that imposing such requirements on small employers may discourage them from providing group health coverage to their employees. There is no reason to distinguish, as the approach in the 1987 proposed regulations would have done, between two employers with identical numbers of full- and part-time employees based on the particular days that the part-time employees work.

In contrast to the result under the 1987 proposed regulations, the 1999 proposed regulations and these final regulations provide for the uniform treatment of employers employing the same number of part-time employees for equivalent periods, regardless of how the hours are scheduled. The full-time equivalency approach therefore avoids creating an incentive for employers to schedule the work of their part-time employees in a manner that is inconsistent with the convenience of the employees or the needs of the business.

One commenter asked if it is permissible to count part-time employees on an aggregate basis rather than an individual basis. On an individual basis, the number of part-time employees is computed by dividing the hours worked by each part-time employee by the hours required to be considered working full-time and then by adding all the quotients together. On an aggregate basis, the number of part-time employees is computed by adding all the hours worked by part-time employees and dividing that sum by the number of hours required for one worker to be considered working full-time. Because the two methods produce identical results, both methods are permissible.

Determination of Number of Plans

The 1999 proposed regulations relating to the determination of the number of plans that an employer or employee organization maintains are modified and reorganized. Under the 1999 proposed regulations, the number of plans is determined by the instruments governing the employer's or employee organization's arrangement or arrangements to provide health care benefits (the instruments rule). Another rule (the default rule) in the 1999 proposed regulations provides that if there are no instruments or if the instruments are unclear about whether there is one plan or more than one plan, all health care benefits (except benefits for long-term care) provided by a corporation, partnership, or other entity or trade or business, or by an employee organization, constitute one group health plan.

Under these final regulations, these rules are reorganized so that the default rule, under which all health care benefits provided by one entity or trade or business are treated as one plan, is presented first. The default rule applies unless it is clear from the instruments governing an arrangement or arrangements to provide health care benefits that the benefits are being provided under separate plans and the arrangement or arrangements are operated pursuant to such instruments as separate plans. In effect, this rule revises the instruments rule in the 1999 proposed regulations by adding the requirement that the arrangement or arrangements must be operated pursuant to the instruments as separate plans to avoid the application of the default rule. These organizational and substantive changes from the 1999 proposed regulations were developed at the suggestion of and with substantial assistance from the U.S. Department of Labor, Pension and Welfare Benefits Administration.

Health Flexible Spending Arrangements

The 1999 proposed regulations relating to health flexible spending arrangements (health FSAs) are adopted with one minor change and one addition. The minor change is the cross-reference in which a health FSA is defined. The 1999 proposed regulations cite the definition in proposed regulations under section 125. These final regulations cite the definition in section 106(c)(2) of the Internal Revenue Code. (Regulations published recently under section 125 also use the section 106(c)(2) definition. See 65 F.R. 15548, 15553 (March 23, 2000).)

The one addition is a clarification that, to the extent a health FSA is obligated to make COBRA continuation coverage available to a qualified beneficiary, all the general COBRA continuation coverage rules apply in the same way that they apply to coverage under other group health plans, including the rule for how plan limits on coverage apply to someone on COBRA continuation coverage. This addition was made in response to the request of one commenter and numerous inquiries about how the annual election of a certain dollar amount by an employee under a health FSA applies once there is a qualifying event.

Several commenters were pleased with the limited exception from the COBRA rules for health FSAs under the 1999 proposed regulations and asked that the final regulations go even further. They requested that when participants under a health FSA experience a qualifying event (and the benefits under the health FSA are excepted benefits under sections 9831 and 9832), the final regulations should allow the health FSA to compute the contributions made during that plan year on the participant's behalf, reduce that amount by reimbursements already made during the plan year, and — instead of requiring the health FSA to offer COBRA continuation coverage in those cases in which there is a positive balance — allow the participant to spend whatever balance remains during the remainder of the plan year without requiring or allowing additional contributions. However, such an approach is inconsistent with the requirements under sections 125 and 4980B and thus has not been adopted.

One commenter requested that the final regulations clarify that the applicable premium includes any employer subsidy. The statute makes clear that the applicable premium is computed based on the total cost of coverage, regardless of whether paid by the employer or employee. The regulations generally do not address how to calculate the applicable premium. However, the example for the health FSA exception makes clear that the maximum amount a plan is permitted to charge for COBRA coverage under a health FSA includes any employer subsidy.

One commenter requested that the final regulations clarify that a health FSA is obligated to make COBRA continuation coverage available only in connection with qualifying events that are a termination of employment or reduction of hours of employment. This suggestion is not adopted in the final regulations because it is inconsistent with the statute. If health care expenses incurred for a spouse or dependent child of an active employee can be reimbursed under a health FSA, but, were it not for the COBRA continuation coverage rules, would not be reimbursed after the death of the employee, the divorce from the employee, or a dependent child's ceasing to be a dependent child under the generally applicable requirements under the health FSA, then the spouse or dependent child has experienced a qualifying event and is entitled to continue coverage under the health FSA to the same extent as they would following termination of the employee's employment.

Increase in Premium is Loss of Coverage

The 1999 final regulations provide, in describing what constitutes a loss of coverage for determining whether a qualifying event has occurred, that any increase in premium or contribution that must be paid for coverage as a result of one of the events that can be a qualifying event is a loss of coverage. Several commenters questioned why this rule was adopted and pointed out that it creates administrative burdens in two situations without apparently providing any advantage to the people whose premium is being increased. The two situations concern retiring employees and full-time employees reducing their work hours to become part-time employees. In both situations, often employers will grant the employees access to the same coverage but will require them to pay a premium that is higher than what active employees pay though still significantly less than the 102 percent rate permitted under COBRA. The commenters wondered why it is necessary to provide these individuals with a COBRA notice if it is always advantageous for the individual to take the other coverage. They suggested that a loss of coverage should not be considered to have occurred if employees (or other qualified beneficiaries) can get access to the same coverage for less than the applicable premium under COBRA.

The IRS and Treasury were mindful of these situations before they adopted the rule in the 1999 final regulations. However, if a mere increase in premium were not considered a loss in coverage, the person whose premium is being increased would not be entitled by law to a 60-day election period nor to a 45-day period after the election for making the first premium payment. Although in many cases a qualified beneficiary might prefer a lower premium over these procedural protections under COBRA, in some cases these procedural protections might be more valuable. The likelihood of the COBRA procedural protections being more valuable than the lower premium becomes substantial as the amount required to be paid for part-time or retiree coverage approaches the amount of the applicable premium. Accordingly, the final regulations retain the rule in the 1999 final regulations so as not to deprive qualified beneficiaries of potentially valuable rights.

Termination of Coverage in Anticipation of a Qualifying Event

The 1999 final regulations provide that if coverage is reduced or eliminated in anticipation of an event, the elimination or reduction is disregarded in determining whether the event causes a loss of coverage. The regulations provide examples of an employer eliminating an employee's coverage in anticipation of a termination of employment and of an employee eliminating a spouse's coverage in anticipation of a divorce.

One commenter requested a clarification that a reduction or elimination more than six months before an event could not be considered to be in anticipation of the event. However, in many cases where coverage is eliminated by an employee in anticipation of a divorce, the divorce will follow the elimination by more than six months. Whether a reduction or elimination of coverage is in anticipation of a qualifying event is a question to be resolved based on all the relevant facts and circumstances. Thus, these final regulations do not amend the rule in the 1999 final regulations to limit the window during which an anticipatory reduction or elimination can be considered to have occurred.

The commenter also requested a clarification that the coverage the qualified beneficiary is entitled to in such a situation is the coverage the qualified beneficiary had before coverage was reduced or eliminated. The general rule in the 1999 final regulations for determining what is COBRA continuation coverage applies in this situation. Under the rule in the 1999 final regulations, the qualified beneficiary will generally be entitled to the coverage that the qualified beneficiary had before the qualifying event. However, if between the date of the elimination or reduction in coverage and the date of the qualifying event coverage is modified for similarly situated nonCOBRA beneficiaries, then the modified coverage must be made available to the qualified beneficiary.

Moving Outside Region of Region-Specific Coverage

The 1999 final regulations require employers and employee organizations to make alternative coverage available to qualified beneficiaries moving outside the service area of a region-specific benefit package. One commenter asked for a clarification that the alternative coverage must be made available immediately and cannot be deferred until the beginning of the plan's next open enrollment period. These final regulations clarify that the alternative coverage must be made available not later than the date of the qualified beneficiary's relocation, or, if later, the first day of the month following the month in which the qualified beneficiary requests the alternative coverage.

Another commenter expressed concern that a plan might have to incur extraordinary costs (such as negotiating for a separate network of providers in an indemnity plan with a preferred provider organization, or establishing a separate schedule of usual, customary, and reasonable costs) to provide coverage in areas to which a qualified beneficiary might relocate but in which there were no active employees of the employer or employee organization. The rule in the 1999 final regulations does not require employers or employee organizations to incur extraordinary costs to extend coverage to qualified beneficiaries in areas in which the employer or employee organization does not have active employees. In the case of an indemnity plan with a preferred provider organization, the plan need only provide benefits at the standard rate (that is, not at the rate for preferred providers) to a qualified beneficiary who moves outside the service area of the preferred provider network. Similarly, a plan is not required to establish a separate schedule of usual, customary, and reasonable costs solely for qualified beneficiaries who reside in a region where no active employees work or reside (regardless of whether this is to the qualified beneficiary's benefit or detriment based on prevailing costs in the region where the qualified beneficiary resides). Accordingly, these final regulations do not modify the rule in the 1999 final regulations based on this commenter's concern.

When COBRA Continuation Coverage Must Become Effective

The 1999 final regulations provide that, in the case of an indemnity or reimbursement arrangement, claims incurred during the election period do not have to be paid before the election (and, if applicable, payment for the coverage) is made. In the case of indemnity or reimbursement arrangements that allow retroactive reinstatement of coverage, the 1999 final regulations provide that coverage for qualified beneficiaries can be terminated and then reinstated when the election is made. One commenter asked if these two rules mean that coverage must be reinstated at the time of the election even if payment is not made but that no claims need be paid under that coverage until payment for the coverage is made. The commenter pointed out that this would a pose a problem for employers and employee organizations maintaining insured plans in that they would have to pay the insurer premiums for the coverage even if payment for the coverage was never made (whereas the insurer would never have to pay any claim under the coverage). These final regulations clarify this rule by explicitly providing that in the case of indemnity plans and reimbursement arrangements that allow retroactive reinstatement of coverage, coverage can be terminated and later reinstated when the election (and, if applicable, payment for the coverage) is made. Thus, under these final regulations, the rules for when coverage must be reinstated and when claims must be paid are the same.

Maximum Coverage Period

The 1999 proposed regulations relating to the maximum coverage period are adopted as final regulations with a minor change to a cross-reference.

Insignificant Underpayments

The 1999 final regulations prescribe how plans are to treat payments for COBRA continuation coverage that are short by an amount that is not significant. They require the plan to treat the payment as full payment unless the plan notifies the qualified beneficiary of the amount of the deficiency and grants a reasonable period for payment of the deficiency. The regulations provide as a safe harbor that a period of 30 days after the notice is provided is a reasonable period for this purpose.

Many commenters requested that the regulations specify what is considered a significant amount. These final regulations provide that a shortfall is not significant if it is no greater than the lesser of $50 (or another amount specified by the Commissioner in guidance of general applicability) or 10 percent of the required amount.

Several commenters also requested that the regulations specify a period shorter than 30 days for payment of the deficiency to be considered timely, but these final regulations do not adopt this suggestion. The regulations require only that a plan grant a reasonable period for payment of the deficiency. In some circumstances, a period shorter than 30 days may be reasonable. However, in other circumstances, a shorter period might not be reasonable. The IRS and Treasury believe it is useful to provide the certainty of a safe harbor, but they do not believe that a period shorter than 30 days is sufficiently long in all cases.

Business Reorganizations

The 1999 proposed regulations relating to business reorganizations are adopted as final regulations with two clarifications. The proposed regulations provide that, in an asset sale (which is defined as the sale of substantial assets such as a plant or division or substantially all the assets of a trade or business), a purchaser of assets is considered a successor employer if the seller ceases to provide any group health plan to any employee in connection with the sale and if the buyer continues the business operations associated with those assets without substantial change or interruption. Several inquiries raised the question whether this rule applies if the assets are purchased as part of a bankruptcy proceeding. The final regulations clarify this rule for assets purchased in bankruptcy by providing that a buying group does not fail to be a successor employer in connection with an asset sale merely because the sale takes place in connection with a bankruptcy proceeding. Thus, the general rule for determining whether a buyer is a successor employer applies in bankruptcy the same way that it does outside of bankruptcy.

These final regulations also clarify that asset sale includes not only sales but other transfers as well.

Comments were received about other aspects of the proposed rules for business reorganizations. Several commenters requested additional guidance on the amount of assets that would constitute "substantial assets" for purposes of the asset sale rules. The final regulations retain the definition in the proposed regulations. This definition is intended to be flexible enough to apply reasonably to the myriad situations in which this issue arises. The asset sale rules, including the definition of asset sale, are similar to the various formulations of successor employer rules that have been fashioned by the courts for various labor law purposes, adapted to the peculiar circumstances that the COBRA continuation coverage requirements create. In those cases, as in the final rule, a case-by-case approach is favored. See, for example, *Golden State Bottling Co. v. NLRB*, 414 U.S. 168 (1973); *Howard Johnson Co. v. Detroit Local Joint Executive Board, Hotel & Restaurant Employees & Bartenders International Union*, 417 U.S. 249 (1974); *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964); *NLRB v. Burns International Security Services, Inc.*, 406 U.S. 272 (1972); *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27 (1987); *EEOC v. MacMillan Bloedel Containers, Inc.*, 503 F.2d 1086 (6th Cir. 1974); *In re National Airlines, Inc.*, 700 F.2d 695 (11th Cir. 1983); *Upholsterers' International Union Pension Fund v. Artistic Furniture of Pontiac*, 920 F.2d 1323 (7th Cir. 1990); *Central States, Southeast & Southwest Areas Pension Fund v. PYA/Monarch of Texas, Inc.*, 851 F.2d 780 (5th Cir. 1988).

One commenter requested clarification that the cessation of a plan shortly before an asset sale is in connection with the sale (and thus that the buying group would be responsible for making COBRA continuation coverage available to M&A qualified beneficiaries in connection with the sale if the buying group is a successor employer). The regulations have not been modified for this request. In many circumstances, cessation of a plan shortly before an asset sale would be considered to be in connection with the sale. However, there may be cases in which the plan was being terminated for an unrelated reason. The application of this rule in any particular case depends on all the relevant facts and circumstances.

The preamble to the 1999 proposed regulations included a description of a potential rule that the IRS and Treasury were considering adopting and solicited comments on that potential rule. The rule would have provided that no loss of coverage occurs, and thus no qualifying event occurs, if a purchaser of assets maintains substantially the same plan for continuing employees for what would otherwise be the maximum coverage period (generally 18 months). The IRS and Treasury also acknowledged in the 1999 preamble concerns about protecting the rights of qualified beneficiaries in this situation. After consideration of the comments, the IRS and Treasury have determined not to adopt such a special rule. Thus, under these final regulations, in an asset sale, employees who terminate employment with the seller and who no longer get health coverage from the seller experience a qualifying event with respect to the seller's plan even though they are employed by the buyer at the same jobs they had with the seller and have the same health coverage through the buyer.

Like the 1999 proposed regulations, these final regulations do not address how the obligation to make COBRA continuation coverage available is affected by the transfer of an ownership interest in a noncorporate entity. However, it is intended that, in general, the principles reflected in the rules in the final regulations for transfers of ownership interests in corporate entities should apply in a similar fashion in analogous cases involving the transfer of ownership interests in noncorporate entities.

Employer Withdrawals from Multiemployer Plans

The 1999 proposed regulations relating to employer withdrawals from a multiemployer plan are adopted with two changes and two additional examples to illustrate the rules as changed. The general approach of the 1999 proposed regulations is retained. However, the proposed rule renders an employer who stops contributing to a multiemployer plan responsible for making COBRA continuation coverage available to qualified beneficiaries associated with that employer only if the employer establishes a new plan to cover active employees formerly covered under the multiemployer plan. Several commenters suggested that the employer should also be responsible for COBRA if the coverage provided to employees formerly covered under the multiemployer plan comes from an existing plan of the employer (rather than from a new plan). The final rules have been revised to apply the general approach to existing plans as well as to new plans.

The 1999 proposed regulations also place a threshold condition on the obligation of an employer or subsequent multiemployer plan to make COBRA coverage available to existing qualified beneficiaries associated with the withdrawing employer. That threshold is that the employer or subsequent multiemployer plan must cover a significant number of the employer's employees formerly covered under the multiemployer plan. Several commenters requested further guidance on what a significant number was in this context. Some of them also wanted to know what purpose this threshold condition serves. The intent in imposing this threshold condition in the proposed regulations was to leave responsibility for COBRA compliance with the existing multiemployer plan in a case where, for example, only one or two of the employees formerly covered under the multiemployer plan were transferred into management and became covered under a plan of the employer for which union employees were not eligible. The final rule has been revised to more clearly accomplish this intent. This threshold condition has been revised so that the employer plan or subsequent multiemployer plan has responsibility for COBRA compliance once coverage under the plan is available to a class of employees formerly covered under the multiemployer plan. New examples illustrate the application of this standard.

Several commenters expressed concern that the proposed regulations would require multiemployer plans to begin investigating why an employer stops contributing to the multiemployer plan and to determine whether the withdrawing employer subsequently covered union (or former union) employees under a single employer plan. Concern was also expressed that the proposed regulations would require the multiemployer plan to keep employer-by-employer data for qualified beneficiaries receiving COBRA continuation coverage. The IRS and Treasury recognized when they proposed these rules that in many industries it is impracticable for multiemployer plans to determine whether an employer that stops contributing to a multiemployer plan covers union employees under its own plan and that it is impracticable to maintain employer-specific data on employees and qualified beneficiaries. If a multiemployer plan finds it easier to make COBRA coverage available for the maximum coverage period, these final regulations do not require the plan to start gathering information that is difficult to assemble. Such a plan can comply with the COBRA continuation coverage requirements by making COBRA continuation coverage available to existing qualified beneficiaries in accordance with the general rules for the duration of COBRA continuation coverage (in §54.4980B–7).

One commenter requested clarification of the proposed rules if an employer establishes a plan for employees formerly covered under the multiemployer plan but applies a waiting period before the employees are eligible for coverage under that plan. These final regulations clarify that the employer's obligation does not arise until the employer makes coverage available. Thus, the multiemployer plan would be responsible for COBRA coverage until the waiting period under the employer's plan had expired for a class of employees formerly covered under the multiemployer plan.

Several commenters submitted substantially similar comments requesting that the rules be revised so that a multiemployer plan no longer receiving contributions from a certain employer would not be required to make COBRA continuation coverage available to any qualified beneficiaries affiliated with that employer. Such an approach, however, would not resolve the problem of qualified beneficiaries not having access to COBRA coverage, and the statutory basis for such a position is questionable in situations in which none of the statutory reasons for ending a plan's obligation to make COBRA coverage available to a particular qualified beneficiary is present. The final regulations do not adopt this suggestion.

The IRS and Treasury received an inquiry about who has the obligation to make COBRA continuation coverage available to existing qualified beneficiaries in a situation that reverses the situation addressed in the proposed rules, one in which employees cease to be covered under a plan maintained by their employer and commence to be covered under a multiemployer plan. In such a situation, the existing qualified beneficiaries should get the same coverage that similarly situated nonCOBRA beneficiaries are receiving, that is, the coverage under the multiemployer plan. The 1999 final regulations suggest this result in describing what COBRA continuation coverage is. However, the language used in the 1999 final regulations can be read to suggest that this is the result only when coverage is under the same plan: "If coverage *under the plan* is modified for similarly situated nonCOBRA beneficiaries, then the coverage made available to qualified beneficiaries is modified in the same way." (Q&A-1(a) of §54.4980B–5; emphasis added.) These final regulations delete the phrase "under the plan" from the quoted language to make clear that if coverage for the similarly situated nonCOBRA beneficiaries is modified by switching from one plan to another, then coverage for the qualified beneficiaries is modified by switching to the other plan too. Although this amendment is being made due to an inquiry about a switch from a single-employer plan to a multi-employer plan, it applies in any situation in which coverage for nonCOBRA beneficiaries is terminated under one plan and commences under another, including those situations in which a single employer maintains both plans.

COBRA and FMLA

The 1999 proposed regulations relating to how COBRA applies in connection with leave taken under the Family and Medical Leave Act of 1993 (FMLA) are adopted as final regulations with one minor addition. One commenter observed that the 1999 proposed regulations suggest by way of cross reference in an example that the Labor regulations in 29 CFR part 825, not the COBRA regulations, determine when FMLA leave ends. This commenter requested that this suggestion in an example be made express in the text of the rules. The final regulations add in the text of the rules (preceding the examples) that the end of FMLA leave is not determined under these regulations but under the regulations in 29 CFR part 825.

Effective Date

This Treasury decision applies with respect to qualifying events occurring on or after January 1, 2002, except as provided in the following paragraphs.

Paragraphs (d), (e), and (f) in Q&A-5 of §54.4980B–2 (relating to the counting of employees for purposes of the small employer plan exception) are applicable beginning January 1, 2002 for determinations made with reference to the number of employees in calendar year 2001 or later.

Q&A-4 of §54.4980B–7 (describing the maximum coverage period) is applicable with respect to individuals who are qualified beneficiaries on or after January 1, 2002. (See Q&A-1(f) of §54.4980B–3, under which an individual ceases to be a qualified beneficiary once the plan's obligation to provide COBRA continuation coverage to the individual has ended.)

Q&A-1 through Q&A-8 of §54.4980B–9 (containing rules for business reorganizations) are applicable with respect to business reorganizations that take effect on or after January 1, 2002.

Q&A-9 and Q&A-10 of §54.4980B–9 (containing rules for employer withdrawals from a multiemployer plan) are applicable with respect to cessations of contributions that occur on or after January 1, 2002. For this purpose, a cessation of contributions occurs on or after January 1, 2002, if the employer's last contribution to the plan is made on or after January 1, 2002.

Section 54.4980B–10 (relating to the interaction of COBRA and FMLA leave) is applicable with respect to FMLA leave that begins on or after January 1, 2002.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

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

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 54 is amended as follows:

PART 54 – PENSION EXCISE TAXES

Paragraph 1. The authority citation for part 54 is amended in part by adding entries in numerical order to read as follows:

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

Section 54.4980B–9 also issued under 26 U.S.C. 4980B.

Section 54.4980B–10 also issued under 26 U.S.C. 4980B. * * *

Par. 2. Section 54.4980B–0 is amended by:

1. Revising the introductory text.
2. Adding entries for §§54.4980B–9 and 54.4980B–10 at the end of the "List of Sections".
3. Revising the entry for Q-2 of §54.4980B–1 in the "List of Questions".
4. Revising the entries for Q-3 and Q-6 of §54.4980B–2 in the "List of Questions".
5. Revising the entry for Q-4 of §54.4980B–7 in the "List of Questions".
6. Adding entries for the section headings for §§54.4980B–9 and 54.4980B–10 in the "List of Questions".

The additions and revisions read as follows:

§54.4980B–0 Table of contents.

This section contains first a list of the section headings and then a list of the questions in each section in §§54.4980B–1 through 54.4980B–10.

LIST OF SECTIONS

* * * * *

§54.4980B–9 Business reorganizations and employer withdrawals from multiemployer plans.

§54.4980B–10 Interaction of FMLA and COBRA.

LIST OF QUESTIONS

§54.4980B–1 COBRA in general.

* * * * *

Q-2: What standard applies for topics not addressed in §§54.4980B–1 through 54.4980B–10?

* * * * *

§54.4980B–2 Plans that must comply.

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Q-3: What is a multiemployer plan?

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Q-6: How is the number of group health plans that an employer or employee organization maintains determined?

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§54.4980B–7 Duration of COBRA continuation coverage.

*   *   *   *   *

Q-4: When does the maximum coverage period end?

*   *   *   *   *

§54.4980B–9 Business reorganizations and employer withdrawals from multiemployer plans.

Q-1: For purposes of this section, what are a business reorganization, a stock sale, and an asset sale?

Q-2: In the case of a stock sale, what are the selling group, the acquired organization, and the buying group?

Q-3: In the case of an asset sale, what are the selling group and the buying group?

Q-4: Who is an M&A qualified beneficiary?

Q-5: In the case of a stock sale, is the sale a qualifying event with respect to a covered employee who is employed by the acquired organization before the sale and who continues to be employed by the acquired organization after the sale, or with respect to the spouse or dependent children of such a covered employee?

Q-6: In the case of an asset sale, is the sale a qualifying event with respect to a covered employee whose employment immediately before the sale was associated with the purchased assets, or with respect to the spouse or dependent children of such a covered employee who are covered under a group health plan of the selling group immediately before the sale?

Q-7: In a business reorganization, are the buying group and the selling group permitted to allocate by contract the responsibility to make COBRA continuation coverage available to M&A qualified beneficiaries?

Q-8: Which group health plan has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries in a business reorganization?

Q-9: Can the cessation of contributions by an employer to a multiemployer group health plan be a qualifying event?

Q-10: If an employer stops contributing to a multiemployer group health plan, does the multiemployer plan have the obligation to make COBRA continuation coverage available to a qualified beneficiary who was receiving coverage under the multiemployer plan on the day before the cessation of contributions and who is, or whose qualifying event occurred in connection with, a covered employee whose last employment prior to the qualifying event was with the employer that has stopped contributing to the multiemployer plan?

§54.4980B–10 Interaction of FMLA and COBRA.

Q-1: In what circumstances does a qualifying event occur if an employee does not return from leave taken under FMLA?

Q-2: If a qualifying event described in Q&A-1 of this section occurs, when does it occur, and how is the maximum coverage period measured?

Q-3: If an employee fails to pay the employee portion of premiums for coverage under a group health plan during FMLA leave or declines coverage under a group health plan during FMLA leave, does this affect the determination of whether or when the employee has experienced a qualifying event?

Q-4: Is the application of the rules in Q&A-1 through Q&A-3 of this section affected by a requirement of state or local law to provide a period of coverage longer than that required under FMLA?

Q-5: May COBRA continuation coverage be conditioned upon reimbursement of the premiums paid by the employer for coverage under a group health plan during FMLA leave?

Par. 3. Section 54.4980B–1 is amended by:

1. Removing the language “54.4980 B–8” and adding “54.4980B–10” in its place in the last sentence of paragraph (a) in A-1.

2. Removing the language “54.4980 B–8” and adding “54.4980B–10” in its place in the third sentence and the last sentence of paragraph (b) in A-1.

3. Removing the last sentence of paragraph (c) in A-1 and adding two sentences in its place.

4. Revising Q&A-2.

The addition and revision read as follows:

§54.4980B–1 COBRA in general.

*   *   *   *   *

A-1: * * *

(c) * * * Section 54.4980B–9 contains special rules for how COBRA applies in connection with business reorganizations and employer withdrawals from a multiemployer plan, and §54.4980B–10 addresses how COBRA applies for individuals who take leave under the Family and Medical Leave Act of 1993. Unless the context indicates otherwise, any reference in §§54.4980B–1 through §54.4980B–10 to COBRA refers to section 4980B (as amended) and to the parallel provisions of ERISA.

Q-2: What standard applies for topics not addressed in §§54.4980B–1 through 54.4980B–10?

A-2: For purposes of section 4980B, for topics relating to the COBRA continuation coverage requirements of section 4980B that are not addressed in §§54.4980B–1 through 54.4980B–10 (such as methods for calculating the applicable premium), plans and employers must operate in good faith compliance with a reasonable interpretation of the statutory requirements in section 4980B.

Par. 4. Section 54.4980B–2 is amended by:

1. Revising paragraph (a) in A-1.

2. Removing the language “54.4980 B–8” and adding “54.4980B–10” in its place in the first sentence of paragraph (b) in A-1.

3. Revising A-2.

4. Adding Q&A-3.

5. Removing the language “54.4980 B–8” and adding “54.4980B–10” in its place in the last sentence of paragraph (a) in A-4.

6. Adding a sentence immediately before the last sentence of the introductory text of paragraph (a) in A-5.

7. Removing the language “54.4980 B–8” and adding “54.4980B–10” in its place in the last sentence of the introduc-

tory text of paragraph (c) in A-5.

8. Adding paragraphs (d), (e), and (f) in A-5.

9. Adding Q&A-6.

10. Revising A-8.

11. Revising paragraph (a) in A-10.

The additions and revisions read as follows:

§54.4980B–2 Plans that must comply.

* * * * *

A-1: (a) For purposes of section 4980B**,** a group health plan is a plan maintained by an employer or employee organization to provide health care to individuals who have an employment-related connection to the employer or employee organization or to their families. Individuals who have an employment-related connection to the employer or employee organization consist of employees, former employees, the employer, and others associated or formerly associated with the employer or employee organization in a business relationship (including members of a union who are not currently employees). Health care is provided under a plan whether provided directly or through insurance, reimbursement, or otherwise, and whether or not provided through an on-site facility (except as set forth in paragraph (d) of this Q&A-1), or through a cafeteria plan (as defined in section 125) or other flexible benefit arrangement. (See paragraphs (b) through (e) in Q&A-8 of this section for rules regarding the application of the COBRA continuation coverage requirements to certain health flexible spending arrangements.) For purposes of this Q&A-1, insurance includes not only group insurance policies but also one or more individual insurance policies in any arrangement that involves the provision of health care to two or more employees. A plan maintained by an employer or employee organization is any plan of, or contributed to (directly or indirectly) by, an employer or employee organization. Thus, a group health plan is maintained by an employer or employee organization even if the employer or employee organization does not contribute to it if coverage under the plan would not be available at the same cost to an individual but for the individual's employment-related connection to the employer or employee organization. These rules are further explained in paragraphs (b) through (d) of this Q&A-1. An exception for qualified long-term care services is set forth in paragraph (e) of this Q&A-1, and for medical savings accounts in paragraph (f) of this Q&A-1. See Q&A-6 of this section for rules to determine the number of group health plans that an employer or employee organization maintains.

* * * * *

A-2: (a) For purposes of section 4980B, employer refers to —

(1) A person for whom services are performed;

(2) Any other person that is a member of a group described in section 414(b), (c), (m), or (o) that includes a person described in paragraph (a)(1) of this Q&A-2; and

(3) Any successor of a person described in paragraph (a)(1) or (2) of this Q&A-2.

(b) An employer is a successor employer if it results from a consolidation, merger, or similar restructuring of the employer or if it is a mere continuation of the employer. See paragraph (c) in Q&A-8 of §54.4980B–9 for rules describing the circumstances in which a purchaser of substantial assets is a successor employer to the employer selling the assets.

Q-3: What is a multiemployer plan?

A-3: For purposes of §§54.4980B–1 through 54.4980B–10, a multiemployer plan is a plan to which more than one employer is required to contribute, that is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer, and that satisfies such other requirements as the Secretary of Labor may prescribe by regulation. Whenever reference is made in §§54.4980B–1 through 54.4980B–10 to a plan of or maintained by an employer or employee organization, the reference includes a multiemployer plan.

* * * * *

A-5: (a) * * * See Q&A-6 of this section for rules to determine the number of plans that an employer or employee organization maintains. * * *

* * * * *

(d) In determining the number of the employees of an employer, each full-time employee is counted as one employee and each part-time employee is counted as a fraction of an employee, determined in accordance with paragraph (e) of this Q&A-5.

(e) An employer may determine the number of its employees on a daily basis or a pay period basis. The basis used by the employer must be used with respect to all employees of the employer and must be used for the entire year for which the number of employees is being determined. If an employer determines the number of its employees on a daily basis, it must determine the actual number of full-time employees on each typical business day and the actual number of part-time employees and the hours worked by each of those part-time employees on each typical business day. Each full-time employee counts as one employee on each typical business day and each part-time employee counts as a fraction, with the numerator of the fraction equal to the number of hours worked by that employee and the denominator equal to the number of hours that must be worked on a typical business day in order to be considered a full-time employee. If an employer determines the number of its employees on a pay period basis, it must determine the actual number of full-time employees employed during that pay period and the actual number of part-time employees employed and the hours worked by each of those part-time employees during the pay period. For each day of that pay period, each full-time employee counts as one employee and each part-time employee counts as a fraction, with the numerator of the fraction equal to the number of hours worked by that employee during that pay period and the denominator equal to the number of hours that must be worked during that pay period in order to be considered a full-time employee. The determination of the number of hours required to be considered a full-time employee is based upon the employer's employment practices, except that in no event may the hours required to be considered a full-time employee exceed eight hours for any day or 40 hours for any week.

(f) In the case of a multiemployer plan, the determination of whether the plan is a small-employer plan on any particular date depends on which employers are contributing to the plan on that date and on the workforce of those employers during the preceding calendar year. If a plan that is otherwise subject to COBRA ceases to be a small-employer plan because of the addition during a calendar year of an employer that did not normally employ fewer than 20 employees on a typical business day during the preceding calendar year, the plan ceases to be excepted from COBRA immediately upon the addition of the new employer. In contrast, if the plan ceases to be a small-employer plan by reason of an increase during a calendar year in the workforce of an employer contributing to the plan, the plan ceases to be excepted from COBRA on the January 1 immediately following the calendar year in which the employer's workforce increased.

* * * * *

Q-6: How is the number of group health plans that an employer or employee organization maintains determined?

A-6: (a) The rules of this Q&A-6 apply in determining the number of group health plans that an employer or employee organization maintains. All references elsewhere in §§54.4980B–1 through 54.4980B–10 to a group health plan are references to a group health plan as determined under Q&A-1 of this section and this Q&A-6. Except as provided in paragraph (b) or (c) of this Q&A-6, all health care benefits, other than benefits for qualified long-term care services (as defined in section 7702B(c)), provided by a corporation, partnership, or other entity or trade or business, or by an employee organization, constitute one group health plan, unless —

(1) It is clear from the instruments governing an arrangement or arrangements to provide health care benefits that the benefits are being provided under separate plans; and

(2) The arrangement or arrangements are operated pursuant to such instruments as separate plans.

(b) A multiemployer plan and a nonmultiemployer plan are always separate plans.

(c) If a principal purpose of establishing separate plans is to evade any requirement of law, then the separate plans will be considered a single plan to the extent necessary to prevent the evasion.

(d) The significance of treating an arrangement as two or more separate group health plans is illustrated by the following examples:

Example 1. (i) Employer *X* maintains a single group health plan, which provides major medical and prescription drug benefits. Employer *Y* maintains two group health plans; one provides major medical benefits and the other provides prescription drug benefits.

(ii) *X*'s plan could comply with the COBRA continuation coverage requirements by giving a qualified beneficiary experiencing a qualifying event with respect to *X*'s plan the choice of either electing both major medical and prescription drug benefits or not receiving any COBRA continuation coverage under *X*'s plan. By contrast, for *Y*'s plans to comply with the COBRA continuation coverage requirements, a qualified beneficiary experiencing a qualifying event with respect to each of *Y*'s plans must be given the choice of electing COBRA continuation coverage under either the major medical plan or the prescription drug plan or both.

Example 2. If a joint board of trustees administers one multiemployer plan, that plan will fail to qualify for the small-employer plan exception if any one of the employers whose employees are covered under the plan normally employed 20 or more employees during the preceding calendar year. However, if the joint board of trustees maintains two or more multiemployer plans, then the exception would be available with respect to each of those plans in which each of the employers whose employees are covered under the plan normally employed fewer than 20 employees during the preceding calendar year.

* * * * *

A-8: (a)(1) The provision of health care benefits does not fail to be a group health plan merely because those benefits are offered under a cafeteria plan (as defined in section 125) or under any other arrangement under which an employee is offered a choice between health care benefits and other taxable or nontaxable benefits. However, the COBRA continuation coverage requirements apply only to the type and level of coverage under the cafeteria plan or other flexible benefit arrangement that a qualified beneficiary is actually receiving on the day before the qualifying event. See paragraphs (b) through (e) of this Q&A-8 for rules limiting the obligations of certain health flexible spending arrangements.

(2) The rules of this paragraph (a) are illustrated by the following example:

Example: (i) Under the terms of a cafeteria plan, employees can choose among life insurance coverage, membership in a health maintenance organization (HMO), coverage for medical expenses under an indemnity arrangement, and cash compensation. Of these available choices, the HMO and the indemnity arrangement are the arrangements providing health care. The instruments governing the HMO and indemnity arrangements indicate that they are separate group health plans. These group health plans are subject to COBRA. The employer does not provide any group health plan outside of the cafeteria plan. *B* and *C* are unmarried employees. *B* has chosen the life insurance coverage, and *C* has chosen the indemnity arrangement.

(ii) *B* does not have to be offered COBRA continuation coverage upon terminating employment, nor is a subsequent open enrollment period for active employees required to be made available to *B*. However, if *C* terminates employment and the termination constitutes a qualifying event, *C* must be offered an opportunity to elect COBRA continuation coverage under the indemnity arrangement. If *C* makes such an election and an open enrollment period for active employees occurs while *C* is still receiving the COBRA continuation coverage, *C* must be offered the opportunity to switch from the indemnity arrangement to the HMO (but not to the life insurance coverage because that does not constitute coverage provided under a group health plan).

(b) If a health flexible spending arrangement (health FSA), within the meaning of section 106(c)(2), satisfies the two conditions in paragraph (c) of this Q&A-8 for a plan year, the obligation of the health FSA to make COBRA continuation coverage available to a qualified beneficiary who experiences a qualifying event in that plan year is limited in accordance with paragraphs (d) and (e) of this Q&A-8, as illustrated by an example in paragraph (f) of this Q&A-8. To the extent that a health FSA is obligated to make COBRA continuation coverage available to a qualified beneficiary, the health FSA must comply with all the applicable rules of §§54.4980B–1 through 54.4980B–10, including the rules of Q&A-3 in §54.4980B–5 (relating to limits).

(c) The conditions of this paragraph (c) are satisfied if —

(1) Benefits provided under the health FSA are excepted benefits within the meaning of sections 9831 and 9832; and

(2) The maximum amount that the health FSA can require to be paid for a year of COBRA continuation coverage under Q&A-1 of §54.4980B–8 equals or exceeds the maximum benefit available under the health FSA for the year.

(d) If the conditions in paragraph (c) of this Q&A-8 are satisfied for a plan year, then the health FSA is not obligated to make COBRA continuation coverage available for any subsequent plan year to any qualified beneficiary who experiences a qualifying event during that plan year.

(e) If the conditions in paragraph (c) of this Q&A-8 are satisfied for a plan year, the health FSA is not obligated to make COBRA continuation coverage available for that plan year to any qualified beneficiary who experiences a qualifying event during that plan year unless, as of the date of the qualifying event, the qualified beneficiary can become entitled to receive during the remainder of the plan year a benefit that exceeds the maximum amount that the health FSA is permitted to require to be paid for COBRA continuation coverage for the remainder of the plan year. In determining the amount of the benefit that a qualified beneficiary can become entitled to receive during the remainder of the plan year, the health FSA may deduct from the maximum benefit available to that qualified beneficiary for the year (based on the election made under the health FSA for that qualified beneficiary before the date of the qualifying event) any reimbursable claims submitted to the health FSA for that plan year before the date of the qualifying event.

(f) The rules of paragraphs (b), (c), (d), and (e) of this Q&A-8 are illustrated by the following example:

Example. (i) An employer maintains a group health plan providing major medical benefits and a group health plan that is a health FSA, and the plan year for each plan is the calendar year. Both the plan providing major medical benefits and the health FSA are subject to COBRA. Under the health FSA, during an open season before the beginning of each calendar year, employees can elect to reduce their compensation during the upcoming year by up to $1200 per year and have that same amount contributed to a health flexible spending account. The employer contributes an additional amount to the account equal to the employee's salary reduction election for the year. Thus, the maximum amount available to an employee under the health FSA for a year is two times the amount of the employee's salary reduction election for the year. This amount may be paid to the employee during the year as reimbursement for health expenses not covered by the employer's major medical plan (such as deductibles, copayments, prescription drugs, or eyeglasses). The employer determined, in accordance with section 4980B(f)(4), that a reasonable estimate of the cost of providing coverage for similarly situated nonCOBRA beneficiaries for 2002 under this health FSA is equal to two times their salary reduction election for 2002 and, thus, that two times the salary reduction election is the applicable premium for 2002.

(ii) Because the employer provides major medical benefits under another group health plan, and because the maximum benefit that any employee can receive under the health FSA is not greater than two times the employee's salary reduction election for the plan year, benefits under this health FSA are excepted benefits within the meaning of sections 9831 and 9832. Thus, the first condition of paragraph (c) of this Q&A-8 is satisfied for the year. The maximum amount that a plan can require to be paid for coverage (outside of coverage required to be made available due to a disability extension) under Q&A-1 of §54.4980B–8 is 102 percent of the applicable premium. Thus, the maximum amount that the health FSA can require to be paid for coverage for the 2002 plan year is 2.04 times the employee's salary reduction election for the plan year. Because the maximum benefit available under the health FSA is 2.0 times the employee's salary reduction election for the year, the maximum benefit available under the health FSA for the year is less than the maximum amount that the health FSA can require to be paid for coverage for the year. Thus, the second condition in paragraph (c) of this Q&A-8 is also satisfied for the 2002 plan year. Because both conditions in paragraph (c) of this Q&A-8 are satisfied for 2002, with respect to any qualifying event occurring in 2002, the health FSA is not obligated to make COBRA continuation coverage available for any year after 2002.

(iii) Whether the health FSA is obligated to make COBRA continuation coverage available in 2002 to a qualified beneficiary with respect to a qualifying event that occurs in 2002 depends upon the maximum benefit that would be available to the qualified beneficiary under COBRA continuation coverage for that plan year. *Case 1*: Employee *B* has elected to reduce *B*'s salary by $1200 for 2002. Thus, the maximum benefit that *B* can become entitled to receive under the health FSA during the entire year is $2400. *B* experiences a qualifying event that is the termination of *B*'s employment on May 31, 2002. As of that date, *B* had submitted $300 of reimbursable expenses under the health FSA. Thus, the maximum benefit that *B* could become entitled to receive for the remainder of 2002 is $2100. The maximum amount that the health FSA can require to be paid for COBRA continuation coverage for the remainder of 2002 is 102 percent times 1/12 of the applicable premium for 2002 times the number of months remaining in 2002 after the date of the qualifying event. In *B*'s case, the maximum amount that the health FSA can require to be paid for COBRA continuation coverage for 2002 is 2.04 times $1200, or $2448. One-twelfth of $2448 is $204. Because seven months remain in the plan year, the maximum amount that the health FSA can require to be paid for *B*'s coverage for the remainder of the year is seven times $204, or $1428. Because $1428 is less than the maximum benefit that *B* could become entitled to receive for the remainder of the year ($2100), the health FSA is required to make COBRA continuation coverage available to *B* for the remainder of 2002 (but not for any subsequent year).

(iv) *Case 2*: The facts are the same as in *Case 1* except that *B* had submitted $1000 of reimbursable expenses as of the date of the qualifying event. In that case, the maximum benefit available to *B* for the remainder of the year would be $1400 instead of $2100. Because the maximum amount that the health FSA can require to be paid for *B*'s coverage is $1428, and because the $1400 maximum benefit for the remainder of the year does not exceed $1428, the health FSA is not obligated to make COBRA continuation coverage available to *B* in 2002 (or any later year). (Of course, the administrator of the health FSA is permitted to make COBRA continuation coverage available to every qualified beneficiary in the year that the qualified beneficiary's qualifying event occurs in order to avoid having to determine the maximum benefit available for each qualified beneficiary for the remainder of the plan year.)

* * * * *

A-10: (a) In general, the excise tax is imposed on the employer maintaining the plan, except that in the case of a multiemployer plan (see Q&A-3 of this section for a definition of multiemployer plan) the excise tax is imposed on the plan.

* * * * *

§54.4980B–3 [Amended]

Par. 5. Section 54.4980B–3 is amended by:

1. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in the last sentence of paragraph (a)(3) in A-1.

2. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in the first sentence of paragraph (g) in A-1.

3. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in the first and second sentences of paragraph (a)(1) in A-2.

4. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in the first sentence of paragraph (a)(2) in A-2.

5. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in the first and last sentences in paragraph (b) in A-2.

6. Removing the language "54.49 80B–8" and adding "54.4980B–10" in its place in A-3.

7. Removing the language "section 9801(f)(2), and §54.9801–6T(b)" and adding "and section 9801(f)(2)" in its place in the last sentence of paragraph (b) in A-1,.

8. Removing the language "and §54.9801–6T(b)" in the second sentence of paragraph (i) in *Example 1* of paragraph (h) of A-1.

Par. 6. Section 54.4980B–4 is amended by:

1. Adding a sentence at the end of paragraph (a) in A-1.

2. Removing the language "Q&A-1" and adding "Q&A-4" in its place in the fifth sentence of paragraph (c) of A-1.

3. Revising the third sentence in paragraph (e) of A-1.

4. Removing the language "section 9801(f)(2), and §54.9801–6T(b)" and adding "and section 9801(f)(2)" in its place in paragraph (i) in *Example 4* of paragraph (g) in A-1.

The addition and revision read as follows:

§54.4980B–4 Qualifying events.

* * * * *

A-1: (a) * * * See Q&A-1 through Q&A-3 of §54.4980B–10 for special rules in the case of leave taken under the Family and Medical Leave Act of 1993 (29 U.S.C. 2601–2619).

* * * * *

(e) * * * For example, an absence from work due to disability, a temporary layoff, or any other reason (other than due to leave that is FMLA leave; see §54.4980B–10) is a reduction of hours of a covered employee's employment if there is not an immediate termination of employment. * * *

* * * * *

Par. 7. Section 54.4980B–5 is amended by:

1. Revising paragraph (a) of A-1.
2. Revising paragraph (b) in A-4.
3. Removing the language "and §54.9801–6T" in the second sentence of paragraph (a) in A-5.

The revisions read as follows:

§54.4980B–5 COBRA continuation coverage.

* * * * *

A-1: (a) If a qualifying event occurs, each qualified beneficiary (other than a qualified beneficiary for whom the qualifying event will not result in any immediate or deferred loss of coverage) must be offered an opportunity to elect to receive the group health plan coverage that is provided to similarly situated nonCOBRA beneficiaries (ordinarily, the same coverage that the qualified beneficiary had on the day before the qualifying event). See Q&A-3 of §54.4980B–3 for the definition of similarly situated nonCOBRA beneficiaries. This coverage is COBRA continuation coverage. If coverage is modified for similarly situated nonCOBRA beneficiaries, then the coverage made available to qualified beneficiaries is modified in the same way. If the continuation coverage offered differs in any way from the coverage made available to similarly situated nonCOBRA beneficiaries, the coverage offered does not constitute COBRA continuation coverage and the group health plan is not in compliance with COBRA unless other coverage that does constitute COBRA continuation coverage is also offered. Any elimination or reduction of coverage in anticipation of an event described in paragraph (b) of Q&A-1 of §54.4980B–4 is disregarded for purposes of this Q&A-1 and for purposes of any other reference in §§54.4980B–1 through 54.4980B–10 to coverage in effect immediately before (or on the day before) a qualifying event. COBRA continuation coverage must not be conditioned upon, or discriminate on the basis of lack of, evidence of insurability.

* * * * *

A-4: * * *

(b) If a qualified beneficiary participates in a region-specific benefit package (such as an HMO or an on-site clinic) that will not service her or his health needs in the area to which she or he is relocating (regardless of the reason for the relocation), the qualified beneficiary must be given, within a reasonable period after requesting other coverage, an opportunity to elect alternative coverage that the employer or employee organization makes available to active employees. If the employer or employee organization makes group health plan coverage available to similarly situated nonCOBRA beneficiaries that can be extended in the area to which the qualified beneficiary is relocating, then that coverage is the alternative coverage that must be made available to the relocating qualified beneficiary. If the employer or employee organization does not make group health plan coverage available to similarly situated nonCOBRA beneficiaries that can be extended in the area to which the qualified beneficiary is relocating but makes coverage available to other employees that can be extended in that area, then the coverage made available to those other employees must be made available to the relocating qualified beneficiary. The effective date of the alternative coverage must be not later than the date of the qualified beneficiary's relocation, or, if later, the first day of the month following the month in which the qualified beneficiary requests the alternative coverage. However, the employer or employee organization is not required to make any other coverage available to the relocating qualified beneficiary if the only coverage the employer or employee organization makes available to active employees is not available in the area to which the qualified beneficiary relocates (because all such coverage is region-specific and does not service individuals in that area).

* * * * *

Par. 8. Section 54.4980B–6 is amended by:

1. Revising the *Example* in paragraph (c) of A-1.
2. Revising the first sentence in paragraph (b) of A-3.

The revisions read as follows:

§54.4980B–6 Electing COBRA continuation coverage.

* * * * *

A-1: * * *

(c) * * *

Example. (i) An unmarried employee without children who is receiving employer-paid coverage under a group health plan voluntarily terminates employment on June 1, 2001. The employee is not disabled at the time of the termination of employment nor at any time thereafter, and the plan does not provide for the extension of the required periods (as is permitted under paragraph (b) of Q&A-4 of §54.4980B–7).

(ii) *Case 1*: If the plan provides that the employer-paid coverage ends immediately upon the termination of employment, the election period must begin not later than June 1, 2001, and must not end earlier than July 31, 2001. If notice of the right to elect COBRA continuation coverage is not provided to the employee until June 15, 2001, the election period must not end earlier than August 14, 2001.

(iii) *Case 2*: If the plan provides that the employer-paid coverage does not end until 6 months after the termination of employment, the employee does not lose coverage until December 1, 2001. The election period can therefore begin as late as December 1, 2001, and must not end before January 30, 2002.

(iv) *Case 3*: If employer-paid coverage for 6 months after the termination of employment is offered only to those qualified beneficiaries who waive COBRA continuation coverage, the employee loses coverage on June 1, 2001, so the election period is the same as in Case 1. The difference between Case 2 and Case 3 is that in Case 2 the employee can receive 6 months of employer-paid coverage and then elect to pay for up to an additional 12 months of COBRA continuation coverage, while in Case 3 the employee must choose between 6 months of employer-paid coverage and paying for up to 18 months of COBRA continuation coverage. In all three cases, COBRA continuation coverage need not be provided for more than 18 months after the termination of employment (see Q&A-4 of §54.4980B–7), and in certain circumstances might be provided for a shorter period (see Q&A-1 of §54.4980B–7).

* * * * *

A-3: * * *

(b) In the case of an indemnity or reimbursement arrangement, the employer or employee organization can provide for plan coverage during the election period or, if the plan allows retroactive reinstatement, the employer or employee organization can terminate the coverage of the qualified beneficiary and reinstate her or him when the election (and, if applicable, payment for the coverage) is made. * * *

* * * * *

Par. 9. Section 54.4980B–7 is amended by:

1. Revising paragraph (a) of A-1.
2. Adding Q&A-4.
3. Revising the second sentence in paragraph (c) of A-5.
4. Revising paragraph (b) of Q&A-6.
5. Removing the language "Q&A-1" and adding "Q&A-4" in its place in paragraph (a) of A-7.

The addition and revisions read as follows:

§54.4980B–7 Duration of COBRA continuation coverage.

* * * * *

A-1: (a) Except for an interruption of coverage in connection with a waiver, as described in Q&A-4 of §54.4980B–6, COBRA continuation coverage that has been elected for a qualified beneficiary must extend for at least the period beginning on the date of the qualifying event and ending not before the earliest of the following dates —

(1) The last day of the maximum coverage period (see Q&A-4 of this section);

(2) The first day for which timely payment is not made to the plan with respect to the qualified beneficiary (see Q&A-5 in §54.4980B–8);

(3) The date upon which the employer or employee organization ceases to provide any group health plan (including successor plans) to any employee;

(4) The date, after the date of the election, upon which the qualified beneficiary first becomes covered under any other group health plan, as described in Q&A-2 of this section;

(5) The date, after the date of the election, upon which the qualified beneficiary first becomes entitled to Medicare benefits, as described in Q&A-3 of this section; and

(6) In the case of a qualified beneficiary entitled to a disability extension (see Q&A-5 of this section), the later of —

(i) Either 29 months after the date of the qualifying event, or the first day of the month that is more than 30 days after the date of a final determination under Title II or XVI of the Social Security Act (42 U.S.C. 401–433 or 1381–1385) that the disabled qualified beneficiary whose disability resulted in the qualified beneficiary's being entitled to the disability extension is no longer disabled, whichever is earlier; or

(ii) The end of the maximum coverage period that applies to the qualified beneficiary without regard to the disability extension.

* * * * *

Q-4: When does the maximum coverage period end?

A-4: (a) Except as otherwise provided in this Q&A-4, the maximum coverage period ends 36 months after the qualifying event. The maximum coverage period for a qualified beneficiary who is a child born to or placed for adoption with a covered employee during a period of COBRA continuation coverage is the maximum coverage period for the qualifying event giving rise to the period of COBRA continuation coverage during which the child was born or placed for adoption. Paragraph (b) of this Q&A-4 describes the starting point from which the end of the maximum coverage period is measured. The date that the maximum coverage period ends is described in paragraph (c) of this Q&A-4 in a case where the qualifying event is a termination of employment or reduction of hours of employment, in paragraph (d) of this Q&A-4 in a case where a covered employee becomes entitled to Medicare benefits under Title XVIII of the Social Security Act (42 U.S.C. 1395–1395ggg) before experiencing a qualifying event that is a termination of employment or reduction of hours of employment, and in paragraph (e) of this Q&A-4 in the case of a qualifying event that is the bankruptcy of the employer. See Q&A-8 of §54.4980B–2 for limitations that apply to certain health flexible spending arrangements. See also Q&A-6 of this section in the case of multiple qualifying events. Nothing in §§54.4980B–1 through 54.4980B–10 prohibits a group health plan from providing coverage that continues beyond the end of the maximum coverage period.

(b)(1) The end of the maximum coverage period is measured from the date of the qualifying event even if the qualifying event does not result in a loss of coverage under the plan until a later date. If, however, coverage under the plan is lost at a later date and the plan provides for the extension of the required periods, then the maximum coverage period is measured from the date when coverage is lost. A plan provides for the extension of the required periods if it provides both —

(i) That the 30-day notice period (during which the employer is required to notify the plan administrator of the occurrence of certain qualifying events such as the death of the covered employee or the termination of employment or reduction of hours of employment of the covered employee) begins on the date of the loss of coverage rather than on the date of the qualifying event; and

(ii) That the end of the maximum coverage period is measured from the date of the loss of coverage rather than from the date of the qualifying event.

(2) In the case of a plan that provides for the extension of the required periods, whenever the rules of §§54.4980B–1 through 54.4980B–10 refer to the measurement of a period from the date of the qualifying event, those rules apply in such a case by measuring the period instead from the date of the loss of coverage.

(c) In the case of a qualifying event that is a termination of employment or reduction of hours of employment, the maximum coverage period ends 18 months after the qualifying event if there is no disability extension, and 29 months after the qualifying event if there is a disability extension. See Q&A-5 of this section for rules to determine if there is a disability extension. If there is a disability extension and the disabled qualified beneficiary is later determined to no longer be disabled, then a plan may terminate the COBRA continuation coverage of an affected qualified beneficiary before the end of the disability extension; see paragraph (a)(6) in Q&A-1 of this section.

(d)(1) If a covered employee becomes entitled to Medicare benefits under Title XVIII of the Social Security Act (42 U.S.C. 1395–1395ggg) before experiencing a qualifying event that is a termination of employment or reduction of hours of employment, the maximum coverage period for qualified beneficiaries other than the covered employee ends on the later of —

(i) 36 months after the date the covered employee became entitled to Medicare benefits; or

(ii) 18 months (or 29 months, if there is a disability extension) after the date of the covered employee's termination of employment or reduction of hours of employment.

(2) See paragraph (b) of Q&A-3 of this section regarding the determination of when a covered employee becomes entitled to Medicare benefits.

(e) In the case of a qualifying event that is the bankruptcy of the employer, the maximum coverage period for a qualified beneficiary who is the retired covered employee ends on the date of the retired covered employee's death. The maximum coverage period for a qualified beneficiary who is the spouse, surviving spouse, or dependent child of the retired covered employee ends on the earlier of —

(1) The date of the qualified beneficiary's death; or

(2) The date that is 36 months after the death of the retired covered employee.

* * * * *

A-5: * * *

(c) * * * For this purpose, the period of the first 60 days of COBRA continuation coverage is measured from the date of the qualifying event described in paragraph (b) of this Q&A-5 (except that if a loss of coverage would occur at a later date in the absence of an election for COBRA continuation coverage and if the plan provides for the extension of the required periods (as described in paragraph (b) of Q&A-4 of this section) then the period of the first 60 days of COBRA continuation coverage is measured from the date on which the coverage would be lost). * * *

* * * * *

A-6: * * *

(b) The requirements of this paragraph (b) are satisfied if a qualifying event that gives rise to an 18-month maximum coverage period (or a 29-month maximum coverage period in the case of a disability extension) is followed, within that 18-month period (or within that 29-month period, in the case of a disability extension), by a second qualifying event (for example, a death or a divorce) that gives rise to a 36-month maximum coverage period. (Thus, a termination of employment following a qualifying event that is a reduction of hours of employment cannot be a second qualifying event that expands the maximum coverage period; the bankruptcy of an employer also cannot be a second qualifying event that expands the maximum coverage period.) In such a case, the original 18-month period (or 29-month period, in the case of a disability extension) is expanded to 36 months, but only for those individuals who were qualified beneficiaries under the group health plan in connection with the first qualifying event and who are still qualified beneficiaries at the time of the second qualifying event. No qualifying event (other than a qualifying event that is the bankruptcy of the employer) can give rise to a maximum coverage period that ends more than 36 months after the date of the first qualifying event (or more than 36 months after the date of the loss of coverage, in the case of a plan that provides for the extension of the required periods; see paragraph (b) in Q&A-4 of this section). For example, if an employee covered by a group health plan that is subject to COBRA terminates employment (for reasons other than gross misconduct) on December 31, 2000, the termination is a qualifying event giving rise to a maximum coverage period that extends for 18 months to June 30, 2002. If the employee dies after the employee and the employee's spouse and dependent children have elected COBRA continuation coverage and on or before June 30, 2002, the spouse and dependent children (except anyone among them whose COBRA continuation coverage had already ended for some other reason) will be able to receive COBRA continuation coverage through December 31, 2003. See Q&A-8(b) of §54.4980B–2 for a special rule that applies to certain health flexible spending arrangements.

* * * * *

Par. 10. Section 54.4980B–8 is amended by:

1. Revising paragraph (c) in A-1.

2. Adding a new sentence at the end of paragraph (d) and adding paragraphs (d)(1) and (d)(2) in A-5.

The revision and addition read as follows:

§54.4980B–8 Paying for COBRA continuation coverage.

* * * * *

A-1: * * *

* * * * *

(c) A group health plan does not fail to comply with section 9802(b) (which generally prohibits an individual from being charged, on the basis of health status, a higher premium than that charged for similarly situated individuals enrolled in the plan) with respect to a qualified beneficiary entitled to the disability extension merely because the plan requires payment of an amount permitted under paragraph (b) of this Q&A-1.

* * * * *

A-5: * * *

(d) * * * An amount is not significantly less than the amount the plan requires to be paid for a period of coverage if and only if the shortfall is no greater than the lesser of the following two amounts —

(1) Fifty dollars (or such other amount as the Commissioner may provide in a revenue ruling, notice, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii) of this chapter)); or

(2) 10 percent of the amount the plan requires to be paid.

* * * * *

Par. 11. Sections 54.4980B–9 and 54.4980B–10 are added to read as follows:

§54.4980B–9 Business reorganizations and employer withdrawals from multiemployer plans.

The following questions-and-answers address who has the obligation to make COBRA continuation coverage available to affected qualified beneficiaries in the context of business reorganizations and employer withdrawals from multiemployer plans:

Q-1: For purposes of this section, what are a business reorganization, a stock sale, and an asset sale?

A-1: For purposes of this section:

(a) A *business reorganization* is a stock sale or an asset sale.

(b) A *stock sale* is a transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer. (See Q&A-2 of §54.4980B–2, which defines *employer* to include all members of a controlled group of corporations.) Thus, for example, a sale or distribution of stock in a corporation that causes the corporation to cease to be a member of one controlled group of corporations, whether or not it becomes a member of another controlled group of corporations, is a stock sale.

(c) An *asset sale* is a transfer of substantial assets, such as a plant or division or substantially all the assets of a trade or business.

(d) The rules of §1.414(b)–1 of this chapter apply in determining what constitutes a controlled group of corporations, and the rules of §§1.414(c)–1 through 1.414(c)–5 of this chapter apply in determining what constitutes a group of trades or businesses under common control.

Q-2: In the case of a stock sale, what are the selling group, the acquired organization, and the buying group?

A-2: In the case of a stock sale —

(a) The *selling group* is the controlled group of corporations, or the group of trades or businesses under common control, of which a corporation ceases to be a member as a result of the stock sale;

(b) The *acquired organization* is the corporation that ceases to be a member of the selling group as a result of the stock sale; and

(c) The *buying group* is the controlled group of corporations, or the group of trades or businesses under common control, of which the acquired organization becomes a member as a result of the stock sale. If the acquired organization does not become a member of such a group, the *buying group* is the acquired organization.

Q-3: In the case of an asset sale, what are the selling group and the buying group?

A-3: In the case of an asset sale —

(a) The *selling group* is the controlled group of corporations or the group of trades or businesses under common control that includes the corporation or other trade or business that is selling the assets; and

(b) The *buying group* is the controlled group of corporations or the group of trades or businesses under common control that includes the corporation or other trade or business that is buying the assets.

Q-4: Who is an M&A qualified beneficiary?

A-4: (a) Asset sales: In the case of an asset sale, an individual is an M&A qualified beneficiary if the individual is a qualified beneficiary whose qualifying event occurred prior to or in connection with the sale and who is, or whose qualifying event occurred in connection with, a covered employee whose last employment prior to the qualifying event was associated with the assets being sold.

(b) Stock sales: In the case of a stock sale, an individual is an M&A qualified beneficiary if the individual is a qualified beneficiary whose qualifying event occurred prior to or in connection with the sale and who is, or whose qualifying event occurred in connection with, a covered employee whose last employment prior to the qualifying event was with the acquired organization.

(c) In the case of a qualified beneficiary who has experienced more than one qualifying event with respect to her or his current right to COBRA continuation coverage, the qualifying event referred to in paragraphs (a) and (b) of this Q&A-4 is the first qualifying event.

Q-5: In the case of a stock sale, is the sale a qualifying event with respect to a covered employee who is employed by the acquired organization before the sale and who continues to be employed by the acquired organization after the sale, or with respect to the spouse or dependent children of such a covered employee?

A-5: No. A covered employee who continues to be employed by the acquired organization after the sale does not experience a termination of employment as a result of the sale. Accordingly, the sale is not a qualifying event with respect to the covered employee, or with respect to the covered employee's spouse or dependent children, regardless of whether they are provided with group health coverage after the sale, and neither the covered employee, nor the covered employee's spouse or dependent children, become qualified beneficiaries as a result of the sale.

Q-6: In the case of an asset sale, is the sale a qualifying event with respect to a covered employee whose employment immediately before the sale was associated with the purchased assets, or with respect to the spouse or dependent children of such a covered employee who are covered under a group health plan of the selling group immediately before the sale?

A-6: (a) Yes, unless —

(1) The buying group is a successor employer under paragraph (c) of Q&A-8 of this section or Q&A-2 of §54.4980B–2, and the covered employee is employed by the buying group immediately after the sale; or

(2) The covered employee (or the spouse or any dependent child of the covered employee) does not lose coverage (within the meaning of paragraph (c) in Q&A-1 of §54.4980B–4) under a group health plan of the selling group after the sale.

(b) Unless the conditions in paragraph (a)(1) or (2) of this Q&A-6 are satisfied, such a covered employee experiences a termination of employment with the selling group as a result of the asset sale, regardless of whether the covered employee is employed by the buying group or whether the covered employee's employment is associated with the purchased assets after the sale. Accordingly, the covered employee, and the spouse and dependent children of the covered employee who lose coverage under a plan of the selling group in connection with the sale, are M&A qualified beneficiaries in connection with the sale.

Q-7: In a business reorganization, are the buying group and the selling group permitted to allocate by contract the responsibility to make COBRA continuation coverage available to M&A qualified beneficiaries?

A-7: Yes. Nothing in this section prohibits a selling group and a buying group from allocating to one or the other of the parties in a purchase agreement the responsibility to provide the coverage required under §§54.4980B–1 through 54.4980B–10. However, if and to the extent that the party assigned this responsibility under the terms of the contract fails to perform, the party who has the obligation under Q&A-8 of this section to make COBRA continuation coverage available to M&A qualified beneficiaries continues to have that obligation.

Q-8: Which group health plan has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries in a business reorganization?

A-8: (a) In the case of a business reorganization (whether a stock sale or an asset sale), so long as the selling group maintains a group health plan after the sale, a group health plan maintained by the selling group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that sale. This Q&A-8 prescribes rules for cases in which the selling group ceases to provide any group health plan to any employee in connection with the sale. Paragraph (b) of this Q&A-8 contains these rules for stock sales, and paragraph (c) of this Q&A-8 contains these rules for asset sales. Neither a stock sale nor an asset sale has any effect on the COBRA continuation coverage requirements applicable to any group health plan for any period before the sale.

(b)(1) In the case of a stock sale, if the selling group ceases to provide any group health plan to any employee in connection with the sale, a group health plan maintained by the buying group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that stock sale. A group health plan of the buying group has this obligation beginning on the later of the following two dates and continuing as long as the buying group continues to maintain a group health plan (but subject to the rules in §54.4980B–7, relating to the duration of COBRA continuation coverage) —

(i) The date the selling group ceases to provide any group health plan to any employee; or

(ii) The date of the stock sale.

(2) The determination of whether the selling group's cessation of providing any group health plan to any employee is in connection with the stock sale is based on all of the relevant facts and circumstances. A group health plan of the buying group does not, as a result of the stock sale, have an obligation to make COBRA continuation coverage available to those qualified beneficiaries of the selling group who are not M&A qualified beneficiaries with respect to that sale.

(c)(1) In the case of an asset sale, if the selling group ceases to provide any group health plan to any employee in connection with the sale and if the buying group continues the business operations associated with the assets purchased from the selling group without interruption or substantial change, then the buying group is a successor employer to the selling group in connection with that asset sale. A buying group does not fail to be a successor employer in connection with an asset sale merely because the asset sale takes place in connection with a proceeding in bankruptcy under Title 11 of the United States Code. If the buying group is a successor employer, a group health plan maintained by the buying group has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to that asset sale. A group health plan of the buying group has this obligation beginning on the later of the following two dates and continuing as long as the buying group continues to maintain a group health plan (but subject to the rules in §54.4980B–7, relating to the duration of COBRA continuation coverage) —

(i) The date the selling group ceases to provide any group health plan to any employee; or

(ii) The date of the asset sale.

(2) The determination of whether the selling group's cessation of providing any group health plan to any employee is in connection with the asset sale is based on all of the relevant facts and circumstances. A group health plan of the buying group does not, as a result of the asset sale, have an obligation to make COBRA continuation coverage available to those qualified beneficiaries of the selling group who are not M&A qualified beneficiaries with respect to that sale.

(d) The rules of Q&A-1 through Q&A-7 of this section and this Q&A-8 are illustrated by the following examples; in each example, each group health plan is subject to COBRA:

Stock Sale Examples

Example 1. (i) Selling Group *S* consists of three corporations, *A*, *B*, and *C*. Buying Group *P* consists of two corporations, *D* and *E*. *P* enters into a contract to purchase all the stock of *C* from *S* effective July 1, 2002. Before the sale of *C*, *S* maintains a single group health plan for the employees of *A*, *B*, and *C* (and their families). *P* maintains a single group health plan for the employees of *D* and *E* (and their families). Effective July 1, 2002, the employees of *C* (and their families) become covered under *P*'s plan. On June 30, 2002, there are 48 qualified beneficiaries receiving COBRA continuation coverage under *S*'s plan, 15 of whom are M&A qualified beneficiaries with respect to the sale of *C*. (The other 33 qualified beneficiaries had qualifying events in connection with a covered employee whose last employment before the qualifying event was with either *A* or *B*.)

(ii) Under these facts, *S*'s plan continues to have the obligation to make COBRA continuation coverage available to the 15 M&A qualified beneficiaries under *S*'s plan after the sale of *C* to *P*. The employees who continue in employment with *C* do not experience a qualifying event by virtue of *P*'s acquisition of *C*. If they experience a qualifying event after the sale, then the group health plan of *P* has the obligation to make COBRA continuation coverage available to them.

Example 2. (i) Selling Group *S* consists of three corporations, *A*, *B*, and *C*. Each of *A*, *B*, and *C* maintains a group health plan for its employees (and their families). Buying Group *P* consists of two corporations, *D* and *E*. *P* enters into a contract to purchase all of the stock of *C* from *S* effective July 1, 2002. As of June 30, 2002, there are 14 qualified beneficiaries receiving COBRA continuation coverage under *C*'s plan. *C* continues to employ all of its employees and continues to maintain its group health plan after being acquired by *P* on July 1, 2002.

(ii) Under these facts, *C* is an acquired organization and the 14 qualified beneficiaries under *C*'s plan are M&A qualified beneficiaries. A group health plan of *S* (that is, either the plan maintained by *A* or the plan maintained by *B*) has the obligation to make COBRA continuation coverage available to the 14 M&A qualified beneficiaries. *S* and *P* could negotiate to have *C*'s plan continue to make COBRA continuation coverage available to the 14 M&A qualified beneficiaries. In such a case, neither *A*'s plan nor *B*'s plan would make COBRA continuation coverage available to the 14 M&A qualified beneficiaries unless *C*'s plan failed to fulfill its contractual responsibility to make COBRA continuation coverage available to the M&A qualified beneficiaries. *C*'s employees (and their spouses and dependent children) do not experience a qualifying event in connection with *P*'s acquisition of *C*, and consequently no plan maintained by either *P* or *S* has any obligation to make COBRA continuation coverage available to *C*'s employees (or their spouses or dependent children) in connection with the transfer of stock in *C* from *S* to *P*.

Example 3. (i) The facts are the same as in *Example 2*, except that *C* ceases to employ two employees on June 30, 2002, and those two employees never become covered under *P*'s plan.

(ii) Under these facts, the two employees experience a qualifying event on June 30, 2002, because their termination of employment causes a loss of group health coverage. A group health plan of *S* (that is, either the plan maintained by *A* or the plan maintained by *B*) has the obligation to make COBRA continuation coverage available to the two employees (and to any spouse or dependent child of the two employees who loses coverage under *C*'s plan in connection with the termination of employment of the two employees) because they are M&A qualified beneficiaries with respect to the sale of *C*.

Example 4. (i) Selling Group *S* consists of three corporations, *A*, *B*, and *C*. Buying Group *P* consists of two corporations, *D* and *E*. *P* enters into a contract to purchase all of the stock of *C* from *S* effective July 1, 2002. Before the sale of *C*, *S* maintains a single group health plan for the employees of *A*, *B*, and *C* (and their families). *P* maintains a single group health plan for the employees of *D* and *E* (and their families). Effective July 1, 2002, the employees of *C* (and their families) become covered under

P's plan. On June 30, 2002, there are 25 qualified beneficiaries receiving COBRA continuation coverage under *S*'s plan, 20 of whom are M&A qualified beneficiaries with respect to the sale of *C*. (The other five qualified beneficiaries had qualifying events in connection with a covered employee whose last employment before the qualifying event was with either *A* or *B*.) *S* terminates its group health plan effective June 30, 2002, and begins to liquidate the assets of *A* and *B* and to lay off the employees of *A* and *B*.

(ii) Under these facts, *S* ceases to provide a group health plan to any employee in connection with the sale of *C* to *P*. Thus, beginning July 1, 2002, *P*'s plan has the obligation to make COBRA continuation coverage available to the 20 M&A qualified beneficiaries, but *P* is not obligated to make COBRA continuation coverage available to the other 5 qualified beneficiaries with respect to *S*'s plan as of June 30, 2002 or to any of the employees of *A* or *B* whose employment is terminated by *S* (or to any of those employees' spouses or dependent children).

Asset Sale Examples

Example 5. (i) Selling Group *S* provides group health plan coverage to employees at each of its operating divisions. *S* sells the assets of one of its divisions to Buying Group *P*. Under the terms of the group health plan covering the employees at the division being sold, their coverage will end on the date of the sale. *P* hires all but one of those employees, gives them the same positions that they had with *S* before the sale, and provides them with coverage under a group health plan. Immediately before the sale, there are two qualified beneficiaries receiving COBRA continuation coverage under a group health plan of *S* whose qualifying events occurred in connection with a covered employee whose last employment prior to the qualifying event was associated with the assets sold to *P*.

(ii) These two qualified beneficiaries are M&A qualified beneficiaries with respect to the asset sale to *P*. Under these facts, a group health plan of *S* retains the obligation to make COBRA continuation coverage available to these two M&A qualified beneficiaries. In addition, the one employee *P* does not hire as well as all of the employees *P* hires (and the spouses and dependent children of these employees) who were covered under a group health plan of *S* on the day before the sale are M&A qualified beneficiaries with respect to the sale. A group health plan of *S* also has the obligation to make COBRA continuation coverage available to these M&A qualified beneficiaries.

Example 6. (i) Selling Group *S* provides group health plan coverage to employees at each of its operating divisions. *S* sells substantially all of the assets of all of its divisions to Buying Group *P*, and *S* ceases to provide any group health plan to any employee on the date of the sale. *P* hires all but one of *S*'s employees on the date of the asset sale by *S*, gives those employees the same positions that they had with *S* before the sale, and continues the business operations of those divisions without substantial change or interruption. *P* provides these employees with coverage under a group health plan. Immediately before the sale, there are 10 qualified beneficiaries receiving COBRA continuation coverage under a group health plan of *S* whose qualifying events occurred in connection with a covered employee whose last employment prior to the qualifying event was associated with the assets sold to *P*.

(ii) These 10 qualified beneficiaries are M&A qualified beneficiaries with respect to the asset sale to *P*. Under these facts, *P* is a successor employer described in paragraph (c) of this Q&A-8. Thus, a group health plan of *P* has the obligation to make COBRA continuation coverage available to these 10 M&A qualified beneficiaries.

(iii) The one employee that *P* does not hire and the family members of that employee are also M&A qualified beneficiaries with respect to the sale. A group health plan of *P* also has the obligation to make COBRA continuation coverage available to these M&A qualified beneficiaries.

(iv) The employees who continue in employment in connection with the asset sale (and their family members) and who were covered under a group health plan of *S* on the day before the sale are not M&A qualified beneficiaries because *P* is a successor employer to *S* in connection with the asset sale. Thus, no group health plan of *P* has any obligation to make COBRA continuation coverage available to these continuing employees with respect to the qualifying event that resulted from their losing coverage under *S*'s plan in connection with the asset sale.

Example 7. (i) Selling Group *S* provides group health plan coverage to employees at each of its two operating divisions. *S* sells the assets of one of its divisions to Buying Group *P1*. Under the terms of the group health plan covering the employees at the division being sold, their coverage will end on the date of the sale. *P1* hires all but one of those employees, gives them the same positions that they had with *S* before the sale, and provides them with coverage under a group health plan.

(ii) Under these facts, a group health plan of *S* has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the sale to *P1*. (If an M&A qualified beneficiary first became covered under *P1*'s plan after electing COBRA continuation coverage under *S*'s plan, then *S*'s plan could terminate the COBRA continuation coverage once the M&A qualified beneficiary became covered under *P1*'s plan, provided that the remaining conditions of Q&A-2 of §54.4980B–7 were satisfied.)

(iii) Several months after the sale to *P1*, *S* sells the assets of its remaining division to Buying Group *P2*, and *S* ceases to provide any group health plan to any employee on the date of that sale. Thus, under Q&A-1 of §54.4980B–7, *S* ceases to have an obligation to make COBRA continuation coverage available to any qualified beneficiary on the date of the sale to *P2*. *P1* and *P2* are unrelated organizations.

(iv) Even if it was foreseeable that *S* would sell its remaining division to an unrelated third party after the sale to *P1*, under these facts the cessation of *S* to provide any group health plan to any employee on the date of the sale to *P2* is not in connection with the asset sale to *P1*. Thus, even after the date *S* ceases to provide any group health plan to any employee, no group health plan of *P1* has any obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1* by *S*. If *P2* is a successor employer under the rules of paragraph (c) of this Q&A-8 and maintains one or more group health plans after the sale, then a group health plan of *P2* would have an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P2* by *S* (but in such a case employees of *S* before the sale who continued working for *P2* after the sale would not be M&A qualified beneficiaries). However, even in such a case, no group health plan of *P2* would have an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1* by *S*. Thus, under these facts, after *S* has ceased to provide any group health plan to any employee, no plan has an obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the asset sale to *P1*.

Example 8. (i) Selling Group *S* provides group health plan coverage to employees at each of its operating divisions. *S* sells substantially all of the assets of all of its divisions to Buying Group *P*. *P* hires most of *S*'s employees on the date of the purchase of *S*'s assets, retains those employees in the same positions that they had with *S* before the purchase, and continues the business operations of those divisions without substantial change or interruption. *P* provides these employees with coverage under a group health plan. *S* continues to employ a few employees for the principal purpose of winding up the affairs of *S* in preparation for liquidation. S continues to provide coverage under a group health plan to these few remaining employees for several weeks after the date of the sale and then ceases to provide any group health plan to any employee.

(ii) Under these facts, the cessation by *S* to provide any group health plan to any employee is in connection with the asset sale to *P*. Because of this, and because *P* continued the business operations associated with those assets without substantial change or interruption, *P* is a successor employer to *S* with respect to the asset sale. Thus, a group health plan of *P* has the obligation to make COBRA continuation coverage available to M&A qualified beneficiaries with respect to the sale beginning on the date that *S* ceases to provide any group health plan to any employee. (A group health plan of *S* retains this obligation for the several weeks after the date of the sale until *S* ceases to provide any group health plan to any employee.)

Q-9: Can the cessation of contributions by an employer to a multiemployer group health plan be a qualifying event?

A-9: The cessation of contributions by an employer to a multiemployer group health plan is not itself a qualifying event, even though the cessation of contributions may cause current employees (and their spouses and dependent children) to lose coverage under the multiemployer plan. An event coinciding with the employer's cessation of contributions (such as a reduction of hours of employment in the case of striking employees) will constitute a qualifying event if it otherwise satisfies the requirements of Q&A-1 of §54.4980B–4.

Q-10: If an employer stops contributing to a multiemployer group health plan, does the multiemployer plan have the obligation to make COBRA continuation coverage available to a qualified beneficiary who was receiving coverage under the multiemployer plan on the day before the cessation of contributions and who is, or whose qualifying event occurred in connection with, a covered employee whose last employment prior to the qualifying event was with the employer that has stopped contributing to the multiemployer plan?

A-10: (a) In general, yes. (See Q&A-3 of §54.4980B–2 for a definition of *multiemployer plan*.) If, however, the employer that stops contributing to the multiemployer plan makes group health plan coverage available to (or starts contributing to another multiemployer plan that is a group health plan with respect to) a class of the employer's employees formerly covered under the multiemployer plan, the plan maintained by the employer (or the other multiemployer plan), from that date forward, has the obligation to make COBRA continuation coverage available to any qualified beneficiary who was receiving coverage under the multiemployer plan on the day before the cessation of contributions and who is, or whose qualifying event occurred in connection with, a covered employee whose last employment prior to the qualifying event was with the employer.

(b) The rules of Q&A-9 of this section and this Q&A-10 are illustrated by the following examples; in each example, each group health plan is subject to COBRA:

Example 1. (i) Employer *Z* employs a class of employees covered by a collective bargaining agreement and participating in multiemployer group health plan *M*. As required by the collective bargaining agreement, *Z* has been making contributions to *M*. *Z* experiences financial difficulties and stops making contributions to *M* but continues to employ all of the employees covered by the collective bargaining agreement. *Z*'s cessation of contributions to *M* causes those employees (and their spouses and dependent children) to lose coverage under *M*. *Z* does not make group health plan coverage available to any of the employees covered by the collective bargaining agreement.

(ii) After *Z* stops contributing to *M*, *M* continues to have the obligation to make COBRA continuation coverage available to any qualified beneficiary who experienced a qualifying event that preceded or coincided with the cessation of contributions to *M* and whose coverage under *M* on the day before the qualifying event was due to an employment affiliation with *Z*. The loss of coverage under *M* for those employees of *Z* who continue in employment (and the loss of coverage for their spouses and dependent children) does not constitute a qualifying event.

Example 2. (i) The facts are the same as in *Example 1* except that *B*, one of the employees covered under *M* before *Z* stops contributing to *M*, is transferred into management. *Z* maintains a group health plan for managers and *B* becomes eligible for coverage under the plan on the day of *B*'s transfer.

(ii) Under these facts, *Z* does not make group health plan coverage available to a class of employees formerly covered under *M* after *B* becomes eligible under *Z*'s group health plan for managers. Accordingly, *M* continues to have the obligation to make COBRA continuation coverage available to any qualified beneficiary who experienced a qualifying event that preceded or coincided with the cessation of contributions to *M* and whose coverage under *M* on the day before the qualifying event was due to an employment affiliation with *Z*.

Example 3. (i) Employer *Y* employs two classes of employees – skilled and unskilled laborers – covered by a collective bargaining agreement and participating in multiemployer group health plan *M*. As required by the collective bargaining agreement, *Y* has been making contributions to *M*. *Y* stops making contributions to *M* but continues to employ all the employees covered by the collective bargaining agreement. *Y*'s cessation of contributions to *M* causes those employees (and their spouses and dependent children) to lose coverage under *M*. *Y* makes group health plan coverage available to the skilled laborers immediately after their coverage ceases under *M*, but *Y* does not make group health plan coverage available to any of the unskilled laborers.

(ii) Under these facts, because *Y* makes group health plan coverage available to a class of employees previously covered under *M* immediately after both classes of employees lose coverage under *M*, *Y* alone has the obligation to make COBRA continuation coverage available to any qualified beneficiary who experienced a qualifying event that preceded or coincided with the cessation of contributions to *M* and whose coverage under *M* on the day before the qualifying event was due to an employment affiliation with *Y*, regardless of whether the employment affiliation was as a skilled or unskilled laborer. However, the loss of coverage under *M* for those employees of *Y* who continue in employment (and the loss of coverage for their spouses and dependent children) does not constitute a qualifying event.

Example 4. (i) Employer *X* employs a class of employees covered by a collective bargaining agreement and participating in multiemployer group health plan *M*. As required by the collective bargaining agreement, *X* has been making contributions to *M*. *X* experiences financial difficulties and is forced into bankruptcy by its creditors. *X* continues to employ all of the employees covered by the collective bargaining agreement. *X* also continues to make contributions to *M* until the current collective bargaining agreement expires, on June 30, 2001, and then *X* stops making contributions to *M*. *X*'s employees (and their spouses and dependent children) lose coverage under *M* effective July 1, 2001. *X* does not enter into another collective bargaining agreement covering the class of employees covered by the expired collective bargaining agreement. Effective September 1, 2001, *X* establishes a group health plan covering the class of employees formerly covered by the collective bargaining agreement. The group health plan also covers their spouses and dependent children.

(ii) Under these facts, *M* has the obligation to make COBRA continuation coverage available from July 1, 2001 until August 31, 2001, and the group health plan established by *X* has the obligation to make COBRA continuation coverage available from September 1, 2001, until the obligation ends (see Q&A-1 of §54.4980B–7) to any qualified beneficiary who experienced a qualifying event that preceded or coincided with the cessation of contributions to *M* and whose coverage under *M* on the day before the qualifying event was due to an employment affiliation with *X*. The loss of coverage under *M* for those employees of *X* who continue in employment (and the loss of coverage for their spouses and dependent children) does not constitute a qualifying event.

Example 5. (i) Employer *W* employs a class of employees covered by a collective bargaining agreement and participating in multiemployer group health plan *M*. As required by the collective bargaining agreement, *W* has been making contributions to *M*. The employees covered by the collective bargaining agreement vote to decertify their current employee representative effective January 1, 2002, and vote to certify a new employee representative effective the same date. As a consequence, on January 1, 2002, they cease to be covered under *M* and commence to be covered under multiemployer group health plan *N*.

(ii) Effective January 1, 2002, *N* has the obligation to make COBRA continuation coverage available to any qualified beneficiary who experienced a qualifying event that preceded or coincided with the cessation of contributions to *M* and whose coverage under *M* on the day before the qualifying event was due to an employment affiliation with *W*. The loss of coverage under *M* for those employees of *W* who continue in employment (and the loss of coverage for their spouses and dependent children) does not constitute a qualifying event.

§54.4980B–10 Interaction of FMLA and COBRA.

The following questions-and-answers address how the taking of leave under the Family and Medical Leave Act of 1993 (FMLA) (29 U.S.C. 2601–2619) affects the COBRA continuation coverage requirements:

Q-1: In what circumstances does a qualifying event occur if an employee does not return from leave taken under FMLA?

A-1: (a) The taking of leave under FMLA does not constitute a qualifying event. A qualifying event under Q&A-1 of §54.4980B–4 occurs, however, if —

(1) An employee (or the spouse or a dependent child of the employee) is cov-

ered on the day before the first day of FMLA leave (or becomes covered during the FMLA leave) under a group health plan of the employee's employer;

(2) The employee does not return to employment with the employer at the end of the FMLA leave; and

(3) The employee (or the spouse or a dependent child of the employee) would, in the absence of COBRA continuation coverage, lose coverage under the group health plan before the end of the maximum coverage period.

(b) However, the satisfaction of the three conditions in paragraph (a) of this Q&A-1 does not constitute a qualifying event if the employer eliminates, on or before the last day of the employee's FMLA leave, coverage under a group health plan for the class of employees (while continuing to employ that class of employees) to which the employee would have belonged if the employee had not taken FMLA leave.

Q-2: If a qualifying event described in Q&A-1 of this section occurs, when does it occur, and how is the maximum coverage period measured?

A-2: A qualifying event described in Q&A-1 of this section occurs on the last day of FMLA leave. (The determination of when FMLA leave ends is not made under the rules of this section. See the FMLA regulations, 29 CFR Part 825 (§§825.100–825.800).) The maximum coverage period (see Q&A-4 of §54.4980B–7) is measured from the date of the qualifying event (that is, the last day of FMLA leave). If, however, coverage under the group health plan is lost at a later date and the plan provides for the extension of the required periods (see paragraph (b) of Q&A-4 of §54.4980B–7), then the maximum coverage period is measured from the date when coverage is lost. The rules of this Q&A-2 are illustrated by the following examples:

Example 1. (i) Employee *B* is covered under the group health plan of Employer *X* on January 31, 2001. *B* takes FMLA leave beginning February 1, 2001. *B*'s last day of FMLA leave is 12 weeks later, on April 25, 2001, and *B* does not return to work with *X* at the end of the FMLA leave. If *B* does not elect COBRA continuation coverage, *B* will not be covered under the group health plan of *X* as of April 26, 2001.

(ii) *B* experiences a qualifying event on April 25, 2001, and the maximum coverage period is measured from that date. (This is the case even if, for part or all of the FMLA leave, *B* fails to pay the employee portion of premiums for coverage under the group health plan of *X* and is not covered under *X*'s plan. See Q&A-3 of this section.)

Example 2. (i) Employee *C* and *C*'s spouse are covered under the group health plan of Employer *Y* on August 15, 2001. *C* takes FMLA leave beginning August 16, 2001. *C* informs *Y* less than 12 weeks later, on September 28, 2001, that *C* will not be returning to work. Under the FMLA regulations, 29 CFR Part 825 (§§825.100–825.800), *C*'s last day of FMLA leave is September 28, 2001. *C* does not return to work with *Y* at the end of the FMLA leave. If *C* and *C*'s spouse do not elect COBRA continuation coverage, they will not be covered under the group health plan of *Y* as of September 29, 2001.

(ii) *C* and *C*'s spouse experience a qualifying event on September 28, 2001, and the maximum coverage period (generally 18 months) is measured from that date. (This is the case even if, for part or all of the FMLA leave, *C* fails to pay the employee portion of premiums for coverage under the group health plan of *Y* and *C* or *C*'s spouse is not covered under *Y*'s plan. See Q&A-3 of this section.)

Q-3: If an employee fails to pay the employee portion of premiums for coverage under a group health plan during FMLA leave or declines coverage under a group health plan during FMLA leave, does this affect the determination of whether or when the employee has experienced a qualifying event?

A-3: No. Any lapse of coverage under a group health plan during FMLA leave is irrelevant in determining whether a set of circumstances constitutes a qualifying event under Q&A-1 of this section or when such a qualifying event occurs under Q&A-2 of this section.

Q-4: Is the application of the rules in Q&A-1 through Q&A-3 of this section affected by a requirement of state or local law to provide a period of coverage longer than that required under FMLA?

A-4: No. Any state or local law that requires coverage under a group health plan to be maintained during a leave of absence for a period longer than that required under FMLA (for example, for 16 weeks of leave rather than for the 12 weeks required under FMLA) is disregarded for purposes of determining when a qualifying event occurs under Q&A-1 through Q&A-3 of this section.

Q-5: May COBRA continuation coverage be conditioned upon reimbursement of the premiums paid by the employer for coverage under a group health plan during FMLA leave?

A-5: No. The U.S. Department of Labor has published rules describing the circumstances in which an employer may recover premiums it pays to maintain coverage, including family coverage, under a group health plan during FMLA leave from an employee who fails to return from leave. See 29 CFR 825.213. Even if recovery of premiums is permitted under 29 CFR 825.213, the right to COBRA continuation coverage cannot be conditioned upon the employee's reimbursement of the employer for premiums the employer paid to maintain coverage under a group health plan during FMLA leave.

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

Approved December 18, 2000.

Jonathan Talisman,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 9, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 10, 2001, 66 F.R. 1843)

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(c)–1T: Disclosure of returns and return information to designee of taxpayer.

T.D. 8935

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Disclosure of Returns and Return Information to Designee of Taxpayer

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains a temporary regulation relating to the disclosure of returns and return information to a designee of the taxpayer. The temporary regulation provides guidance to IRS employees responsible for disclosing returns and return information and to taxpayers who wish to designate a person or persons to whom returns and return information may be disclosed. The portion of

this temporary regulation pertaining to nonwritten requests or consents reflects changes to the law made by the Taxpayer Bill of Rights II, Public Law 104–168, section 1207, 110 Stat. 1473. With respect to written requests or consents, the temporary regulation amends the existing regulation to provide further guidance in certain limited situations and to clarify existing procedures. The text of the temporary regulation also serves as the text of the proposed regulation set forth in the notice of proposed rulemaking (REG–103320–00) on page 714 of this Bulletin.

DATES: *Effective Date*: This regulation is effective January 11, 2001.

Applicability Date: For dates of applicability, see §301.6103(c)–1T(g).

FOR FURTHER INFORMATION CONTACT: Joseph Conley, (202) 622-4580 (not a toll-free number).

Background

Under section 6103(a), returns and return information are confidential unless disclosure is otherwise authorized by the Internal Revenue Code. Section 6103(c), as amended by section 1207 of the Taxpayer Bill of Rights II, Public Law 104–168 (110 Stat. 1452), authorizes the IRS to disclose returns and return information to such person or persons as the taxpayer may designate in a request for or consent to disclosure, or to any other person at the taxpayer's request to the extent necessary to comply with a request for information or assistance made by the taxpayer to such other person. Disclosure is permitted subject to such requirements and conditions as may be prescribed by regulations. With the amendment in 1996, Congress eliminated the longstanding requirement that disclosures to designees of the taxpayer must be pursuant to the written request or consent of the taxpayer. The purpose of this amendment to section 6103(c) was to assist the IRS in developing a paperless tax administration system that relies on, among other things, electronic communication. H.R. Rep. No. 104–506, at 49 (1996), reprinted in 1996 U.S.C.A.N. 1143, 1172. This document contains a temporary regulation that authorizes the disclosure of tax returns and return information to a designee of the taxpayer pursuant to a nonwritten request or consent when the taxpayer seeks the assistance of a third party in resolving a tax matter.

This document also amends the existing regulation to clarify the rules applicable to written requests or consents to disclosure. On October 3, 1980, a final regulation (T.D. 7723, 1980–2 C.B. 346) relating to the disclosure of tax returns and return information to a person designated by the taxpayer in a written request or consent were published in the **Federal Register** (45 F.R. 65564). Since the publication of this final regulation, the IRS and the Treasury Department have determined that further guidance on written consent requirements is necessary.

Explanation of Provisions

Nonwritten consents

Under the existing regulation, if a taxpayer wishes a third party to assist in the resolution of a tax matter between the taxpayer and the IRS, and the third party is not otherwise authorized to practice before the Internal Revenue Service, a written section 6103(c) request or consent must be executed by the taxpayer.

The temporary regulation authorizes the IRS to accept nonwritten requests or consents authorizing the disclosure of tax returns and return information to third parties assisting taxpayers in resolving tax related matters. Thus, for example, the temporary regulation clarifies that the taxpayer can orally consent to disclosures by the IRS to a person accompanying the taxpayer to meetings or interviews with the IRS, or participating in a telephone conversation with the taxpayer. When the taxpayer is present, either physically or on the telephone, the taxpayer will be able to knowingly and voluntarily consent to the disclosure without the need for further expressing that intent in writing.

Thus, the use of nonwritten consents will enable the IRS to improve its customer service in that, with the assistance of their designees, taxpayers will be able to resolve tax problems in a more timely fashion, without the need for burdensome paperwork. Additionally, nonwritten requests or consents will assist the IRS in moving to a paperless environment by further facilitating the use of electronic communication systems.

As with written requests or consents, before disclosing tax returns and return information to a third party pursuant to a taxpayer's nonwritten request or consent, the IRS will take reasonable steps to confirm the identity of the taxpayer and the designee. For example, IRS personnel, pursuant to existing procedures, verify that they are speaking to the taxpayer prior to disclosing return information to that taxpayer.

Nonwritten requests for or consents to disclosure do not take the place of a power of attorney authorizing a third party to represent the taxpayer before the IRS. Practice before the IRS remains governed by the regulations at 26 CFR 601.501 *et seq.* and Treasury Department Circular 230 (31 CFR part 10).

Acknowledgments of, and Notices Regarding, Electronically Filed Returns

The temporary regulation also provides parameters for the development of consents for the electronic filing program. The IRS currently provides an acknowledgment to an electronic return originator (ERO) to indicate that it has received information from the ERO in an acceptable form, and that the taxpayer identity information, as defined by section 6103(b)(6), matches IRS records. Alternatively, the IRS may notify the ERO that it has rejected the ERO's electronic submission because the taxpayer identity information does not match IRS records or, for example, because the taxpayer is not responsible for the tax payment. The taxpayer may also have authorized an electronic debit to pay a tax debt, and the taxpayer may want the IRS to send an acknowledgment to the ERO that the account has been properly debited, or to disclose information to the taxpayer's financial institution to resolve a problem with the electronic debit transaction. To ensure that the IRS is authorized to disclose tax returns and return information to third parties in an electronic system, the IRS must receive a valid request for or consent to disclosure pursuant to section 6103(c). The current system requires the taxpayer to execute a written consent on Form 8453 to permit these disclosures.

The temporary regulation authorizes an electronic consent to permit the disclosures of the return information described above and such other information as the

IRS determines is necessary to the operation of the electronic filing program. Such consent must inform the taxpayer of the return information that will be transmitted to the ERO and other third parties as a result of the electronic filing of the taxpayer's return or other information.

Combined FedState Filing Programs

The temporary regulation also reduces the burden on taxpayers in combined Federal-State (FedState) return filing programs. If the taxpayer files a single combined Federal and State tax return with the IRS, the information contained in such FedState return that is gathered with respect to a taxpayer's liability under both Federal and State law, including the taxpayer's name, taxpayer identification number, and adjusted gross income, is return information protected by section 6103. If the IRS discloses such return information to the State in satisfaction of the taxpayer's State filing obligations, the information can be used by the State only for State tax administration purposes under section 6103(d). On the other hand, if a State tax return is filed directly with the State, information on the State return is not subject to the restrictions of section 6103(d) and can be used for appropriate non-tax purposes permitted under State law.

In the current electronic FedState filing program, to avoid these section 6103 restrictions, return preparers make two separate electronic transmissions to the IRS—one for the Federal return and one for the State return. The common items of data are sent twice, once in the Federal "packet" and once in the State "packet." The items of information in the State packet are not restricted by section 6103 because they have not been filed with the IRS with regard to Federal tax liability.

Alternatively, in the FedState telefile program, a consent has been developed that permits the Internal Revenue Service to disclose common data items to the State tax agency. The information received by the State pursuant to the taxpayer's request or consent is treated, for purposes of section 6103, as if the State had received the information directly from the taxpayer, and therefore the information can be used for appropriate non-tax purposes under State law.

Under the existing regulation, consents for FedState filing programs must comply with current §301.6103(c)–1(a). The existing regulation requires, among other things, a separate written consent document. The IRS and the Treasury Department believe a taxpayer's voluntary participation in an optional FedState filing program that provides the taxpayer with notice of the disclosures to be made to the State as part of the program constitutes a sufficient knowing and voluntary consent to permit disclosures to States in this situation. To reduce the burden on taxpayers and improve the efficiency of tax administration, the temporary regulation provides that by filing a combined FedState return, the taxpayer consents to the disclosure of the common data items to the State tax agency, and that the information will be treated as if it had been received directly by the State from the taxpayer. As noted above, the temporary regulation requires a notice of the disclosures that are to be made in the FedState filing program so that taxpayers may choose to participate in such programs with knowledge of such disclosures.

Other Changes

The temporary regulation also provides needed clarification in a number of areas not specifically addressed under the existing regulation. The temporary regulation provides rules for receipt of section 6103(c) consents by entities other than the IRS. Certain Treasury Department agencies, such as the Financial Management Service, perform Federal tax administration functions and receive tax information from the IRS. In addition, IRS contractors receive tax information to provide tax administration services pursuant to section 6103(n). The existing regulation provides only for receipt of requests for or consents to disclosure by the IRS. The temporary regulation permits Federal government agencies performing Federal tax administration functions to receive section 6103(c) consents and disclose returns and return information in the possession of such agency to the taxpayer's designee. For example, the temporary regulation clarifies that the Financial Management Service can disclose return information related to the offset of the taxpayer's tax refund to the designee of the taxpayer, such as in response to a Congressional inquiry. The temporary regulation also clarifies that receipt of a request or consent by an agent or contractor of the IRS is the same as receipt by the IRS. However, an agent or contractor of the IRS may make disclosures with the taxpayer's consent only if such disclosures are specifically authorized in the contract or otherwise specifically authorized in writing by the IRS. §301.6103(n)–1(a).

The temporary regulation defines the term *separate written document* to conform to current IRS practice. The temporary regulation also specifies the Secretary of the Treasury's authority to provide for methods of signing requests for or consents to disclosure. See §301.6061–1(b).

The temporary regulation clarifies the requirements for identifying the designee to whom disclosure is to be made when the disclosure occurs in a public forum, such as a courtroom, a congressional hearing, or in the media. In these circumstances, it may not be possible to designate specifically every person to whom disclosure is to be made. While identifying individual designees in a public forum may not be practical, a taxpayer can knowingly and voluntarily authorize disclosure in a public forum by specifically indicating the circumstances surrounding the public disclosure, including, for example, a description of the place, date, and time. The temporary regulation also incorporates the longstanding IRS practice that entities, such as corporations and State and local government agencies, are appropriate designees.

The temporary regulation also affirms longstanding practices of the IRS regarding the authority to execute consents. Generally, persons that may receive returns pursuant to section 6103(e), paragraphs (1) through (5), may execute disclosure consents under section 6103(c). However, a one percent shareholder of a corporation, who may receive corporate returns pursuant to section 6103(e)(1)(D)(iii), may not execute disclosure consents because the right of inspection is personal to the shareholder, and such shareholder is not permitted to redisclose such information. See Internal Revenue Code §§6103(a)(3), 7213(a)(5). The temporary regulation also provides that if the taxpayer is an entity, generally a person with authority under State law to bind the entity may execute a section 6103(c) consent. Finally, the temporary regulation provides that the holder of a taxpayer's power of attorney may not execute a disclosure consent unless that authority is specifically granted in the power.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. This temporary regulation provides taxpayers with enhanced procedures to resolve problems with the IRS. For this reason, notice and public procedure and a delayed effective date would be contrary to the public interest pursuant to 5 U.S.C. 553(b)(B) and 553(d), respectively. Because this notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq*.) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this temporary regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this regulation is Jamie Bernstein, Office of the Associate Chief Counsel, Procedure and Administration (Disclosure & Privacy Law Division). However, other personnel from the IRS and Treasury Department participated in its development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

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

Section 301.6103(c)–1T also issued under 26 U.S.C. 6103(c). * * *

§301.6103(c)–1 [Removed]

Par. 2. Section 301.6103(c)–1 is removed.

Par. 3. Section 301.6103(c)–1T is added to read as follows:

§301.6103(c)–1T Disclosure of returns and return information to designee of taxpayer.

(a) *Overview*. Subject to such requirements and conditions as the Secretary of the Treasury may prescribe by regulation, section 6103(c) of the Internal Revenue Code authorizes the Internal Revenue Service to disclose a taxpayer's return or return information to such person or persons as the taxpayer may designate in a request for or consent to such disclosure, or to any other person at the taxpayer's request to the extent necessary to comply with the taxpayer's request to such other person for information or assistance. This regulation contains the requirements that must be met before, and the conditions under which, the Internal Revenue Service may make such disclosures. Paragraph (b) of this section provides the requirements that are generally applicable to designate a third party to receive the taxpayer's returns and return information. Paragraph (c) of this section provides requirements under which the Internal Revenue Service may disclose information in connection with a taxpayer's written or nonwritten request for a third party to provide information or assistance with regard to a tax matter, for example, a Congressional inquiry. Paragraph (d) of this section provides the parameters for disclosure consents connected with electronic return filing programs and combined Federal State filing. Finally, paragraph (e) provides definitions and general rules related to requests for or consents to disclosure.

(b) *Disclosure of returns and return information to person or persons designated in a written request or consent*—(1) *General requirements*. Pursuant to section 6103(c) of the Internal Revenue Code, the Internal Revenue Service (or an agent or contractor of the Internal Revenue Service) may disclose a taxpayer's return or return information to such person or persons as the taxpayer may designate in a request for or consent to such disclosure. A request for or consent to disclosure under this paragraph (b) must be in the form of a separate written document pertaining solely to the authorized disclosure. (For the meaning of separate written document, see paragraph (e)(1) of this section.) The separate written document must be signed (see paragraph (e)(2) of this section) and dated by the taxpayer who filed the return or to whom the return information relates. The taxpayer must also indicate in the written document—

(i) The taxpayer's taxpayer identity information described in section 6103(b)(6);

(ii) The identity of the person or persons to whom the disclosure is to be made;

(iii) The type of return (or specified portion of the return) or return information (and the particular data) that is to be disclosed; and

(iv) The taxable year or years covered by the return or return information.

(2) *Requirement that request or consent be received within sixty days of when signed and dated*. The disclosure of a return or return information authorized by a written request for or written consent to the disclosure shall not be made unless the request or consent is received by the Internal Revenue Service (or an agent or contractor of the Internal Revenue Service) within 60 days following the date upon which the request or consent was signed and dated by the taxpayer.

(c) *Disclosure of returns and return information to designee of taxpayer to comply with a taxpayer's request for information or assistance*. Where a taxpayer makes a written or nonwritten request, directly to another person or to the Internal Revenue Service, that such other person (for example, a member of Congress, friend, or relative of the taxpayer) provide information or assistance relating to the taxpayer's return or to a transaction or other contact between the taxpayer and the Internal Revenue Service, the Internal Revenue Service (or an agent or contractor of the Internal Revenue Service or a Federal government agency performing a Federal tax administration function) may disclose returns or return information to such other person under the circumstances set forth in paragraphs (c) (1) through- (3) of this section.

(1) *Written request for information or assistance*. (i) The taxpayer's request for information or assistance may be in the form of a letter or other written document, which must be signed (see paragraph (e)(2) of this section) and dated by the taxpayer. The taxpayer must also indicate in the written request—

(A) The taxpayer's taxpayer identity information described in section 6103(b)(6);

(B) The identity of the person or persons to whom disclosure is to be made; and

(C) Sufficient facts underlying the request for information or assistance to enable the Internal Revenue Service to determine the nature and extent of the information or assistance requested and the returns or return information to be disclosed in order to comply with the taxpayer's request.

(ii) A person who receives a copy of a taxpayer's written request for information or assistance but who is not the addressee of the request, such as a member of Congress who is provided with a courtesy copy of a taxpayer's letter to another member of Congress or to the Internal Revenue Service, cannot receive returns or return information under paragraph (c)(1) of this section.

(2) *Nonwritten request or consent*. (i) A request for information or assistance may also be nonwritten. Disclosure of returns and return information to a designee pursuant to a taxpayer's nonwritten request will be made only after the Internal Revenue Service has—

(A) Obtained from the taxpayer sufficient facts underlying the request for information or assistance to enable the Internal Revenue Service to determine the nature and extent of the information or assistance requested and the return or return information to be disclosed in order to comply with the taxpayer's request;

(B) Confirmed the identity of the taxpayer and the designee; and

(C) Confirmed the date, the nature, and the extent of the information or assistance requested.

(ii) Examples of disclosures pursuant to nonwritten requests for information or assistance under this paragraph (c)(2) include, but are not limited to, disclosures to a friend, relative, or other person whom the taxpayer brings to an interview or meeting with Internal Revenue Service officials, or disclosures to a person whom the taxpayer wishes to involve in a telephone conversation with Internal Revenue Service officials.

(3) *Rules applicable to written and nonwritten requests for information or assistance*. A return or return information will be disclosed to the taxpayer's designee as provided by this paragraph only to the extent considered necessary by the Internal Revenue Service to comply with the taxpayer's request or consent. Such disclosures shall not be made unless the request or consent is received by the Internal Revenue Service, its agent or contractor, or a Federal government agency performing a Federal tax administration function in connection with a request for advice or assistance relating to such function. This paragraph (c) does not apply to disclosures to a taxpayer's representative in connection with practice before the Internal Revenue Service (as defined in Treasury Department Circular No. 230). For disclosures in these cases, see section 6103(e)(6) and §§601.501 through 601.508 of this chapter.

(d) *Acknowledgments of electronically filed returns and other documents; combined filing programs with State tax agencies*—(1) *Acknowledgment of, and notices regarding, electronically filed returns and other documents*. When a taxpayer files returns or other documents or information with the Internal Revenue Service electronically, the taxpayer may consent to the disclosure of return information to the transmitter or other third party, such as the taxpayer's financial institution, necessary to acknowledge that the electronic transmission was received and either accepted or rejected by the Internal Revenue Service, the reason for any rejection, and such other information as the Internal Revenue Service determines is necessary to the operation of the electronic filing program. The consent must inform the taxpayer of the return information that will be transmitted and to whom disclosure will be made. The requirements of paragraphs (b) and (c) of this section do not apply to a consent under this paragraph (d)(1).

(2) *Combined return filing programs with State tax agencies*. (i) A taxpayer's participation in a combined return filing program between the Internal Revenue Service and a State agency, body, or commission (State agency) described in section 6103(d)(1) constitutes a consent to the disclosure by the Internal Revenue Service, to the State agency, of taxpayer identity information, signature, and items of common data contained on such return. For purposes of this paragraph, common data means information reflected on the Federal return required by State law to be attached to or included on the State return. Instructions accompanying the forms or published procedures involved in such program must indicate that by participating in the program, the taxpayer is consenting to the Internal Revenue Service's disclosure to the State agency of the taxpayer identity information, signature, and items of common data, and that such information will be treated by the State agency as if it had been directly filed with the State agency. Such instructions or procedures must also describe any verification that takes place before the taxpayer identity information, signature and common data is transmitted by the Internal Revenue Service to the State agency.

(ii) No disclosures may be made under this paragraph (d)(2) unless there are provisions of State law protecting the confidentiality of such items of common data.

(e) *Definitions and rules applicable to this section*—(1) *Separate written document*. (i) For the purposes of paragraph (b) of this section, *separate written document* means—

(A) One side of a standard (8 2" by 11" or larger) sheet of paper, which may be included as part of a larger document;

(B) Text appearing on a single computer screen containing all the elements described in paragraph (b)(1) of this section, which can be signed (see paragraph (e)(2) of this section) and dated by the taxpayer, and which can be reproduced, if necessary; or

(C) A consent on the record in an administrative or judicial proceeding, or a transcript of such proceeding recording such consent, containing the information required under paragraph (b)(1) of this section.

(ii) A provision included in a taxpayer's application for a loan or other benefit authorizing the grantor of the loan or other benefit to obtain any financial information, including returns or return information, from any source as the grantor may request for purposes of verifying information supplied on the application, does not meet the requirements of paragraph (b)(1) of this section because the provision is not a separate written document relating solely to the disclosure of returns and return information. In addition, the provision does not contain the other information specified in paragraph (b)(1) of this section.

(2) *Method of signing*. A request for or consent to disclosure may be signed by any method of signing the Secretary of the Treasury has prescribed pursuant to §301.6061–1(b) in forms, instructions, or other appropriate guidance.

(3) *Permissible designees and public forums*. Permissible designees under this section include individuals; trusts; estates; corporations; partnerships; Federal, State, local and foreign government agencies or subunits of such agencies; or the general public. When disclosures are to be made in a public forum, such as in a courtroom or congressional hearing, the request for or consent to disclosure must describe the circumstances surrounding the public disclosure, *e.g.*, congressional hearing, judicial proceeding, media, and the date or dates of the disclosure.

(4) *Authority to execute a request for or consent to disclosure*. Any person who may obtain returns under section 6103(e)(1) through (5), except section 6103(e)(1)(D)(iii), may execute a request for or consent to disclose a return or return information to third parties. For taxpayers that are legal entities, such as corporations and municipal bond issuers, any officer of the entity with authority under applicable State law to legally bind the entity may execute a request for or consent to disclosure. A person described in section 6103(e)(6) (a taxpayer's representative or individual holding a power of attorney) may not execute a request for or consent to disclosure unless the designation of representation or power of attorney specifically delegates such authority. A designee pursuant to this section does not have authority to execute a request for or consent to disclosure permitting the Internal Revenue Service to disclose returns or return information to another person.

(5) *No disclosure of return information if impairment*. A disclosure of return information shall not be made under this section if the Internal Revenue Service determines that the disclosure would seriously impair Federal tax administration (as defined in section 6103(b)(4) of the Internal Revenue Code).

(f) *Effective date*. This section is applicable on January 11, 2001, through January 10, 2004.

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

Approved December 29, 2000.

Jonathan Talisman,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 10, 2001, 8:45 a. m., and published in the issue of the Federal Register for January 11, 2001, 66 F.R. 2261)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part 1, § 6212; 301.6212–1.)

Rev. Proc. 2001–18

SECTION 1. PURPOSE

.01 This revenue procedure explains how a taxpayer is to inform the Internal Revenue Service of a change of address. When so informed, the Service will update the taxpayer's address of record to the new address. The Service uses the taxpayer's address of record for the various notices that are required to be sent to a taxpayer's "last known address" under the Internal Revenue Code and for refunds of overpayments of tax. Rev. Proc. 90–18, 1990–1 C.B. 491, is amplified and superseded by this Revenue Procedure.

SECTION 2. SCOPE

.01 This revenue procedure applies to notices that are required to be sent to a taxpayer's "last known address" under the following sections of the Code:

Section 982(c)(1) (formal document request for the production of foreign-based documentation);

Section 6110(f)(3)(B) (notification of disclosure proceedings);

Section 6110(f)(4)(B) (notification of disclosure proceedings);

Section 6212(b) (notice of deficiency);

Section 6245(b)(1) (notice of partnership adjustment for electing large partnerships);

Section 6303(a) (notice and demand for tax);

Section 6320(a)(2)(C) (notice and opportunity for hearing upon filing of notice of lien);

Section 6325(f)(2)(A) (notice of revocation of certificate of release or nonattachment of a lien);

Section 6330(a)(2)(C) (notice and opportunity for hearing before levy);

Section 6331(d)(2)(C) (notice of intention to levy);

Section 6332(b)(1) (copy of notice of levy with respect to a life insurance or endowment contract);

Section 6335(a) and (b) (notices of seizure and sale);

Section 6901(g) (notice of liability in transferee cases);

Section 7603(b)(1) (summons by mail to third-party record keeper); and

Section 7609(a)(2) (notice of third-party summons).

.02 The Service generally will use the address on the most recently filed and properly processed return as the address of record for all the notices set forth in section 2.01 above. However, the Service may update the taxpayer's address of record by using United States Postal Service's (USPS) National Change of Address database (NCOA database) in accordance with Treas. Reg. § 301.6212–2 (effective January 29, 2001). If a taxpayer wishes to change the address of record, the taxpayer must give clear and concise notification as provided by this revenue procedure. The terms "return," "properly processed," "address on return," and "clear and concise notification" are defined in section 5 below.

SECTION 3. BACKGROUND

.01 The Code sections listed in section 2.01 of this revenue procedure use the phrase "last known address." The intended purpose of the phrase "last known address" can be found in the legislative history of a predecessor to section 6212(b) of the Code, which provides that the purpose of imposing a last known address standard was to relieve the Service of the obviously impossible task of keeping an up-to-date record of taxpayers' addresses. H.R. Rep. No. 2, 70th Cong., 1st Sess. 22 (1927), 1939–1 (Part 2) C.B. 384, 399.

.02 The meaning of the phrase "last known address" is important, and taxpayers should be aware of their need to update their address with the Service in order to receive refunds of tax and the notices listed in section 2.01 of this revenue procedure. When such a notice is sent to a taxpayer's "last known address," the notice is legally effective even if the taxpayer never receives it.

.03 The Tax Court in *Abeles v. Commissioner*, 91 T.C. 1019 (1988), *acq.*, 1989–2 C.B. 1, held that "last known address" is the address on the most recently filed and properly processed return, unless the Service has been given clear and concise notification of a different address. This definition has since been incorporated into Treas. Reg. § 301.6212–2(a) (effective January 29, 2001).

SECTION 4. PROCEDURES FOR CHANGE OF ADDRESS

.01 If a taxpayer files a return with new address information, the proper processing of the return will update the taxpayer's address of record. With the exception of the returns listed in section 4.04, a taxpayer's address of record will be updated for the name and taxpayer identification number (the employer identification number or the social security number) under which the return is filed.

.02 If a taxpayer no longer wishes the address of record to be the one shown on the most recently filed return, for instance, because the taxpayer moved after the return was filed, clear and concise written notification of a change of address should be sent to the Internal Revenue Service Center serving the taxpayer's old address or to the Customer Service Division in the local area office. Form 8822 may be used by taxpayers as clear and concise written notification of a change of address pursuant to this revenue procedure.

.03 If, after a joint return is filed, either taxpayer establishes a separate residence, each taxpayer should send clear and concise written notification of a current address to the Service as provided in section 4.02 above.

.04 The Service maintains address records for gift, estate, and generation-skipping transfer tax returns (Forms 706, 706–A, 706NA, 709, and 709–A) separate from the address records for individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, 1040–PR, 1040SS, and 1040X). Thus, an individual taxpayer's notification of a change of address should identify whether any gift, estate, or generation-skipping transfer tax returns are affected by the notification.

.05 If a Service employee contacts a taxpayer in connection with the filing of a return or an adjustment in the taxpayer's account, the taxpayer may provide clear and concise written notification as provided in section 4.02 above or oral notification of a change of address to the Service employee who initiated the contact. What constitutes "clear and concise notification" is defined in section 5 below.

.06 A taxpayer should notify the USPS facility serving the taxpayer's old address of the taxpayer's new address so that mail from the Service can be forwarded to the new address. The Service may also update a taxpayer's address of record based on a new address that the taxpayer provides the USPS that is retained in USPS's NCOA database. *See* Treas. Reg. § 301.6212–2 (effective January 29, 2001). Taxpayers are nonetheless advised to notify the Service directly of a change of address to ensure a timely and accurate update of the Service's address of record for the taxpayer.

SECTION 5. DEFINITIONS

.01 Return. For purposes of updating a taxpayer's address of record, the term "return" includes the following federal tax or information forms:

(1) Returns filed under a social security number or an individual taxpayer identification number:

(a) Individual income tax returns:

Form 1040 U.S. Individual Income Tax Return;

Form 1040A U.S. Individual Income Tax Return;

Form 1040EZ Income Tax Return for Single and Joint Filers With No Dependents;

Form 1040NR U.S. Nonresident Alien Income Tax Return;

Form 1040NR-EZ U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents;

Form 1040-PR Planilla Para La Declaracion De La Contribucion Federal Sobre El Trabajo Por Cuenta Propia — Puerto Rico;

Form 1040-SS U.S. Self-Employment Tax Return, Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), or Puerto Rico;

Form 1040X Amended U.S. Individual Income Tax Return;

(b) Gift, estate, and generation-skipping transfer tax returns:

Form 706 United States Estate (and Generation-Skipping Transfer) Tax Return;

Form 706-A United States Additional Estate Tax Return;

Form 706-NA United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States;

Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return;

Form 709-A United States Short Form Gift Tax Return;

(2) Returns filed under an employer identification number:

Form CT-1 Employer's Annual Railroad Retirement Tax Return;

Form 720 Quarterly Federal Excise Tax Return;

Form 730 Monthly Tax on Wagering (Section 4401 of the Internal Revenue Code);

Form 940 Employer's Annual Federal Unemployment (FUTA) Tax Return;

Form 940-PR Planilla Para La Declaracion Anual Del Patrono — La Contribucion Federal Para El Desempleo (FUTA);

Form 940-EZ Employer's Annual Federal Unemployment (FUTA) Tax Return;

Form 941 Employer's Quarterly Federal Tax Return;

Form 941c Supporting Statement to Correct Information;

Form 941E Quarterly Return of Withheld Federal Income Tax and Medicare Tax;

Form 941-M Employer's Monthly Federal Tax Return;

Form 941cPR Planilla Para La Correccion De Informacion Facilitada Anteriormente En Cumplimiento Con La Ley Del Seguro Social Y Del Seguro Medicare;

Form 941-PR Planilla Para La Declaracion Trimestral Del Patrono — La Contribucion Federal Al Seguro Social Y Al Seguro Medicare;

Form 941SS Employer's Quarterly Federal Tax Return;

Form 943 Employer's Annual Tax Return for Agricultural Employees;

Form 943-PR Planilla Para La Declaracion Anual De La Contribucion Del Patrono De Empleados Agricolas;

Form 945 Annual Return of Withheld Federal Income Tax;

Form 990 Return of Organization Exempt from Income Tax — Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation), section 527, or section 4947(a)(1) nonexempt charitable trust;

Form 990-C Farmers' Cooperative Association Income Tax Return;

Form 990-EZ Short Form Return of Organization Exempt From Income Tax — Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation), section 527, or section 4947(a)(1) nonexempt charitable trust;

Form 990-PF Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation;

Form 990-T Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e));

Form 1041 U.S. Income Tax Return for Estates and Trusts;

Form 1042 Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;

Form 1065 U.S. Return of Partnership Income;

Form 1066 U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return;

Form 1120 U.S. Corporation Income Tax Return;

Form 1120-A U.S. Corporation Short-Form Income Tax Return;

Form 1120-F U.S. Income Tax Return of a Foreign Corporation;

Form 1120-FSC U.S. Income Tax Return of a Foreign Sales Corporation;

Form 1120-H U.S. Income Tax Return for Homeowners Associations;

Form 1120-L U.S. Life Insurance Company Income Tax Return;

Form 1120-ND Return for Nuclear Decommissioning Funds and Certain Related Persons;

Form 1120-PC U.S. Property and Casualty Insurance Company Income Tax Return;

Form 1120-POL U.S. Income Tax Return for Certain Political Organizations;

Form 1120-REIT U.S. Income Tax Return for Real Estate Investment Trusts;

Form 1120-RIC U.S. Income Tax Return for Regulated Investment Companies;

Form 1120S U.S. Income Tax Return for an S Corporation;

Form 1120-SF U.S. Income Tax Return for Settlement Funds (Under Section 468B);

Form 1120X Amended U.S. Corporation Income Tax Return;

Form 1139 Corporation Application for Tentative Refund;

Form 2290 Heavy Highway Vehicle Use Tax Return; and

Form 5227 Split-Interest Trust Information Return.

(3) The term "return" includes substitute forms (as defined in Rev. Proc. 2000–19, 2000–12 I.R.B. 785, reprinted in IRS Publication 1167, or as defined in other current revenue procedures concerning the requirements for substitute forms) for those forms listed in section 5.01(1) and (2) above.

(4) The term "return" does not include applications for extension of time to file a return. Thus, for example, a new address listed on Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, will not be used by the Service to update the taxpayer's address of record.

.02 Properly processed.

(1) Except as otherwise provided by the exceptions below, a return will be considered properly processed after a 45-day processing period which begins the day after the date of receipt of the return by the Internal Revenue Service Center. However, if a return is received prior to the due date for the return, the 45-day processing period will begin the day after the due date of the return. Returns that are not filed in a processible form may require additional processing time. In such cases, the 45-day processing period for address changes will begin the day after the error that caused the return to be unprocessible is corrected.

(2) Due to the high volume of returns received during the filing season, if a taxpayer provides new address information on a Form 1040, 1040A, 1040EZ, 1040NR, 1040-PR, 1040-SS, or 1040X, that is received by the Service after February 14 and before June 1, the return will be considered properly processed on July 16.

(3) A clear and concise written notification of a change of address will be considered properly processed after a 45-day processing period which begins the day after the date of receipt by:

(a) the Internal Revenue Service Center serving the taxpayer's old address;

(b) the Customer Service Division in the local area office; or

(c) a Service employee who contacted the taxpayer in connection with the filing of a return or an adjustment in the taxpayer's account.

(4) Clear and concise oral notification of a change of address will be considered properly processed after a 45-day processing period which begins the day after the date of the communication to the Service employee who contacted the taxpayer in connection with the filing of a return or an adjustment in the taxpayer's account.

(5) When the processing of address change information on a particular return will require a processing time in excess of 45 days, such as in section 5.02(2), taxpayers may send clear and concise written notification of a change of address to the Service in accordance with section 5.02(3) above.

.03 Address on Return.

The "address on return" is the address information shown in the upper portion of the front page of the return. When a taxpayer files an electronic/magnetic media return, the address information on the electronic/magnetic media portion of the return will be used to update the taxpayer's address of record. Although the electronic/magnetic media return includes a Form 8453 series declaration, the declaration is not used by the Service to update the taxpayer's address of record.

.04 Clear and Concise Written Notification.

(1) Clear and concise written notification is a statement signed by the taxpayer informing the Service that a taxpayer wishes the address of record changed to a new address. In addition to the new address, this notification must contain the taxpayer's full name, signature, old address, and social security number and/or employer identification number. Filers of a joint return should provide both names, social security numbers, and signatures. Individuals that have changed last names, for instance, due to marriage, should provide the last name shown on the most recently filed return and the new last name. In all cases, clear and concise written notification must be specific as to a change of address. Thus, a new address reflected in the letterhead of taxpayer correspondence will not by itself change a taxpayer's address of record.

(2) Correspondence sent by the Service that solicits or requires a response by the taxpayer that is returned to the Service by the taxpayer with corrections marked on the taxpayer's address information will constitute clear and concise written notification of a change of address. The taxpayer's signature on the correspondence is not required.

(3) Additionally, the Form 8822, Change of Address, can be used by taxpayers as clear and concise written notification of a change of address pursuant to this revenue procedure.

.05 Clear and Concise Oral Notification.

Clear and concise oral notification is a statement made by a taxpayer directly to a Service employee, who initiated contact with the taxpayer on an active account, informing the Service employee that the taxpayer wishes the address of record changed to a new address. In addition to the new address, the taxpayer must provide the taxpayer's full name, old address, and social security number and/or employer identification number. The Service employee should follow established procedures to determine that the person providing the information is in fact the taxpayer whose address of record will be changed.

SECTION 6. AREAS NOT COVERED BY THIS REVENUE PROCEDURE

.01 This revenue procedure does not apply to the notice requirements under sections 6221 through 6234, and 6037(c) of the Code concerning the tax treatment of partnership and subchapter S items.

.02 This revenue procedure does not apply to the following returns because they have unique processing requirements:

Form 5330 Return of Excise Taxes Related to Employee Benefits Plans (Under sections 4971, 4972, 4973(a)(3), 4975, 4976, 4977, 4978, 4978A, 4978B, 4979A, and 4980 of the Internal Revenue Code);

Form 5500 Annual Return/Report of Employee Benefit Plan;

Form 5500-C/R Return/Report of Employee Benefit Plan (with fewer than 100 participants); and

Form 5500-EZ Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan.

.03 This revenue procedure does not require the Service to send notices to an address furnished by the taxpayer when it is determined that a taxpayer cannot actually be contacted or located at that address.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective February 20, 2001, the date of its publication.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is R. Bradley Taylor of the Office of the Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice). For further information regarding this revenue procedure, contact R. Bradley Taylor at (202) 622-4940 (not a toll-free call).

Part IV. Items of General Interest

Partial Withdrawal of Notice of Proposed Rulemaking and Amendments to Notice of Proposed Rulemaking

Tax Treatment of Cafeteria Plans

REG–209461–79

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking and amendments to notice of proposed rulemaking.

SUMMARY: This document withdraws §1.125–2 Q&A–6(b),(c), and (d), and amends §1.125–2 Q&A–6(a) in the notice of proposed rulemaking (EE–130–86, 1989–1 C.B. 944) relating to cafeteria plans that was published in the **Federal Register** on March 7, 1989. Further, this document amends §1.125–1 Q&A–8 in the notice of proposed rulemaking relating to cafeteria plans that was published in the Federal Register on May 7, 1984, and amended on November 7, 1997, and March 23, 2000. This withdrawal and amendment are made because of changes made to these rules in the §1.125–4 final regulations (T.D. 8921, 2001–7 I.R.B. 532) relating to cafeteria plans.

DATES: Written or electronically generated comments and requests for a public hearing must be received by April 10, 2001.

ADDRESSES: Send submission to: CC:M&SP:RU (REG–209461–79), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:M&SP:RU (REG–209461–79), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html.

FOR FURTHER INFORMATION CONTACT: Christine Keller or Janet Laufer at (202)622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 7, 1989, the IRS issued proposed regulations §1.125–2 Q&A-6 relating to the circumstances under which participants may revoke existing elections and make new elections under a cafeteria plan. The IRS published final regulations (T.D. 8921, 2001–7 I.R.B. 532) under § 1.125–4 that address certain parts of this rule. Accordingly, §1.125–2 Q&A-6(b), (c), and (d) are withdrawn and §1.125–2 Q&A-6(a) of this rule is amended.

Further, on May 7, 1984, the IRS issued proposed regulations §1.125–1 Q&A-8 relating to the requirements that apply to participants' elections under a cafeteria plan. Q&A-8 of these regulations was amended on November 7, 1997, and March 23, 2000, to conform with the §1.125–4T and §1.125–4 regulations published on these dates, and is further amended to conform with the final §1.125–4 regulations published on January 10, 2001.

Partial Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §1.125–2 Q&A-6(b), (c) and (d) in the notice of proposed rulemaking that was published on March 7, 1989 (54 F.R. 9460), is withdrawn.

* * * * *

Amendments to Previously Proposed Rules

Accordingly, the proposed rules published on May 7, 1984 (49 F.R. 19321), and amended on November 7, 1997 (62 F.R. 60196), and March 23, 2000 (65 F.R. 15587), and the rules published on March 7, 1989 (54 F.R. 9460), are amended as follows:

PART 1— INCOME TAXES

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

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

Par. 2. In §1.125–1, as proposed May 7, 1984 (49 F.R. 19321), and as amended March 23, 2000 (65 F.R. 15587), Q&A-8 is amended by removing the last four sentences of A-8 and adding a sentence in their place to read as follows:

§1.125–1 Questions and answers relating to cafeteria plan.

* * * * *

Q-8: What requirements apply to participants' elections under a cafeteria plan?

A-8: * * * However, a cafeteria plan may permit a participant to revoke a benefit election after the period of coverage has commenced and make a new election with respect to the remainder of the period of coverage if both the revocation and the new election are permitted under § 1.125–4.

* * * * *

Par. 3. In §1.125–2, as proposed March 7, 1989 (54 F.R. 9460), and as amended March 23, 2000 (65 F.R. 15587), A-6 is amended by removing A-6(b), A-6(c), and A-6(d), redesignating A-6(e) as paragraph A-6(b), removing the last 5 sentences of A-6(a) and adding a sentence in their place to read as follows:

Q-6: In what circumstance may participants revoke existing elections and make new elections under a cafeteria plan?

A-6: * * *

(a) * * * However, to the extent permitted under §1.125–4, the terms of a cafeteria plan may permit a participant to revoke an existing election and to make a new election with respect to the remaining portion of the period of coverage.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 9, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 10, 2001, 66 F.R. 1923)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Excise Taxes on Excess Benefit Transactions

REG–246256–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In T.D. 8920 on page 654 of this Bulletin, the IRS is issuing temporary regulations relating to the excise taxes on excess benefit transactions under section 4958 of the Internal Revenue Code (Code), as well as certain amendments and additions to existing Income Tax Regulations affected by section 4958. Section 4958 was enacted in section 1311 of the Taxpayer Bill of Rights 2. Section 4958 generally is effective for transactions occurring on or after September 14, 1995.

Section 4958 imposes excise taxes on transactions that provide excess economic benefits to disqualified persons of public charities and social welfare organizations (referred to as applicable tax-exempt organizations). Disqualified persons who benefit from an excess benefit transaction with an applicable tax-exempt organization are liable for a tax of 25 percent of the excess benefit. Such persons are also liable for a tax of 200 percent of the excess benefit if the excess benefit is not corrected by a certain date. Additionally, organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause, are liable for a tax of 10 percent of the excess benefit. The tax for which participating organization managers are liable cannot exceed $10,000 for any one excess benefit transaction.

DATES: Written comments and requests for a public hearing must be received by April 10, 2001. In addition to any comments addressing substantive issues of the proposed regulations, the IRS and Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–246256–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–246256–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/prod/tax_regs/comments.html. A public hearing will be scheduled if requested.

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Guy Traynor, (202) 622-7180; concerning the regulations, Phyllis D. Haney, (202) 622-4290 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

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

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

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

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

An initial regulatory flexibility analysis was prepared as required for the collection of information under 5 U.S.C. 603 in the notice of proposed rulemaking, REG–246256–96, Failure by Certain Charitable Organizations to Meet Certain Qualification Requirements; Taxes on Excess Benefit Transactions, published August 4, 1998, at 63 F.R. 41486. The initial analysis was submitted to the Chief Counsel for Advocacy of the Small Business Administration pursuant to section 7805(f) of the Code for comment on its impact on business. The initial analysis continues to apply to this proposed rule. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place will be published in the **Federal Register**.

Drafting Information

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

* * * * *

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements. Accordingly, 26 CFR Parts 53 and 301 are proposed to be amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

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

Authority: 26 U.S.C. 7805.

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

[The text of proposed §§53.4958–0 through 53.4958–8 is the same as the text of §53.4958–0T through 53.4958–8T published in T.D. 8920.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 9, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 10, 2001, 66 F.R. 2173)

Notice of Proposed Rulemaking

Disclosure of Returns and Return Information to Designee of Taxpayer

REG –103320–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: In T.D. 8935 on page 702 of this Bulletin, the IRS is issuing a temporary regulation relating to the disclosure of returns and return information to the designee of a taxpayer. The text of that temporary regulation also serves as the text of this regulation.

DATES: Written and electronic comments and requests for a public hearing must be received by April 11, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–103320–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–103320–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site: http://www.irs.gov/prod/tax_regs/comments/html.

FOR FURTHER INFORMATION CONTACT: Joseph Conley (202) 622-4580 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 6103(c), as amended by section 1207 of the Taxpayer Bill of Rights II, Public Law 104–168 (110 Stat. 1452), authorizes the IRS to disclose returns and return information to such person or persons as the taxpayer may designate in a request for or consent to disclosure or to any other person at the taxpayer's request to the extent necessary to comply with a request for information or assistance made by the taxpayer to such other person. Disclosure is permitted subject to such requirements and conditions as may be prescribed by regulations. With the amendment in 1996, Congress eliminated the longstanding requirement that disclosures to designees of the taxpayer must be pursuant to the written request or consent of the taxpayer. The purpose of this amendment to section 6103(c) was to assist the IRS in developing a paperless tax administration system that relies on, among other things, electronic communication. H.R. Rep. No. 104–506, at 49 (1996), reprinted in 1996 U.S.C.A.N. 1143, 1172.

On October 3, 1980, a final regulation (T.D. 7723, 1980–2 C.B. 346) relating to the disclosure of tax returns and return information to a person designated by the taxpayer in a written request or consent was published in the **Federal Register** (45 F.R. 65564). Since the publication of this final regulation, the IRS has determined that further guidance on written consent requirements is necessary.

This document contains a proposed regulation that authorizes the disclosure of tax returns and return information to a designee of the taxpayer pursuant to nonwritten requests or consents authorizing the disclosures. Such proposed regulation also amends the existing regulation to clarify the rules applicable to written requests or consents to disclosure.

The text of the temporary regulation (T.D. 8935) on page 702 of this Bulletin serves as the text of this proposed regulation. The preamble to the temporary regulation explains the regulation.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that this proposed regulation will not impose a significant economic impact on a substantial number of small entities. The regulation is intended to reduce the burden on taxpayers and to facilitate the development of a paperless tax administration system. The prior regulation required that a taxpayer provide a written request or consent before the IRS could disclose the taxpayer's return information to a designee of the taxpayer; this regulation permits such a disclosure, under certain specified circumstances, pursuant to the taxpayer's nonwritten request or consent. The regulation also provides parameters for the development of consents for the electronic filing program, and it reduces the burden on taxpayers in combined Federal-State return filing programs by facilitating the electronic filing of a Federal-State return by means of a single electronic transmission.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel of Small Business Administration for comment on its impact on small businesses.

Comments and Requests for a Public Hearing

Before the proposed regulation is adopted as a final regulation, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on consents or notices authorizing disclosures in an electronic environment. Additionally, the IRS and Treasury Department specifically request comments on the clarity of the proposed regulation and how it can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of this regulation is Jamie Bernstein, Office of the Associate Chief Counsel, Procedure and Administration (Disclosure & Privacy Law Division). However, other personnel from the IRS and Treasury Department participated in its development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read in part as follows:

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

Section 301.6103(c)–1 also issued under 26 U.S.C. 6103(c). ***

Par. 2. Section 301.6103(c)–1 is added to read as follows:

§301.6103(c)–1 Disclosure of returns and return information to designee of taxpayer.

[The text of this proposed section is the same as the text of §301.6103(c)–1T published in T.D. 8935.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 10, 2001, 8:45 a.m., and published in the issue of the Federal Register for January 11, 2001, F.R. 2373)

Extended Time for Use of the Revised Form W-9

Announcement 2001–15

Purpose

This is to advise persons required to file information returns of the availability and required use of Form W-9, *Request for Taxpayer Identification Number and Certification* (Rev. December, 2000). In response to payor concerns about implementing the new certification requirements, the use of revised Form W-9 is optional until July 1, 2001.

Certification of U.S. Status

The major change to the form is that under Part III, Certification, a payee must now certify that he or she is a U.S. person (including a U.S. resident alien). Payors must use the revised Form W-9 for all new solicitations after June 30, 2001.

Foreign Payees

A foreign person may not use Form W-9 to furnish his or her taxpayer identification number to the payor after December 31, 2000. Instead, foreign payees must use the appropriate Form W-8.

Guidance to Federally Recognized Indian Tribal Governments About Their Federal Unemployment Tax Act Obligations for 2000

Announcement 2001–16

This announcement provides guidance to federally recognized Indian tribal governments, including any subdivision, subsidiary, or wholly-owned business enterprise, about their Federal Unemployment Tax Act (FUTA) obligations for 2000. The announcement is being made because the recent enactment of Section 166 of the Community Renewal Tax Relief Act of 2000 (H.R. 5662, incorporated in H.R. 4577, the Consolidated Appropriations Act, 2001) (Pub. L. No. 106–554, 114 Stat. 2763) changed how FUTA applies to Indian tribal governments.

For services rendered after December 20, 2000, federally recognized Indian tribal governments are exempt from FUTA. Instead, an Indian tribal government may elect to make contributions to the State unemployment fund as if services by its employees were employment under FUTA, or it may make payments in lieu of the contributions in amounts equal to the unemployment benefits attributable under the State law to such service; and Indian tribal governments may make separate elections for any subdivision, subsidiary, or business enterprise wholly owned by it.

The new law also includes a transition rule that may eliminate an Indian tribal government's obligation to pay FUTA taxes for certain services rendered during 2000, but before December 21, of that year. Under the transition rule, an Indian tribal government has no FUTA tax liability for services performed by its employees if the following conditions are satisfied: (1) the service was performed before December 21, 2000; (2) the tax imposed under FUTA was not paid; *and* (3) the Indian tribal government reimburses a State unemployment fund for unemployment benefits actually paid for services performed before December 21, 2000.

The due date for Form 940, for services rendered in 2000, is January 31, 2001, and FUTA taxes deposited during 2000, generally are deemed not paid until that date. Therefore, FUTA tax deposits for services performed from January 1, 2000, through December 20, 2000, were not paid by December 21, 2000, and are therefore not considered paid for purposes of the transition rule. Note, however, that FUTA tax liability paid before the enactment of the Community Renewal Tax Relief Act of 2000 (i.e., for years before 2000), may not be refunded under the terms of the law. Therefore, the transition rule options described in this announcement apply to Form 940 only for year 2000.

Because this law was enacted in December of 2000, many Indian tribal governments may not have had time to consider the options available and may not know how they plan to proceed by January 31, 2001, under this new law. Furthermore, the State governments have not yet had time to establish procedures for the reimbursement of the State unemployment funds.

Indian tribal governments may use one of the following options in filing Form 940 for 2000:

OPTION 1

If the Indian tribal government knows before January 31, 2001, that it wishes to use the transition rule for all of its 2000 FUTA liabilities and will satisfy the terms of that rule, including the reimbursement of the State, it may file a Form 940 filled out in the following way:

1. Write across the top of the Form 940: "Announcement 2001–16."
2. Check the box stating that it is not required to file Form 940 in the future.
3. Total payments made in 2000 for services rendered for the year 2000, should be entered on line 1 of Part I of Form 940.
4. The amount entered on line 1 of Part I should also be entered on line 2.
5. Line 2 also requests an explanation about why the amounts are exempt. The Indian tribal government should state: "Announcement 2001–16."
6. On line 5, enter zero as FUTA tax liability.
7. On line 7 of Part II, enter zero.
8. On line 8 of Part II, enter the total FUTA tax deposited for the year.
9. On line 10 of Part II, enter the amount from line 8.

OPTION 2

If the Indian tribal government has not determined how it wishes to proceed concerning the transition rule, it should file the Form 940 for 2000 claiming exemption only for services performed after December 20, 2000. The Indian tribal government may later use an amended return for 2000 to exercise its option to use the transition rule and receive a refund for amounts deposited. If the Indian tribal government chooses to amend its return, it should file another Form 940 and check the box that indicates it is an amended return. It should follow the directions in Option 1 when it prepares this amended Form 940. These amended Forms 940 for 2000 must be filed no later than January 31, 2004.

In the alternative, recognizing the limited period of time the Indian tribal government has to react to the new law, it may file the Form 940 for 2000 as if the new law had not been enacted. The Indian tribal government should later use an amended return for 2000 to receive a refund for amounts deposited for services after December 21, 2000, but before January 1, 2001, even if the Indian tribal government decides not to use the transition rule.

TRANSITION RULE ELECTIONS FOR SUBDIVISIONS, SUBSIDIARIES, OR WHOLLY-OWNED BUSINESS ENTERPRISES

An Indian tribal government may choose to apply the transition rule separately to each subdivision, subsidiary, or wholly-owned business enterprise. For example, the Indian tribal government could elect to reimburse the State unemployment funds for one wholly-owned business enterprise, and receive a refund of amounts deposited with respect to that wholly-owned business enterprise, but not make the election for another wholly-owned business enterprise. If the Indian tribal government decides to apply the transition rule differently to different subdivisions, subsidiaries, or wholly-owned business enterprises, it may use either Option 1 or Option 2, but should enter on line 2 of Part I ONLY those amounts attributable to subdivisions, subsidiaries, or wholly-owned business enterprises to which its transition rule election applies, then complete the calculations by following the form instructions.

For further information regarding this announcement, contact the Tax Exempt and Government Entities Customer Account Services call site at 1-877-829-5500 (toll-free).

New Form 8875, *Taxable REIT Subsidiary Election*

Announcement 2001–17

New Form 8875 is now available for tax years beginning after 2000. An eligible corporation and a REIT use Form 8875 to jointly elect to have the corporation treated as a taxable REIT subsidiary. The corporation and the REIT can make this election if the REIT directly or indirectly owns stock in the corporation.

You can obtain Form 8875 by telephone or by using IRS electronic information services.

Request by	*Number or address*
Telephone	**1-800-TAX-FORM** (1-800-829-3676)
Personal computer:	
IRS Web Site	**www.irs.gov**
File transfer protocol	**ftp://ftp.irs.gov**

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 2001–20

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on February 20, 2001, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428 (c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Hemotec Medical Research Foundation
Ontario, CA
St. David's Health Care System, Inc.
Austin, TX
Watts 13 Foundation
Los Angeles, CA

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Sinclair, Gerald A.	Hammond, IN	Enrolled Agent	August 16, 2000 to August 15, 2001
Barrett, Norman	Dover, DE	CPA	September 1, 2000 to November 30, 2001
Janus, Stephen E.	Michigan City, IN	CPA	September 20, 2000 to September 19, 2003
McCormack, Frank J.	Castlebury, FL	CPA	September 20, 2000 to September 19, 2003
Serio, Vinson J.	Metairie, LA	Enrolled Agent	October 1, 2000 to September 30, 2003
Baker, Linda L.	West Orange, NJ	CPA	October 20, 2000 to April 19, 2004
Duncanson, Thomas D.	Mankato, MN	CPA	November 7, 2000 to May 6, 2003
West, Keith	Pasadena, CA	Enrolled Agent	November 15, 2000 to May 14, 2001
Overbeck, Marietta	Evansville, IN	CPA	November 15, 2000 to November 14, 2002
Garrison, John L.	Guymon, OK	CPA	November 20, 2000 to November 19, 2002

Aiken, Kim Allen	Olympia, WA	CPA	December 10, 2000 to June 9, 2002
D'Arata, David J.	Buffalo, NY	CPA	January 1, 2001 to June 30, 2003
Gambrel, Thomas R.	Corbin, KY	CPA	January 1, 2001 to December 31, 2004

Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years, from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified pubic accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions of the applicable regulations:

Name	Address	Designation	Date of Suspension
Barger, Robert E.	Garden Ridge, TX	Attorney	Indefinite from October 10, 2000
Roberts, Thomas W.	Cincinnati OH	CPA	Indefinite from October 24, 2000

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from futher practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Joyner, Joseph	Gary, IN	CPA	November 24, 2000

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2000–27 through 2000–52 is in Internal Revenue Bulletin 2001–1, dated January 2, 2001.

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