Internal Revenue

bulletin

Bulletin No. 2002–7
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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

T.D. 8981, page 496.
REG–107100–00, page 529.
Final, temporary and proposed regulations under sections 874 and 882 of the Code relate to the disallowance of deductions and credits for nonresident alien individuals and foreign corporations that fail to file a timely U.S. income tax return unless the Commissioner waives the filing deadlines. The temporary regulations revise the waiver standard. A public hearing on the proposed regulations is scheduled for June 3, 2002.

REG–115054–01, page 530.
Proposed regulations under section 66 of the Code relate to the treatment of community income for certain married individuals in community property states who do not file joint individual federal income tax returns. The regulations also reflect changes in the law made by the Internal Revenue Service Restructuring and Reform Act of 1998.

Notice 2002–11, page 526.
Loss disallowance. This notice sets forth the Service's new position with regard to consolidated return loss disallowance rules.

Rev. Proc. 2002–11, page 526.
Dealer in securities futures contracts. This procedure provides guidelines for an exchange to follow in order to obtain a letter ruling regarding whether certain persons trading on that exchange qualify as "dealers" in securities futures contracts (or options on such contracts) for purposes of section 1256(g)(9) of the Code. Also, after issuance of a specific letter ruling determining dealer status, the Service expects to publish the same conclusion in a revenue ruling.

Announcement 2002–13, page 540.
This announcement contains a correction to Table 6 of Rev. Rul. 2002–2 (2002–2 I.R.B. 271), the January 2002 Applicable Federal Rates. Table 6 contains the "Deemed Rate for Transfers to New Pooled Income Funds During 2002." under section 642(c)(5) of the Code.

EXEMPT ORGANIZATIONS

T.D. 8978, page 500.
Final regulations under section 4958 of the Code relate to excise taxes on excess benefit transactions and explain the rules and definitions contained in section 4958, such as rules for when organization managers are liable for a tax and the definitions of "applicable tax-exempt organization" and "disqualified person."

Announcement 2002–16, page 541.
A list is provided of organizations now classified as private foundations.

EXCISE TAX

T.D. 8978, page 500.
Final regulations under section 4958 of the Code relate to excise taxes on excess benefit transactions and explain the rules and definitions contained in section 4958, such as rules for when organization managers are liable for a tax and the definitions of "applicable tax-exempt organization" and "disqualified person."

(Continued on the next page)

Actions Relating to Court Decisions is on the page following the Introduction.
Announcements of Declaratory Judgment Proceedings Under Section 7428 begin on page 542.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2002–10, page 539.

The Service announces the availability of new Form 720X, *Amended Quarterly Federal Excise Tax Return.* This form is used to make adjustments to liability reported on Forms 720 filed for previous quarters.

ADMINISTRATIVE

Notice 2002–12, page 526.

Patriots' Day 2002 in Massachusetts and Maine. Because Patriots' Day falls on April 15, this notice provides individual taxpayers residing in Massachusetts, Michigan, New York (all counties except Nassau, Rockland, Suffolk, Westchester, and New York City), Rhode Island, and Maine an additional day to file their federal income tax returns and make their payments (until April 16, 2002). This includes the payment of the first installment of estimated tax for 2002.

Announcement 2002–9, page 536.

Deduction and capitalization of expenditures. The Service invites comments from the public on issues that the IRS expects to address in proposed regulations (REG–125638–01) relating to rules and standards that the IRS and Treasury Department expect to propose that will clarify the application of section 263(a) of the Code to expenditures incurred in acquiring, creating, or enhancing certain intangible assets or benefits.

Announcement 2002–14, page 540.

This document contains corrections to final regulations (T.D. 8973, 2002–4 I.R.B. 391) relating to the allocation of loss with respect to stock and other personal property under sections 861 and 865 of the Code.

Announcement 2002–15, page 540.

This document contains corrections to proposed regulations (REGs–142299–01 and 209135–88, 2002–4 I.R.B. 418) that apply to certain transactions or events that result in a Regulated Investment Company (RIC) or a Real Estate Investment Trust (REIT) owning property that has a basis determined by reference to a C corporation's basis in the property.

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 Other Related Items, 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.

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both “acquiescence” and “acquiescence in result only” mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, “acquiescence” indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, “acquiescence in result only” indicates disagreement or concern with some or all of those reasons. “Nonacquiescence” signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a “nonacquiescence” indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decision:

Ridge and Marjory Harlan v. Commissioner, [1]
116 T.C. 31 (2001)
T.C. Dkt. Nos. 21214–92; 24609–92

[1] Acquiescence relating to whether, in determining the applicability of the 6-year period of limitations provided by section 6501(e)(1)(A), second-tier partnership information returns are taken into account in computing the amount of gross income stated in the return.

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

Section 162.—Trade or Business Expenses

What rules and standards should be applied to determine whether expenditures incurred in acquiring, creating, or enhancing certain intangible assets or benefits must be deducted or capitalized. Public comments are requested. See Ann. 2002-9 on page 536.

Section 874.—Allowance of Deductions and Credits

26 CFR 1.874–1: Allowance of deductions and credits to nonresident alien individuals.

T.D. 8981

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Disallowance of Deductions and Credits for Failure to File Timely Return

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to the disallowance of deductions and credits for nonresident alien individuals and foreign corporations that fail to file a timely U.S. income tax return. The current regulations permit nonresident aliens and foreign corporations the benefit of deductions and credits only if they timely file a U.S. income tax return in accordance with subtitle F of the Internal Revenue Code, unless the Commissioner waives the filing deadlines. The temporary regulations revise the waiver standard. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: *Effective Date*: These regulations are effective January 29, 2002.

Applicability Date: For dates of applicability, see §§ 1.874–1T(b)(4) and 1.882–4T(a)(3)(iv) of these regulations.

FOR FURTHER INFORMATION CONTACT: Nina E. Chowdhry (202) 622–3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 871(b)(1) provides that a nonresident alien individual engaged in a trade or business within the United States shall be taxed on income effectively connected with the conduct of the trade or business within the United States. Likewise, under section 882(a)(1), a foreign corporation engaged in a trade or business within the United States shall be taxed on its income effectively connected with the conduct of the trade or business within the United States. In determining the amount of effectively connected taxable income, both the nonresident alien individual and the foreign corporation (collectively, foreign taxpayers) generally may deduct from effectively connected gross income expenses that are properly allocated and apportioned to that gross income. However, under sections 874(a)(1) and 882(c)(2), a foreign taxpayer generally is entitled to those deductions, and to allowable credits, only if it files a true and accurate U.S. income tax return in the manner prescribed in subtitle F of the Internal Revenue Code (Code), including on the return all the information necessary for the calculation of the deductions and credits.

Sections 1.874–1(b)(1) and 1.882–4(a)(3)(i) provide filing deadlines beyond which a return entitling the foreign taxpayer to deductions and credits may not be filed. Under §§ 1.874–1(b)(2) and 1.882–4(a)(3)(ii), as currently in effect, the Commissioner may waive the filing deadlines prescribed in §§ 1.874–1(b)(1) and 1.882–4(a)(3)(i) in rare and unusual circumstances if good cause for such waiver, based on the facts and circumstances, is established by a foreign taxpayer who does not file a return (a non-filer). When these regulations were promulgated in 1990, Treasury and the IRS intended that the waiver standard balance the legislative intent to establish strong compliance measures with respect to required income tax return filing by foreign taxpayers with a means to grant relief from the filing deadlines in appropriate cases. In practice, the IRS has found that the standard currently in §§ 1.874–1(b)(2) and 1.882–4(a)(3)(ii) (the waiver standard) is too restrictive and does not achieve this balance.

Explanation of Provisions

The temporary regulations in this document revise the waiver standard contained in §§ 1.874–1(b)(2) and 1.882–4(a)(3)(ii) and provide examples of the application of the revised standard. The revised waiver standard provides that the filing deadlines may be waived by the Commissioner or his or her delegate if the non-filer establishes that, based on the facts and circumstances, the non-filer acted reasonably and in good faith in failing to file a U.S. income tax return (including a protective return). For this purpose, a non-filer is not considered to have acted reasonably and in good faith if the non-filer knew that it was required to file the return but chose not to file the return. In addition, a non-filer shall not be granted a waiver unless the non-filer cooperates in determining the non-filer's U.S. tax liability for the taxable year for which the return was not filed. The following factors will be considered by the IRS in determining whether a non-filer, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return: whether the non-filer voluntarily identifies itself to the IRS as having failed to file a U.S. income tax return before the IRS discovers the failure to file; whether the non-filer did not become aware of the non-filer's ability to file a protective return by the deadline for filing the protective return; whether the non-filer had not previously filed a U.S. income tax return; whether the non-filer failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account relevant experience and level of sophistication), the non-filer was unaware of the necessity for filing the return; whether the non-filer failed to file a U.S. income tax return because of intervening events beyond the non-filer's control; and whether other mitigating or exacerbating circumstances existed.

Effective Date

These regulations apply to open years for which requests for waivers of application of sections 874(a) and 882(c) are filed on or after January 29, 2002.

Special Analyses

It has been determined that these temporary regulations are 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 Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

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

* * * * *

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 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.874–1T also issued under 26 U.S.C. 874. * * *
Section 1.882–4T also issued under 26 U.S.C. 882(c). * * *

Par. 2. Section 1.874–1 is amended by:
1. Revising paragraph (b)(2).
2. Paragraphs (b)(3) and (b)(4) are redesignated as paragraphs (b)(5) and (b)(6), respectively.
3. New paragraphs (b)(3) and (b)(4) are added.

The revision and additions read as follows:

§ 1.874–1 Allowance of deductions and credits to nonresident alien individuals.

* * * * *

(b)(2) through (4) For further guidance, see § 1.874–1T(b)(2) through (4).

* * * * *

Par. 3. Section 1.874–1T is added to read as follows:

§ 1.874–1T Allowance of deductions and credits to nonresident alien individuals (temporary).

(a) through (b)(1) For further guidance, see § 1.874–1(a) through (b)(1).

(b)(2) *Waiver*. The filing deadlines set forth in paragraph (b)(1) of this section may be waived if the nonresident alien individual establishes to the satisfaction of the Commissioner or his or her delegate that the individual, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return (including a protective return (as described in § 1.874–1(b)(6))). For this purpose, a nonresident alien individual shall not be considered to have acted reasonably and in good faith if the individual knew that he or she was required to file the return and chose not to file the return. In addition, a nonresident alien individual shall not be granted a waiver unless the individual cooperates in determining his or her U.S. income tax liability for the taxable year for which the return was not filed. The Commissioner or his or her delegate shall consider the following factors in determining whether the nonresident alien individual, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return:

(i) Whether the individual voluntarily identifies himself or herself to the Internal Revenue Service as having failed to file a U.S. income tax return before the Internal Revenue Service discovers the failure to file;

(ii) Whether the individual did not become aware of his or her ability to file a protective return (as described in § 1.874–1(b)(6)) by the deadline for filing the protective return;

(iii) Whether the individual had not previously filed a U.S. income tax return;

(iv) Whether the individual failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account his or her relevant experience and level of sophistication), the individual was unaware of the necessity for filing the return;

(v) Whether the individual failed to file a U.S. income tax return because of intervening events beyond the individual's control; and

(vi) Whether other mitigating or exacerbating factors existed.

(3) *Examples*. The following examples illustrate the provisions of this paragraph (b). In all examples, A is a nonresident alien individual and uses the calendar year as A's taxable year. The examples are as follows:

Example 1. Nonresident alien individual discloses own failure to file. In Year 1, A became a limited partner with a passive investment in a U.S. limited partnership that was engaged in a U.S. trade or business. During Year 1 through Year 4, A incurred losses with respect to A's U.S. partnership interest. A's foreign tax advisor incorrectly concluded that because A was a limited partner and had only losses from A's partnership interest, A was not required to file a U.S. income tax return. A was aware neither of A's obligation to file a U.S. income tax return for those years nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. In Year 5, A began realizing a profit, rather than a loss, with respect to the partnership interest, and, for this reason, engaged a U.S. tax advisor to handle A's responsibility to file U.S. income tax returns. In preparing A's U.S. income tax return for Year 5, A's U.S. tax advisor discovered that returns were not filed for Year 1 through Year 4. Therefore, with respect to those years for which applicable filing deadlines in § 1.874–1(b)(1) were not met, A would be barred by § 1.874–1(a) from claiming any deductions that otherwise would have given rise to net operating losses on returns for these years, and would have been available as loss carryforwards in subsequent years. At A's direction, A's U.S. tax advisor promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 through Year 4 and by making A's books and records available to an Internal Revenue Service examiner. A has met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in § 1.874–1(b)(1).

Example 2. *Nonresident alien individual refuses to cooperate*. Same facts as in *Example 1*, except that while A's U.S. tax advisor contacted the appropriate examining personnel and filed the appropriate income tax returns for Year 1 through Year 4, A refused all requests by the Internal Revenue Service to provide supporting information (for example, books and records) with respect to those returns. Because A did not cooperate in determining A's U.S. tax liability for the taxable years for which an income tax return was not timely filed, A is not granted a waiver as described in paragraph (b)(2) of this section of any applicable filing deadlines in § 1.874–1(b)(1).

Example 3. *Nonresident alien individual fails to file a protective return*. Same facts as in *Example 1*, except that in Year 1 through Year 4, A also consulted a U.S. tax advisor, who advised A that it was uncertain whether U.S. income tax returns were necessary for those years and that A could protect its right subsequently to claim the loss carryforwards by filing protective returns under § 1.874–1(b)(6). A did not file U.S. income tax returns or protective returns for those years. A did not present evidence that intervening events beyond A's control prevented A from filing an income tax return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in § 1.874–1(b)(1).

Example 4. *Nonresident alien with effectively connected income*. In Year 1, A, a computer programmer, opened an office in the United States to market and sell a software program that A had developed outside the United States. A had minimal business or tax experience internationally, and no such experience in the United States. Through A's personal efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. A, however, did not file U.S. income tax returns for Year 1 or Year 2. A was aware neither of A's obligation to file a U.S. income tax return for those years, nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. In November of Year 3, A engaged U.S. counsel in connection with licensing software to an unrelated U.S. company. U.S. counsel reviewed A's U.S. activities and advised A that A should have filed U.S. income tax returns for Year 1 and Year 2. A immediately engaged a U.S. tax advisor who, at A's direction, promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 and Year 2 and by making A's books and records available to an Internal Revenue Service examiner. A has met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in § 1.874–1(b)(1).

Example 5. *IRS discovers nonresident alien's failure to file*. In Year 1, A, a computer programmer, opened an office in the United States to market and sell a software program that A had developed outside the United States. Through A's personal efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. A had extensive experience conducting similar business activities in other countries, including making the appropriate tax filings. However, A was aware neither of A's obligation to file a U.S. income tax return for those years, nor of A's ability to file a protective return for those years. A had never filed a U.S. income tax return before. Despite A's extensive experience conducting similar business activities in other countries, A made no effort to seek advice in connection with A's U.S. tax obligations. A failed to file either U.S. income tax returns or protective returns for Year 1 and Year 2. In November of Year 3, an Internal Revenue Service examiner asked A for an explanation of A's failure to file U.S. income tax returns. A immediately engaged X, a U.S. tax advisor, and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 and Year 2 and by making A's books and records available to the examiner. A did not present evidence that intervening events beyond A's control prevented A from filing a return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in § 1.874–1(b)(1).

Example 6. *Nonresident alien with prior filing history*. A began a U.S. trade or business in Year 1 as a sole proprietorship. A's tax advisor filed the appropriate U.S. income tax returns for Year 1 through Year 6, reporting income effectively connected with A's U.S. trade or business. In Year 7, A replaced its tax advisor with a tax advisor unfamiliar with U.S. tax law. A did not file a U.S. income tax return for any year from Year 7 through Year 10, although A had effectively connected income for those years. A was aware of A's ability to file a protective return for those years. In Year 11, an Internal Revenue Service examiner contacted A and asked for an explanation of A's failure to file income tax returns after Year 6. A immediately engaged a U.S. tax advisor and cooperated with the Internal Revenue Service in determining A's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 7 through Year 10 and by making A's books and records available to the examiner. A did not present evidence that intervening events beyond A's control prevented A from filing a return, and there were no other mitigating factors. A has not met the standard described in paragraph (b)(2) of this section for waiver of any applicable filing deadlines in § 1.874–1(b)(1).

(4) *Effective date*. Paragraphs (b)(2) and (3) of this section are applicable to open years for which a request for a waiver is filed on or after January 29, 2002.

(b)(5) through (e) For further guidance, see § 1.874–1(b)(5) through (e).

Par. 4. Section 1.882–4 is amended by:

1. Revising paragraph (a)(3)(ii).

2. Paragraphs (a)(3)(iii) through (a)(3)(v) are redesignated as paragraphs (a)(3)(v) through (a)(3)(vii), respectively.

3. New paragraphs (a)(3)(iii) and (a)(3)(iv) are added.

The revision and additions read as follows:

§ 1.882–4 Allowance of deductions and credits to foreign corporations.

(a) * * *

(3) * * *

(ii) through (iv) For further guidance, see § 1.882–4T(a)(3)(ii) through (iv).

* * * * *

Par. 5. Section 1.882–4T is added to read as follows:

§ 1.882–4T Allowance of deductions and credits to foreign corporations (temporary).

(a) through (a)(3)(i) For further guidance, see § 1.882–4(a) through (a)(3)(i).

(a)(3)(ii) The filing deadlines set forth in § 1.882–4(a)(3)(i) may be waived if the foreign corporation establishes to the satisfaction of the Commissioner or his or her delegate that the corporation, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return (including a protective return (as described in § 1.882–4(a)(3)(vi))). For this purpose, a foreign corporation shall not be considered to have acted reasonably and in good faith if the foreign corporation knew that it was required to file the return and chose not to file the return. In addition, a foreign corporation shall not be granted a waiver unless the foreign corporation cooperates in the process of determining its income tax liability for the taxable year for which the return was not filed. The Commissioner or his or her delegate shall consider the following factors in determining whether the foreign corporation, based on the facts and circumstances, acted reasonably and in good faith in failing to file a U.S. income tax return:

(A) Whether the corporation voluntarily identifies itself to the Internal Revenue Service as having failed to file a U.S. income tax return before the Internal Revenue Service discovers the failure to file;

(B) Whether the corporation did not become aware of its ability to file a protective return (as described in § 1.882–4(a)(3)(vi)) by the deadline for filing a protective return;

(C) Whether the corporation had not previously filed a U.S. income tax return;

(D) Whether the corporation failed to file a U.S. income tax return because, after exercising reasonable diligence (taking into account its relevant experience and level of sophistication), the corporation was unaware of the necessity for filing the return;

(E) Whether the corporation failed to file a U.S. income tax return because of intervening events beyond the corporation's control; and

(F) Whether other mitigating or exacerbating factors existed.

(iii) The following examples illustrate the provisions of this section. In all examples, FC is a foreign corporation and uses the calendar year as its taxable year. The examples are as follows:

Example 1. Foreign corporation discloses own failure to file. In Year 1, FC became a limited partner with a passive investment in a U.S. limited partnership that was engaged in a U.S. trade or business. During Year 1 through Year 4, FC incurred losses with respect to FC's U.S. partnership interest. FC's foreign tax director incorrectly concluded that because FC was a limited partner and had only losses from FC's partnership interest, FC was not required to file a U.S. income tax return. FC's management was aware neither of FC's obligation to file a U.S. income tax return for those years nor of FC's ability to file a protective return for those years. FC had never filed a U.S. income tax return before. In Year 5, FC began realizing a profit, rather than a loss, with respect to the partnership interest, and, for this reason, engaged a U.S. tax advisor to handle FC's responsibility to file U.S. income tax returns. In preparing FC's income tax return for Year 5, FC's U.S. tax advisor discovered that returns were not filed for Year 1 through Year 4. Therefore, with respect to those years for which applicable filing deadlines in § 1.882–4(a)(3)(i) were not met, FC would be barred by § 1.882–4(a)(2) from claiming any deductions that otherwise would have given rise to net operating losses on returns for these years, and would have been available as loss carryforwards in subsequent years. At FC's direction, FC's U.S. tax advisor promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining FC's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 through Year 4 and by making FC's books and records available to an Internal Revenue Service examiner. FC has met the standard described in paragraph (a)(3)(ii) of this section for waiver of any applicable filing deadlines in § 1.882–4(a)(3)(i).

Example 2. Foreign corporation refuses to cooperate. Same facts as in *Example 1*, except that while FC's U.S. tax advisor contacted the appropriate examining personnel and filed the appropriate income tax returns for Year 1 through Year 4, FC refused all requests by the Internal Revenue Service to provide supporting information (for example, books and records) with respect to those returns. Because FC did not cooperate in determining its U.S. tax liability for the taxable years for which an income tax return was not timely filed, FC is not granted a waiver as described in paragraph (a)(3)(ii) of this section of any applicable filing deadlines in § 1.882–4(a)(3)(i).

Example 3. Foreign corporation fails to file a protective return. Same facts as in *Example 1*, except that in Year 1 through Year 4, FC's tax director also consulted a U.S. tax advisor, who advised FC's tax director that it was uncertain whether U.S. income tax returns were necessary for those years and that FC could protect its right subsequently to claim the loss carryforwards by filing protective returns under § 1.882–4(a)(3)(vi). FC did not file U.S. income tax returns or protective returns for those years. FC did not present evidence that intervening events beyond FC's control prevented FC from filing an income tax return, and there were no other mitigating factors. FC has not met the standard described in paragraph (a)(3)(ii) of this section for waiver of any applicable filing deadlines in § 1.882–4(a)(3)(i).

Example 4. Foreign corporation with effectively connected income. In Year 1, FC, a technology company, opened an office in the United States to market and sell a software program that FC had developed outside the United States. FC had minimal business or tax experience internationally, and no such experience in the United States. Through FC's direct efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. FC, however, did not file U.S. income tax returns for Year 1 or Year 2. FC's management was aware neither of FC's obligation to file a U.S. income tax return for those years, nor of FC's ability to file a protective return for those years. FC had never filed a U.S. income tax return before. In January of Year 4, FC engaged U.S. counsel in connection with licensing software to an unrelated U.S. company. U.S. counsel reviewed FC's U.S. activities and advised FC that FC should have filed U.S. income tax returns for Year 1 and Year 2. FC immediately engaged a U.S. tax advisor, at FC's direction, who promptly contacted the appropriate examining personnel and cooperated with the Internal Revenue Service in determining FC's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 and Year 2 and by making FC's books and records available to an Internal Revenue Service examiner. FC has met the standard described in paragraph (a)(3)(ii) of this section for waiver of any applicable filing deadlines in § 1.882–4(a)(3)(i).

Example 5. IRS discovers foreign corporation's failure to file. In Year 1, FC, a technology company, opened an office in the United States to market and sell a software program that FC had developed outside the United States. Through FC's direct efforts, U.S. sales of the software produced income effectively connected with a U.S. trade or business. FC had extensive experience conducting similar business activities in other countries, including making the appropriate tax filings. However, FC's management was aware neither of FC's obligation to file a U.S. income tax return for those years, nor of FC's ability to file a protective return for those years. FC had never filed a U.S. income tax return before. Despite FC's extensive experience conducting similar business activities in other countries, FC made no effort to seek advice in connection with FC's U.S. tax obligations. FC failed to file either U.S. income tax returns or protective returns for Year 1 and Year 2. In January of Year 4, an Internal Revenue Service examiner asked FC for an explanation of FC's failure to file U.S. income tax returns. FC immediately engaged X, a U.S. tax advisor, and cooperated with the Internal Revenue Service in determining FC's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 1 and Year 2 and by making FC's books and records available to the examiner. FC did not present evidence that intervening events beyond FC's control prevented FC from filing a return, and there were no other mitigating factors. FC has not met the standard described in paragraph (a)(3)(ii) of this section for waiver of any applicable filing deadlines in § 1.882–4(a)(3)(i).

Example 6. Foreign corporation with prior filing history. FC began a U.S. trade or business in Year 1. FC's tax advisor filed the appropriate U.S. income tax returns for Year 1 through Year 6, reporting income effectively connected with FC's U.S. trade or business. In Year 7, FC replaced its tax advisor with a tax advisor unfamiliar with U.S. tax law. FC did not file a U.S. income tax return for any year from Year 7 through Year 10, although FC had effectively connected income for those years. FC's management was aware of FC's ability to file a protective return for those years. In Year 11, an Internal Revenue Service examiner contacted FC and asked FC's chief financial officer for an explanation of its failure to file U.S. income tax returns after Year 6. FC immediately engaged a U.S. tax advisor and cooperated with the Internal Revenue Service in determining FC's income tax liability, for example, by preparing and filing the appropriate income tax returns for Year 7 through Year 10 and by making FC's books and records available to the examiner. FC did not present evidence that intervening events beyond FC's control prevented FC from filing a return, and there were no other mitigating factors. FC has not met the standard described in paragraph (a)(3)(ii) of this section for waiver of any applicable filing deadlines in paragraph § 1.882–4(a)(3)(i).

(iv) Paragraphs (a)(3)(ii) and (iii) of this section are applicable to open years for which a request for waiver is filed on or after January 29, 2002.

(a)(3)(v) through (b)(2) For further guidance, see § 1.882–4(a)(3)(v) through (b)(2).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved January 4, 2002.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 28, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 29, 2002, 67 F.R. 4173)

Section 4958.—Taxes on Excess Benefit Transactions

26 CFR 53.4958–1: Taxes on excess benefit transactions.

T.D. 8978

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: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final 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 by the Taxpayer Bill of Rights 2. Section 4958 imposes excise taxes on any transaction that provides excess economic benefits to a person in a position to exercise substantial influence over the affairs of a public charity or a social welfare organization.

DATES: *Effective Date*: These regulations are effective January 23, 2002.

Applicability Date: These regulations apply as of January 23, 2002.

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 final 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. Responses to these collections of information are required to obtain the benefit of the rebuttable presumption that a transaction is reasonable or at fair market value.

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

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.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR: MP:FP:S Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this 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 Internal Revenue Code (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. Any disqualified person who benefits from an excess benefit transaction with an applicable tax-exempt organization is liable for a tax of 25 percent of the excess benefit. The person is also liable for a tax of 200 percent of the excess benefit if the excess benefit is not corrected by a certain date. A *disqualified person* is generally defined as a person in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization. An *applicable tax-exempt organization* is an organization described in Code section 501(c)(3) or (4) and exempt from tax under section 501(a). 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 all participating organization managers are liable cannot exceed $10,000 for any one excess benefit transaction.

On August 4, 1998, a notice of proposed rulemaking (REG–246256–96, 1998–2 C.B. 224) clarifying certain definitions and rules contained in section 4958 was published in the **Federal Register** (63 FR 41486). The IRS received numerous written comments responding to this notice. A public hearing was held on March 16 and 17, 1999. Those proposed regulations were revised in response to written and oral comments, and replaced by temporary regulations (T.D. 8920, 2001–8 I.R.B. 654 [66 FR 2144]) and a cross-referencing notice of proposed rulemaking (REG–246256–96, 2001–8 I.R.B. 713 [66 FR 2173]) on January 10, 2001. A few written comments were received in response to the notice of proposed rulemaking of January 10, 2001. A public hearing was held July 31, 2001. After consideration of all comments received, the January 2001 cross-referencing proposed regulations under section 4958 are revised and published in final form, and the temporary regulations removed. The major areas of the comments and revisions are discussed below.

Explanation and Summary of Comments

Tax Paid by Organization Managers

Organization managers who participate in an excess benefit transaction knowingly, willfully, and without reasonable cause, are liable for a tax equal to 10 percent of the excess benefit. 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. Oral comments at the public hearing objected to this safe harbor, suggesting instances of the unreliability of appraisers and accountants. The final regulations retain this safe harbor. The IRS and the Treasury Department believe that an organization manager who has sought and relied upon an appropriate professional opinion has not "fail[ed] to make reasonable attempts to ascertain whether the transaction is an excess benefit transaction", which is a required element of *knowing* for this purpose.

The temporary regulations provide an additional safe harbor: 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. Several comments were received requesting that the safe harbor be modified, either to apply if the organization manager "reasonably believes" that the requirements for the presumption are satisfied, or to eliminate the reliance requirement. In response to these comments, the final regulations no longer require that the organization manager rely on the fact that the requirements of the rebuttable presumption of reasonableness are satisfied. The final regulations state that the organization manager's participation in a transaction will ordinarily not be considered *knowing* if the appropriate authorized body has met the requirements of the rebuttable presumption with respect to the transaction. The IRS and the Treasury Department note that the relief given by this provision is only a safe harbor, so that failure to satisfy its requirements does not necessarily mean that the organization manager acted knowingly.

Definition of Applicable Tax-Exempt Organization

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. A comment was received requesting that the final regulations clarify whether section 115 entities are excepted from the definition of *applicable tax-exempt organization*. Because section 115 exempts certain income, and not the entity itself, the reference in the temporary regulations to any governmental entity "exempt from tax" without regard to section 501(a) is unclear. The final regulations provide that for purposes of section 4958, a governmental unit or an affiliate of a governmental unit is not an *applicable tax-exempt organization* if it is: 1) exempt from (or not subject to) taxation without regard to section 501(a); or 2) relieved from filing an annual return pursuant to the authority of Treasury Regulations under section 6033.

Regulations under section 6033 grant the Commissioner authority to relieve organizations from filing an annual return required by that section in cases where the returns are not necessary for the efficient administration of the internal revenue laws. Under this authority, Rev. Proc. 95–48 (1995–2 C.B. 418) relieves "governmental units" and certain "affiliates of governmental units" from the annual filing requirement. A *governmental unit* as defined in this revenue procedure already falls within the exception provided in the section 4958 temporary regulations for "any governmental entity that is exempt from (or not subject to) taxation without regard to section 501(a)". An *affiliate of a governmental unit* that is relieved from filing an annual return by Rev. Proc. 95–48 (and thus also excepted from the definition of an *applicable tax-exempt organization* under these section 4958 final regulations) includes any organization described in section 501(c) that has a ruling or determination from the IRS that: 1) its income, derived from activities constituting the basis for its exemption under section 501(c), is excluded from gross income under section 115; 2) it is entitled to receive deductible charitable contributions under section 170(c)(1) on the basis that the contributions are "for the use of" governmental units; or 3) it is a wholly owned instrumentality of a State for employment tax purposes. An organization described in section 501(c) that does not have such a ruling or determination may also qualify as an *affiliate of a governmental unit* for purposes of the revenue procedure if: 1) it is either "operated, supervised, or controlled by" governmental units within the meaning of regulations under section 509; 2) it possesses at least two affiliation factors listed in Rev. Proc. 95–48; and 3) its filing of Form 990, "*Return of Organization Exempt From Income Tax*", is not otherwise necessary for the efficient administration of the internal revenue laws.

A comment was also received requesting that the final regulations exclude from the definition of *applicable tax-exempt organization* collectively bargained apprenticeship funds subject to the rules of the Labor Management Relations Act of 1947 (61 Stat. 157) and the Employee Retirement Income Security Act of 1974 (88 Stat. 854) (ERISA). The commenter stated that, like governmental entities, these funds seek recognition under Code section 501(c)(3) on a strictly voluntary basis, and are also eligible for tax exemption under Code section 501(c)(5). The commenter also stated that applying section 4958 to these funds would provide an unnecessary layer of regulation, because these plans already are subject to ERISA.

The final regulations do not except collectively bargained apprenticeship funds from the definition of *applicable tax-exempt organization*. However, in response to this comment, the final regulations provide a special exception under section 4958 for transactions that are covered by a final individual prohibited transaction exemption issued by the Department of Labor. The final regulations provide that section 4958 does not apply to any payment made pursuant to, and in accordance with, a final individual prohibited transaction exemption issued by the Department of Labor under ERISA with respect to a transaction involving a plan that is an applicable tax-exempt organization. Before granting an individual prohibited transaction exemption under ERISA, the Department of Labor must determine that the particular transaction is in the interests of the plan and its participants, and is protective of the rights of participants in the plan. The IRS and the Treasury Department believe that the similarity between the ERISA standard ("in the interests of " and "protective of the rights of " participants) and the fair market value standard of section 4958 warrants this special exception.

Definition of Disqualified Person

The preamble of the temporary regulations notes that the IRS and the Treasury

Department considered adopting a special rule with respect to so-called *donor-advised funds* maintained by applicable tax-exempt organizations, and requested 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. Several comments were received on this issue. Most of the comments objected to treating a donor or advisor to this type of fund as a disqualified person based solely on influence over a donor-advised fund. Others stated that the existing factors contained in the temporary regulations were adequate to find disqualified person status in appropriate circumstances. One commenter requested that if section 4958 were to apply to transactions involving donor-advised funds, the fair market standard should apply, and requested additional definitions and exclusions if the final regulations contained specific rules for these types of funds.

In response to these comments, the final regulations do not adopt a special rule regarding any donor or advisor to a donor-advised fund. Thus, the general rules of § 53.4958–3 will apply to determine if a donor or advisor is a disqualified person.

Some additional comments were received on other specific rules of the *disqualified person* definition contained in the temporary regulations. The final regulations do not change the rules or descriptions contained in the definition. However, several of the comments are discussed below to explain why the IRS and the Treasury Department concluded that changes were not necessary or desirable. Other comments suggested changes to the examples. In response to those comments, several examples in this section of the final regulations were revised from the temporary regulations, as discussed below.

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). A section 501(c)(4) organization can, however, have substantial influence with respect to an organization described in section 501(c)(3). A commenter requested that section 501(c)(4) organizations be excluded from disqualified person status with respect to all applicable tax-exempt organizations.

The IRS and the Treasury Department decline to expand the exclusion for section 501(c)(4) organizations. A section 501(c)(4) organization can engage in certain activities (such as political campaign activities) that a section 501(c)(3) organization cannot. Accordingly, the IRS and the Treasury Department are concerned about transactions in which a section 501(c)(3) organization may provide an excess benefit to a section 501(c)(4) organization to avoid limitations of section 501(c)(3).

Oral comments at the public hearing objected to including, as one of the factors tending to show no substantial influence, the fact that the person's sole relationship to an applicable tax-exempt organization is as a contractor (such as an attorney, accountant, or investment manager or advisor) providing professional advice to the organization. The commenter suggested that these providers of professional advice have a great deal of influence over applicable tax-exempt organizations, but choose not to exercise that influence. The IRS and the Treasury Department believe that the description of this factor in the temporary regulations includes sufficient safeguards to protect the organization. Accordingly, the final regulations retain this factor. Additionally, being in this category of persons is merely a factor tending to show no substantial influence. In appropriate circumstances, the IRS could still conclude that a person ostensibly described in this category was a disqualified person based on all relevant facts and circumstances.

Another comment objected to the standard of one of the factors tending to show substantial influence: that a person's compensation is primarily based on revenues derived from activities of the organization that the person controls. The commenter suggested that this factor be modified to provide that revenues controlled by the person also represent a substantial part of the organization's total revenues. The IRS and the Treasury Department do not believe that a change is necessary. The factor at issue is only one of many factors that may be considered, and will be considered in conjunction with all relevant facts and circumstances.

Another comment requested further revision to two factors tending to show substantial influence. The first factor states that the person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees. The second factor states that the person manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expense of the organization, as compared to the organization as a whole. The commenter suggested that the first factor is sufficient, and requested that the second factor be deleted. Alternatively, the commenter requested that the final regulations define the term *substantial*, and recommended a safe harbor percentage of 15 percent.

The IRS and the Treasury Department did not revise these two factors tending to show substantial influence. The IRS and the Treasury Department do not believe that these two factors are redundant, as they address budget and management authority, respectively, and these two functions may reside in different persons. In addition, as with any of the listed factors, these two factors are considered along with all other relevant facts and circumstances.

In response to a comment regarding the examples of this section, the final regulations revise an example that concludes that a hospital management company is a disqualified person with respect to the applicable tax-exempt organization. The comment stated that the example could create confusion because its language does not match neatly with the factors tending to show substantial influence listed in the temporary regulations. The commenter also pointed out that, under the facts of the example, the functions of the management company seemed close to those of a president, chief executive officer, or chief operating officer, one of the categories of persons who are deemed to have substantial influence. The example is revised in the final regulations to illustrate that the management company is a disqualified person *per se*, because it has ultimate responsibility for supervising the management of the hospital, consistent with the regulatory description of the functions of a president, chief executive officer, or chief operating officer. By concluding that the management company is a disqualified person, this example also addresses a comment requesting that final regulations clarify whether only individuals could be persons having substantial influence.

Economic Benefit Provided Indirectly

One comment analyzed examples in the temporary regulations defining an indirect excess benefit transaction. The commenter questioned one example in which the benefits provided to a disqualified person by an applicable tax-exempt organization and an entity controlled by the organization are evaluated in the aggregate, and the excess over reasonable compensation for the services performed by the disqualified person for both entities is treated as an excess benefit. The commenter recommended that the example be deleted or revised so that the reasonableness of compensation provided by each entity is evaluated separately.

The rules governing an indirect excess benefit transaction are intended to prevent an applicable tax-exempt organization from avoiding section 4958 by using a controlled entity to provide excess benefits to a disqualified person. Thus, for purposes of section 4958, economic benefits provided by a controlled entity will be treated as provided by the applicable tax-exempt organization. Likewise, the IRS and the Treasury Department believe that any services performed by the disqualified person for a controlled entity should be taken into account in determining the reasonableness of compensation paid by the applicable tax-exempt organization. Accordingly, this example is not changed in the final regulations. However, the IRS and the Treasury Department agree with the commenter that the payment of compensation by an applicable tax-exempt organization to a disqualified person for services provided to a controlled entity, other than a wholly-owned subsidiary, may raise private benefit issues if the other investors in the entity do not make a proportional contribution. Accordingly, another example in this section is modified to clarify that the controlled entity for which the disqualified person performs services is a wholly-owned subsidiary of the applicable tax-exempt organization.

Initial Contract Exception

The temporary regulations provide 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. The temporary regulations include examples to illustrate the application of the initial contract rule.

Several comments were received on this section of the temporary regulations, including comments on specific examples. Several commentators requested a more liberal definition of *initial contract*. For instance, requests were received to extend the initial contract exception to cases where there is other contemporaneous written evidence of the terms of employment (but not a binding contract), or for the rule to cover cases where the parties agree to substantial terms of the person's employment, but where a final contract has not been signed before the person begins performing services for the organization. As the term *binding written contract* is governed by State law, in some cases that term may in fact be satisfied by an exchange of writings indicating the substantial terms of an agreement. However, the IRS and the Treasury Department decline to revise the regulatory definition of this term from that contained in the temporary regulations.

One commenter at the public hearing requested that the final regulations eliminate the initial contract exception. In this commenter's view, the Seventh Circuit 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), focused on the wrong moment in time to determine insider status (analogous to disqualified person status under section 4958). The commenter suggested that a person's insider status should be determined at the time payments are made to the person. Therefore, the commenter recommended that the IRS and the Treasury Department decline to follow the reasoning of the Seventh Circuit's decision in the *United Cancer Council* case in the final regulations. Alternatively, the commenter requested that, if the initial contract exception is retained in the section 4958 final regulations, the IRS and the Treasury Department revise the private benefit standard under the section 501(c)(3) regulations to require that any private benefit conferred by a transaction must be insubstantial relative to the public benefit resulting from the transaction (rather than the public benefit resulting from the organization's overall activities).

Although the *United Cancer Council* case addressed the issue of private inurement under the standards of section 501(c)(3) in connection with revocation of the organization's tax exemption, the temporary regulations address the concerns expressed in the Seventh Circuit's opinion in *United Cancer Council* in the context of section 4958. 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 temporary regulations provide that, to the extent that an applicable tax-exempt organization and a person who is not yet a disqualified person enter into a binding written contract that specifies the amounts to be paid to the person (or specifies an objective formula for calculating those amounts), those fixed payments are not subject to scrutiny under section 4958, even if paid after the person becomes a disqualified person. However, the initial contract exception does not apply if the contract is materially modified or if the person fails to substantially perform his or her obligations under the contract. The IRS and the Treasury Department believe that the fact that the initial contract is scrutinized again when either of these situations occurs provides adequate protection to the applicable tax-exempt organization. In addition, the suggested revisions to the regulations under section 501(c)(3) are beyond the scope of this regulations project.

Several comments on specific examples in the initial contract exception section of the temporary regulations were received. One writer commented that in the example involving a hospital management company, the structure of the management fee gives the management company an incentive to provide charity care regardless of whether the hospital has the financial resources to pay for it. The intent of that example is merely to illustrate a fixed payment determined by a fixed formula specified in the contract, where the formula incorporates an amount that is dependent on future specified events, but where no person exercises discretion when calculating the amount of a payment under the contract. Therefore, the example remains unchanged in the final regulations.

Additional comments were received addressing the example in which the same hospital management company also received reimbursements for certain expenses in addition to the fixed management fee. The temporary regulations provide that any amount paid to a person under a reimbursement (or similar) arrangement where discretion is exercised with respect to the amount of expenses incurred or reimbursed is not a *fixed payment* for purposes of the section 4958 initial contract exception. A request was made to distinguish such reimbursement arrangements from payments determined by a fixed formula based on revenues from a particular activity, where a person has discretion over the extent of the activity. The IRS and the Treasury Department believe that reimbursement payments should generally be evaluated for reasonableness for purposes of section 4958. Consequently, the example is not modified in the final regulations, except to clarify that the management fee is a fixed payment, even though the reimbursement payments under the contract are not. However, as discussed below, the IRS and the Treasury Department also believe that reimbursement arrangements that meet the requirements of § 1.62–2(c) (expense reimbursements pursuant to an *accountable plan*) do not raise the same concerns as other reimbursement payments, because of the requirements to qualify as an *accountable plan*. Accordingly, the final regulations disregard amounts reimbursed to employees pursuant to an accountable plan (see the discussion of this topic in this preamble under the heading "Disregarded Economic Benefits"). Because the hospital management company in the example is a contractor, and not an employee, the expense reimbursements do not fall within this exception for expense reimbursements pursuant to an accountable plan.

Disregarded Economic Benefits

The temporary regulations provide that all fringe benefits excluded from income under section 132 (except for certain liability insurance premiums, payments or reimbursements) are disregarded for section 4958 purposes. To provide consistent treatment of benefits provided in cash and in kind, the final regulations also disregard expense reimbursements paid pursuant to an accountable plan that meets the requirements of § 1.62–2(c). Thus, as is the case with section 132(d) working condition fringe benefits, existing standards under section 162 and section 274 will apply to determine whether employee expense reimbursements are disregarded for section 4958 purposes, or are treated as part of the disqualified person's compensation for purposes of determining reasonableness under section 4958.

Several comments were received requesting that lodging furnished for the convenience of the employer (*i.e.*, meeting the requirements of section 119) be disregarded for section 4958 purposes. These comments suggested that benefits excluded from gross income under section 119 should be disregarded for purposes of section 4958 because the policy rationale underlying section 119 is the same as that underlying section 132. However, there are differences between the two sections. In general, section 132 benefits are subject to nondiscrimination rules or are *de minimis* in amount, which is not the case with section 119 benefits. The value of housing benefits is potentially much larger than many of the section 132 benefits, and therefore a greater potential for abuse exists in the section 119 area. Accordingly, the IRS and the Treasury Department believe it is appropriate to treat section 119 benefits differently from section 132 benefits by requiring an evaluation for reasonableness.

The temporary regulations disregard economic benefits provided to a donor solely on account of a contribution deductible under section 170 if two requirements are met. First, any non-disqualified person making a contribution above a specified amount to the organization is given the option of receiving substantially the same economic benefit. Second, the disqualified person and a significant number of non-disqualified persons in fact make a contribution of at least the specified amount. Several comments were received requesting additional guidance with respect to these disregarded benefits. One commenter asked that the rule be revised to address contributions that are not deductible by the donor in the current year because of the percentage limitations under section 170(b). That commenter also requested that the final regulations provide for situations where no other donor makes a comparable contribution to the specific applicable tax-exempt organization. In that instance, the commenter requested that the benefits be considered in relation to benefits customarily provided by similar organizations for that level of contribution. Another commenter requested that any benefit provided to a donor be disregarded if the value of the benefit does not exceed the value of the donation and the donor treats the benefit as a *quid pro quo* that reduces the donor's charitable contribution deduction.

The IRS and the Treasury Department decline to address situations where a disqualified person makes a unique contribution to an applicable tax-exempt organization. As a practical matter, an excess benefit transaction would never arise in connection with a contribution to an applicable tax-exempt organization, where the value of the contribution exceeds the value of any benefit the donor receives in return. However, in response to comments, the final regulations clarify that economic benefits made available on equal terms to a disqualified person and a significant number of other donors who make charitable contributions (within the meaning of section 170) above a specified amount may be disregarded for purposes of section 4958, even if the disqualified person cannot claim a deduction under section 170 with respect to the contribution, because the disqualified person does not itemize deductions, or is subject to the percentage limitations under section 170(b).

Timing of 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) at the time the parties enter into the contract. For non-fixed payments, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. A comment requested that final regulations clarify that the timing for determining the reasonableness of a benefit is not affected by the existence of a substantial risk of forfeiture. In response to this comment, the final regulations are revised to clarify that the general timing rules apply to property subject to a substantial risk of forfeiture. Therefore, if the property subject to a substantial risk of forfeiture satisfies the definition of *fixed payment*, reasonableness is determined at the time the parties enter into the contract providing for the transfer of the property. If the property is not a fixed payment, then reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. An example is also added to illustrate how the regular timing rules for determining reasonableness for section 4958 purposes apply to property that is subject to a substantial risk of forfeiture.

Contemporaneous Substantiation

The temporary regulations provide that an organization must provide written substantiation that is contemporaneous with the transfer of benefits at issue in order to provide clear and convincing evidence of its intent to treat benefits provided to a disqualified person as compensation for services. This requirement may be satisfied by either: 1) the organization reporting the economic benefit as compensation on an original Federal tax information return, or on an amended Federal tax information return filed prior to the commencement of an IRS examination of the applicable tax-exempt organization or the disqualified person for the taxable year in which the transaction occurred; or 2) the recipient disqualified person reporting the benefit as income on the person's original Federal tax return, or on the person's amended Federal tax return filed prior to the commencement of an IRS examination. The final regulations clarify that for an amended return filed by a disqualified person to be considered contemporaneous substantiation, the person must file an amended return prior to the earlier of the following dates: 1) commencement of an IRS examination; or 2) the first documentation in writing by the IRS of a potential excess benefit transaction.

The temporary regulations provide 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. A comment was received requesting that the reference to "established procedures" be deleted.

The final regulations retain the reference to "established procedures" because it appears in the legislative history to section 4958 (See H. REP. NO. 506, 104th Congress, 2d SESS. (1996), 53, 57). The IRS will interpret the term *established procedures* to refer to the organization's usual practice for approving compensation, not to require an organization to have a formal written procedure for approving compensation. For clarity, the final regulations replace the term *authorized officer* with "officer *authorized to approve compensation*".

The final regulations also clarify that written evidence upon which the applicable tax-exempt organization based a reasonable belief that a benefit was nontaxable can serve as written contemporaneous evidence demonstrating that a transfer was approved as compensation, even if the organization's belief later proves to be erroneous. The written evidence must have been in existence on or before the due date of the applicable Federal tax return (including extensions but not amendments). The final regulations include an example illustrating this rule.

Finally, the final regulations provide that in no event will an economic benefit that a disqualified person obtains by theft or fraud be treated as consideration for the performance of services.

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) identifies 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 one or more activities of the applicable tax-exempt organization, where the transaction results in impermissible inurement under section 501(c)(3) or (4). The statute provides, however, that this type of transaction is only an excess benefit transaction to the extent provided in regulations prescribed by the Secretary.

The August 1998 proposed regulations provided standards for determining when a revenue-sharing transaction constitutes an excess benefit transaction. Numerous comments were received on this section of the proposed regulations. Commenters offered multiple, often conflicting, suggestions and recommendations to address the many issues raised with respect to revenue-sharing transactions.

The temporary regulations reserve the section of the regulations governing revenue-sharing transactions. The temporary regulations provide that, until specific rules are issued to regulate such transactions, all transactions with disqualified persons (regardless of whether the person's compensation is computed by reference to revenues of the organization) will be evaluated under general rules defining an *excess benefit transaction* in § 53.4958–4T. A written comment was received supporting the decision to reserve that section of the regulations. However, a speaker at the public hearing objected to the lack of specific limits on revenue-sharing transactions in the temporary regulations. The speaker would allow only a small percentage of a disqualified person's salary to be based on an applicable tax-exempt organization's revenues.

Another comment asked whether revenue-sharing transactions that are reasonable in amount may nonetheless violate the inurement prohibition, so that they jeopardize the organization's tax-exempt status. The temporary regulations and these final regulations make clear that the general exemption standards of sections 501(c)(3) and (4) still apply. Under these standards, inurement may exist even though a disqualified person receives a reasonable amount from a revenue-sharing arrangement. However, most situations that constitute inurement will also violate the general rules of § 53.4958–4 (*e.g.*, exceed reasonable compensation).

The final regulations continue to reserve the separate section governing revenue-sharing transactions. The IRS and the Treasury Department will continue to monitor these types of transactions, and if appropriate, will consider issuing specific rules to regulate them. Any later regulations that may become necessary will be issued in proposed form.

The final regulations provide that the general rules of § 53.4958–4 apply to all transactions with disqualified persons, regardless of whether the amount of the benefit provided is determined, in whole or in part, by the revenues of one or more activities of the organization.

Rebuttable Presumption that a Transaction is not an Excess Benefit Transaction

An informal question was presented with respect to the definition of *authorized body* contained in the temporary regulations for purposes of the rebuttable presumption of reasonableness. The IRS was asked whether approval by one authorized official of an applicable tax-exempt organization could satisfy the requirement of approval by an *authorized body* for purposes of establishing the presumption. Under the regulatory definition of *authorized body* in both the temporary regulations and these final regulations, a single individual may constitute either a committee of the governing body or a party authorized by the governing body to act on its behalf, if State law allows a single individual to act in either of these capacities.

Correction

Several comments were received with respect to the specific correction rules contained in the temporary regulations. One commenter requested that, in the case of an excess benefit involving a transfer of property by an applicable tax-exempt organization to a disqualified person, the final regulations be modified to require the return of the specific property if the organization wants the property back. The commenter suggested that such a rule would be consistent with the private foundation self-dealing regulations under section 4941, which require rescission of the transaction where possible. Rescission is appropriate under section 4941, where most transactions between a private foundation and a disqualified person are absolutely prohibited. By contrast, section 4958 is intended to ensure that transactions between an applicable tax-exempt organization and a disqualified person, which are permissible, do not result in an excess benefit to the disqualified person. Therefore, no change has been made in the final regulations on this point.

Another commenter requested additional guidance on the rules governing correction in the case of an applicable tax-exempt organization that has ceased to exist, or is no longer tax-exempt. The temporary regulations provide that, in such cases, the correction amount may not be paid to an organization that is related to the disqualified person. The commenter noted that the "related to" standard is imprecise. The commenter suggested replacing this standard with a requirement that the recipient organization in these instances either be a publicly-supported charity with respect to which the disqualified person has no authority to make or recommend grants, or an organization selected with the consent of the appropriate State official.

In response to this comment, the final regulations require that a section 501(c)(3) organization receiving the correction amount be a publicly-supported charity that has been in existence as such for a continuous period of at least 60 calendar months ending on the correction date. The time in existence requirement prevents the disqualified person from creating a new organization to receive the correction amount. The final regulations also require that the organization receiving the correction amount does not allow the disqualified person to make or recommend any grants or distributions by the organization. The final regulations replace the relatedness standard with a requirement that the disqualified person is not also a disqualified person with respect to the organization receiving the correction amount. Similar requirements, except for the publicly-supported charity requirement, apply to a section 501(c)(4) organization receiving the correction amount.

Factors to Determine Whether Revocation is Appropriate

The preamble of the August 1998 proposed regulations listed four factors that the IRS will consider in determining whether to revoke an applicable tax-exempt organization's exempt 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 of the temporary regulations indicates that the IRS will publish guidance regarding the factors that it will consider in enforcing the requirements of sections 4958, 501(c)(3), and 501(c)(4), as it gains more experience in administering section 4958. One comment was received recommending several factors in addition to the four factors. The IRS continues to consider the suggested additions and revisions. Until it publishes a revised or expanded list of factors, the IRS will consider all relevant facts and circumstances in the administration of section 4958 cases.

Other Substantiation Requirements

The final regulations add a special rule clarifying that compliance with the specific substantiation rules of the regulations does not relieve applicable tax-exempt organizations of other rules and requirements of the Code, regulations, Revenue Rulings, and other guidance issued by the IRS (such as the substantiation rules of sections 162 and 274, or § 1.6001–1(a) and (c)).

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. A final regulatory flexibility analysis has been prepared for a collection of information in this Treasury decision under 5 U.S.C. 604.

Final Regulatory Flexibility Analysis

These final regulations clarifying section 4958 of the Code (Taxes on excess benefit transactions) may have an impact on small organizations if those organizations avail themselves of the rebuttable presumption of reasonableness described in the regulations (26 CFR 53.4958–6(a)(2), 53.4958–6(a)(3), 53.4958–6(c)(2), and 53.4958–6(c)(3)). The rebuttable presumption is available because the legislative history of section 4958 (H. REP. 506, 104th Congress, 2d SESS. (1996), 53, 56–7) stated that parties to a transaction should be entitled to rely on such a rebuttable presumption that a compensation arrangement or a property transaction between certain organizations and disqualified persons of the organizations is reasonable or at fair market value. The legislative history further instructed the Secretary of the Treasury and the IRS to issue guidance in connection with the standard for establishing reasonable compensation or fair market value that incorporates this presumption.

The objective for the rebuttable presumption is to allow organizations that satisfy the three requirements to presume that compensation arrangements and property transactions entered into with disqualified persons pursuant to satisfaction of those requirements are reasonable or at fair market value. In such cases, the section 4958 excise taxes can be imposed only if the IRS develops sufficient contrary evidence to rebut the probative value of the evidence put forth by the parties to the transaction. The legal basis for the proposed rule is Code sections 4958 and 7805.

The final rule affects organizations described in Code sections 501(c)(3) and (4) (applicable tax-exempt organizations). Some applicable tax-exempt organizations may be small organizations, defined in 5 U.S.C. 601(4) as any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.

The proposed recordkeeping burden entails obtaining and relying on appropriate comparability data and documenting the basis of an organization's determination that compensation is reasonable, or a property transfer (or transfer of the right to use property) is at fair market value. These actions are necessary to meet two of the requirements specified in the legislative history for obtaining the rebuttable presumption of reasonableness. The skills necessary for these actions are of the type required for obtaining and considering comparability data, and for documenting the membership and actions of the governing board or relevant committee of the organization. Applicable tax-exempt organizations that are small entities of the class that files Form 990–EZ, "*Short Form Return of Organization Exempt From Income Tax*" (*i.e.*, those with gross receipts of less than $100,000 and assets of less than $250,000), are unlikely to undertake fulfilling the requirements of the rebuttable presumption of reasonableness, and therefore will not be affected by the recordkeeping burden. All other classes of applicable tax-exempt organizations that file Form 990, "*Return of Organization Exempt from Income Tax*", up to organizations with assets of $50 million, are likely to be small organizations that avail themselves of the rebuttable presumption of reasonableness. These classes range from organizations with assets of $100,000 to $50 million. The final rule contains a less burdensome safe harbor for one of the requirements (obtaining comparability data on compensation) for organizations with annual gross receipts of less than $1 million. The IRS is not aware of any other relevant Federal rules which may duplicate, overlap, or conflict with the final rule. A less burdensome alternative for small organizations would be to exempt those entities from the requirements for establishing the rebuttable presumption of reasonableness. However, it is not consistent with the statute to allow organizations to rely on this presumption without satisfying some conditions. Satisfaction of the requirements as outlined in the legislative history leads to a benefit, but failure to satisfy them does not necessarily lead to a penalty. A more burdensome alternative would be to *require* all applicable tax-exempt organizations under Code section 4958 to satisfy the three requirements of the rebuttable presumption of reasonableness under all circumstances.

Pursuant to section 7805(f) of the Code, this final 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. 1a. Sections 53.4958–0T through 53.4958–8T are removed.

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

§ 53.4958–0 Table of contents.

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

§ 53.4958–1 Taxes on excess benefit transactions.

(a) In general.
(b) Excess benefit defined.
(c) Taxes paid by disqualified person.
(1) Initial tax.
(2) Additional tax on disqualified person.
(i) In general.
(ii) Taxable period.
(iii) Abatement if correction during the correction period.
(d) Tax paid by organization managers.
(1) In general.
(2) Organization manager defined.
(i) In general.
(ii) Special rule for certain committee members.
(3) Participation.
(4) Knowing.
(i) In general.
(ii) Amplification of general rule.
(iii) Reliance on professional advice.
(iv) Satisfaction of rebuttable presumption of reasonableness.
(5) Willful.
(6) Due to reasonable cause.
(7) Limits on liability for management.
(8) Joint and several liability.
(9) Burden of proof.
(e) Date of occurrence.
(1) In general.
(2) Special rules.
(3) Statute of limitations rules.
(f) Effective date for imposition of taxes.
(1) In general.
(2) Existing binding contracts.

§ 53.4958–2 Definition of applicable tax-exempt organization.

(a) Organizations described in section 501(c)(3) or (4) and exempt from tax under section 501(a).
(1) In general.
(2) Exceptions from definition of applicable tax-exempt organization.
(i) Private foundation.
(ii) Governmental unit or affiliate.
(3) Organizations described in section 501(c)(3).
(4) Organizations described in section 501(c)(4).
(5) Effect of non-recognition or revocation of exempt status.
(b) Special rules.
(1) Transition rule for lookback period.
(2) Certain foreign organizations.

§ 53.4958–3 Definition of disqualified person.

(a) In general.
(1) Scope of definition.
(2) Transition rule for lookback period.
(b) Statutory categories of disqualified persons.
(1) Family members.
(2) Thirty-five percent controlled entities.
(i) In general.
(ii) Combined voting power.
(iii) Constructive ownership rules.
(A) Stockholdings.
(B) Profits or beneficial interest.
(c) Persons having substantial influence.
(1) Voting members of the governing body.
(2) Presidents, chief executive officers, or chief operating officers.
(3) Treasurers and chief financial officers.
(4) Persons with a material financial interest in a provider-sponsored organization.
(d) Persons deemed not to have substantial influence.
(1) Tax-exempt organizations described in section 501(c)(3).
(2) Certain section 501(c)(4) organizations.
(3) Employees receiving economic benefits of less than a specified amount in a taxable year.
(e) Facts and circumstances govern in all other cases.
(1) In general.
(2) Facts and circumstances tending to show substantial influence.
(3) Facts and circumstances tending to show no substantial influence.
(f) Affiliated organizations.
(g) Examples.

§ 53.4958–4 Excess benefit transaction.

(a) Definition of excess benefit transaction.
(1) In general.
(2) Economic benefit provided indirectly.
(i) In general.
(ii) Through a controlled entity.
(A) In general.
(B) Definition of control.
(*1*) In general.
(*2*) Constructive ownership.
(iii) Through an intermediary.
(iv) Examples.
(3) Exception for fixed payments made pursuant to an initial contract.
(i) In general.
(ii) Fixed payment.
(A) In general.
(B) Special rules.
(iii) Initial contract.
(iv) Substantial performance required.
(v) Treatment as a new contract.
(vi) Evaluation of non-fixed payments.
(vii) Examples.
(4) Certain economic benefits disregarded for purposes of section 4958.
(i) Nontaxable fringe benefits.
(ii) Expense reimbursement payments pursuant to accountable plans.
(iii) Certain economic benefits provided to a volunteer for the organization.
(iv) Certain economic benefits provided to a member of, or donor to, the organization.
(v) Economic benefits provided to a charitable beneficiary.
(vi) Certain economic benefits provided to a governmental unit.
(5) Exception for certain payments made pursuant to an exemption granted by the Department of Labor under ERISA.
(b) Valuation standards.
(1) In general.
(i) Fair market value of property.
(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.
(A) In general.
(B) Failure to report due to reasonable cause.

(ii) Other written contemporaneous evidence.
(4) Examples.

§ 53.4958–5 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. [Reserved]

§ 53.4958–6 Rebuttable presumption that a transaction is not an excess benefit transaction.

(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.

§ 53.4958–7 Correction.

(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.

§ 53.4958–8 Special rules.

(a) Substantive requirements for exemption still apply.
(b) Interaction between section 4958 and section 7611 rules for church tax inquiries and examinations.
(c) Other substantiation requirements.

§ 53.4958–1 Taxes on excess benefit transactions.

(a) *In general*. Section 4958 imposes excise taxes on each excess benefit transaction (as defined in section 4958(c) and § 53.4958–4) between an applicable tax-exempt organization (as defined in section 4958(e) and § 53.4958–2) and a disqualified person (as defined in section 4958(f)(1) and § 53.4958–3). 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 § 53.4958–7) 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 § 53.4958–7) 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 § 53.4958–7, the 200-percent tax is imposed only on the unpaid portion of the correction amount (as described in § 53.4958–7(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. A 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 § 53.4958–6(c)(1)) that is attempting to invoke the rebuttable presumption of reasonableness described in § 53.4958–6 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 this paragraph (d), 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 this paragraph (d), 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) *Satisfaction of 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 appropriate authorized body has met the requirements of § 53.4958–6(a) 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 of this chapter. 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 § 53.4958–4(b)(2).

(3) *Statute of limitations rules*. See sections 6501(e)(3) and (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.

§ 53.4958–2 Definition of applicable tax-exempt organization.

(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).

(2) *Exceptions from definition of applicable tax-exempt organization*—(i) *Private foundation*. A private foundation as defined in section 509(a) is not an applicable tax-exempt organization for section 4958 purposes.

(ii) *Governmental unit or affiliate*. A governmental unit or an affiliate of a governmental unit is not an applicable tax-exempt organization for section 4958 purposes if it is—

(A) Exempt from (or not subject to) taxation without regard to section 501(a); or

(B) Relieved from filing an annual return pursuant to the authority of § 1.6033–2(g)(6).

(3) *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—

(i) Provides the notice described in section 508; or

(ii) Is described in section 501(c)(3) and specifically is excluded from the requirements of section 508 by that section.

(4) *Organizations described in section 501(c)(4)*. An organization is described in section 501(c)(4) for purposes of section 4958 only 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).

(5) *Effect of non-recognition or revocation of exempt status*. An organization is not described in paragraph (a)(3) or (4) 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 period 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.

§ 53.4958–3 Definition of disqualified person.

(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 § 53.4958–2(a)(4), 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 paragraph (b) or (c) of this section 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, or of a particular department or function 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 a contractor (such as an attorney, accountant, or investment manager or advisor) whose sole relationship to the organization is providing professional advice (without having decision-making authority) with respect to transactions from which the 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 contribution 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. A finding that a person is 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 § 53.4958–4 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. Subject to supervision by C's board, M is given broad discretion to manage C's day to day operation and has ultimate responsibility for supervising the management of the hospital. Because M has ultimate responsibility for supervising the management of 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), M is in a position to exercise substantial influence over the affairs of A. 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 a 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.

§ 53.4958–4 Excess benefit transaction.

(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. The rules of this section apply to all transactions with disqualified persons, regardless of whether the amount of the benefit provided is determined, in whole or in part, by the revenues of one or more activities of the organization. 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 this paragraph (a)(2):

Example 1. K is an applicable tax-exempt organization for purposes of section 4958. L is a wholly-owned taxable subsidiary of K. 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 (a)(3)(iv) of this section, 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 section 401(a), or pursuant to an employee benefit program that is subject to and satisfies coverage and nondiscrimination rules under the Internal Revenue 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 § 53.4958–3 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, 2002, 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 § 53.4958–3 immediately prior to entering into the January 1, 2002, contract (initial contract). S's duties and responsibilities under the contract make S a disqualified person with respect to T (see § 53.4958–3(c)(3)). 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 2003, 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 2003, T changes its payroll system, such that T makes biweekly, rather than monthly, salary payments to its employees. Beginning in 2003, 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, 2003, 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, 2003, at which time S is a disqualified person within the meaning of section 4958(f)(1) and § 53.4958–3. 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 § 53.4958–3 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 § 53.4958–3(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 § 53.4958–3 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 § 53.4958–3(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 § 53.4958–3(b)(2)(i)(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). Although the management fee itself is a fixed payment not subject to section 4958, the 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, 2003, 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 § 53.4958–3, 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 § 53.4958–3 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 paragraph (b)(1)(ii)(B)(*2*) of this section;

(ii) *Expense reimbursement payments pursuant to accountable plans*. Amounts paid under reimbursement arrangements that meet the requirements of § 1.62–2(c) of this chapter;

(iii) *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;

(iv) *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 for which a deduction is allowable under section 170 (charitable contribution), regardless of whether the donor is eligible to claim the deduction, if—

(A) Any non-disqualified person paying a membership fee or making a charitable 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 charitable contribution of at least the specified amount;

(v) *Economic benefits provided to a charitable beneficiary*. An economic benefit provided to a person solely because the person is 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

(vi) *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.

(5) *Exception for certain payments made pursuant to an exemption granted by the Department of Labor under ERISA*. Section 4958 does not apply to any payment made pursuant to, and in accordance with, a final individual prohibited transaction exemption issued by the Department of Labor under section 408(a) of the Employee Retirement Income Security Act of 1974 (88 Stat. 854) (ERISA) with respect to a transaction involving a plan (as defined in section 3(3) of ERISA) that is an applicable tax-exempt organization.

(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 (whether taxable or tax-exempt) 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 compensation 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 § 53.4958–1(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 (other than expense reimbursements pursuant to an accountable plan that meets the requirements of § 1.62–2(c)), and the economic benefit of a below-market loan (within the meaning of section 7872(e)(1)). (For this purpose, the economic benefit of a below-market loan is the amount deemed transferred to the disqualified person under section 7872(a) or (b), regardless of whether section 7872 otherwise applies to the loan).

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

(2) *Timing of reasonableness determination*—(i) *In general*. The facts and circumstances to be taken into consideration in determining reasonableness of a fixed payment (within the meaning of paragraph (a)(3)(ii) of this section) are those existing on the date the parties enter into the contract pursuant to which the payment is made. However, in the event of substantial non-performance, reasonableness is determined based on all facts and circumstances, up to and including circumstances as of the date of payment. In the case of any 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. These general timing rules also apply to property subject to a substantial risk of forfeiture. Therefore, if the property subject to a substantial risk of forfeiture satisfies the definition of fixed payment (within the meaning of paragraph (a)(3)(ii) of this section), reasonableness is determined at the time the parties enter into the contract providing for the transfer of the property. If the property is not a fixed payment, then reasonableness is determined based on all facts and circumstances up to and including circumstances as of the date of 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 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. The facts are the same as in *Example 1*, except that the multi-year employment contract provides, in addition, that G will transfer title to a car to H under the condition that if H fails to complete *x* years of service with G, title to the car will be forfeited back to G. All relevant information about the type of car to be provided (including the make, model, and year) is included in the contract. Although ultimate vesting of title to the car is contingent on H continuing to work for G for *x* years, the amount of property to be vested (*i.e.*, the type of car) is specified in the contract, and no person exercises discretion regarding the type of property or whether H will retain title to the property at the time of vesting. Under these facts, the car is a fixed payment within the meaning of paragraph (a)(3)(ii) of this section. Therefore, the reasonableness of H's compensation, including the value of the car, is determined based on the circumstances existing at the time G and H enter into the employment contract.

Example 3. 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 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. In no event shall an economic benefit that a disqualified person obtains by theft or fraud be treated as consideration for the performance of services.

(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 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*—(A) *In general*. An applicable tax-exempt organization provides contemporaneous written substantiation of its intent to provide an economic benefit as compensation if—

(*1*) 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, "*Wage and Tax Statement*", or Form 1099, "*Miscellaneous Income*") or with respect to the organization (*e.g.*, Form 990, "*Return of Organization Exempt From Income Tax*"), 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 § 53.4958–1(e)); or

(*2*) The recipient disqualified person reports the benefit as income on the person's original Federal tax return (*e.g.*, Form 1040, "*U.S. Individual Income Tax Return*"), or on the person's amended Federal tax return filed prior to the earlier of the following dates—

(*i*) Commencement of an Internal Revenue Service examination described in paragraph (c)(3)(i)(A)(*1*) of this section; or

(*ii*) The first documentation in writing by the Internal Revenue Service of a potential excess benefit transaction involving either the applicable tax-exempt organization or the disqualified person.

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

(ii) *Other written contemporaneous evidence*. In addition, other written contemporaneous evidence may be used to demonstrate that the appropriate decision-making body or an officer authorized to approve compensation approved a transfer as compensation for services in accordance with established procedures, including but not limited to—

(A) An approved written employment contract executed on or before the date of the transfer;

(B) Documentation satisfying the requirements of § 53.4958–6(a)(3) indicating that an authorized body approved the transfer as compensation for services on or before the date of the transfer; or

(C) Written evidence that was in existence on or before the due date of the applicable Federal tax return described in paragraph (c)(3)(i)(A)(*1*) or (*2*) of this section (including extensions but not amendments), of a reasonable belief by the applicable tax-exempt organization that a benefit was a nontaxable benefit as defined in paragraph (c)(2) of this section.

(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 D's 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.

Example 3. H is an applicable tax-exempt organization and J is a disqualified person with respect to H. J's written employment agreement provides for a fixed salary of $*y*. J's duties include soliciting funds for various programs of H. H raises a large portion of its funds in a major metropolitan area. Accordingly, H maintains an apartment there in order to provide a place to entertain potential donors. H makes the apartment available exclusively to J to assist in the fundraising. J's written employment contract does not mention the use of the apartment. H obtains the written opinion of a benefits compensation expert that the rental value of the apartment is not includable in J's income by reason of section 119, based on the expectation that the apartment will be used for fundraising activities. Consequently, H does not report the rental value of the apartment on J's Form W–2, which otherwise correctly reports J's taxable compensation. J does not report the rental value of the apartment on J's individual Form 1040. Later, the Internal Revenue Service correctly determines that the requirements of section 119 were not satisfied. Because of the written expert opinion, H has written evidence of its reasonable belief that use of the apartment was a nontaxable benefit as defined in paragraph (c)(2) of this section. That evidence was in existence on or before the due date of the applicable Federal tax return. Therefore, H has demonstrated its intent to treat the use of the apartment as compensation for services performed by J.

§ 53.4958–5 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.

[Reserved]

§ 53.4958–6 Rebuttable presumption that a transaction is not an excess benefit transaction.

(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 § 53.4958–4(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 § 53.4958–4(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 § 53.4958–4(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 § 53.4958–3(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

§ 53.4958–4(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 § 53.4958–4(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 obtains information indicating that the relevant market conditions have not changed materially, and possesses no other information indicating 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 performing arts organizations 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 § 53.4958–4(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 § 53.4958–4(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.

§ 53.4958–7 Correction.

(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 § 53.4958–1(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 the undistributed deferred compensation by relinquishing any right to receive the excess portion of the undistributed deferred compensation (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 § 53.4958–1(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 § 53.4958–1(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—

(i) The organization receiving the correction amount is described in section 170(b)(1)(A) (other than in section 170(b)(1)(A)(vii) and (viii)) and has been in existence and so described for a continuous period of at least 60 calendar months ending on the correction date;

(ii) The disqualified person is not also a disqualified person (as defined in § 53.4958–3) with respect to the organization receiving the correction amount; and

(iii) The organization receiving the correction amount does not allow the disqualified person (or persons described in § 53.4958–3(b) with respect to that person) to make or recommend any grants or distributions by the organization.

(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 organization described in section 501(c)(3) or (4) and exempt from tax under section 501(a), provided that the requirements of paragraphs (e)(2)(i) through (iii) of this section are satisfied (except that the requirement that the organization receiving the correction amount is described in section 170(b)(1)(A) (other than in section 170(b)(1)(A)(vii) and (viii)) shall not apply if the organization is described in section 501(c)(4)).

(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 § 53.4958–1(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.

§ 53.4958–8 Special rules.

(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–

4(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) *Other substantiation requirements*. These regulations, in § 53.4958–4(c)(3), set forth specific substantiation rules. Compliance with the specific substantiation rules of that section does not relieve applicable tax-exempt organizations of other rules and requirements of the Internal Revenue Code, regulations, Revenue Rulings, and other guidance issued by the Internal Revenue Service (including the substantiation rules of sections 162 and 274, or § 1.6001–1(a) and (c) of this chapter).

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

§ 301.7611–1 [Amended]

Par. 4. In § 301.7611–1, Q–19 and A–19 at the end of the section are revised 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 § 53.4958–8(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. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (b) is amended by removing the entry for "53.4958–6T" and adding an entry for "53.4958–6" 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.
* * * * *	
53.4958–6	1545–1623
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 21, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 22, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 23, 2002, 67 F.R. 3076)

Part III. Administrative, Procedural, and Miscellaneous

IRS Announces New Position With Regard to Consolidated Return Loss Disallowance Rule

Notice 2002–11

This Notice sets forth the Internal Revenue Service's position with respect to the opinion of the U.S. Court of Appeals for the Federal Circuit in *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), and the loss disallowance rules that apply to sales of stock of a member of a consolidated group.

In *Rite Aid*, the Federal Circuit held that the duplicated loss component of § 1.1502–20 of the Income Tax Regulations, which disallows certain losses on sales of stock of a member of a consolidated group, was an invalid exercise of regulatory authority. The Internal Revenue Service believes that the court's analysis and holding were incorrect.

Nevertheless, the Service has decided that the interests of sound tax administration will not be served by continuing to litigate the validity of the loss duplication factor of § 1.1502–20. Moreover, because of the interrelationship in the operation of all of the loss disallowance factors, the Service has decided that new rules governing loss disallowance on sales of stock of a member of a consolidated group should be implemented.

Accordingly, the Service intends to promulgate interim regulations that, prospectively from the date of their issuance, will require consolidated groups to determine the allowable loss on a sale or disposition of subsidiary stock under an amended § 1.337(d)–2 instead of under § 1.1502–20. For transactions (including those for which a return has been filed) completed before the date of issuance of interim regulations, or for which there is a binding contract before that date, groups will be allowed certain choices with respect to a disposition of subsidiary stock, including a choice to apply § 1.337(d)–2 as amended. The Service and Treasury are undertaking a broader study of the regulatory provisions necessary to implement § 337(d) in the context of affiliated groups filing consolidated returns and will request comments in conjunction with the issuance of the interim regulations.

It is the Service's position that the *Rite Aid* opinion implicates only the loss duplication aspect of the loss disallowance regulation and that the authority to prescribe consolidated return regulations conferred on the Secretary is limited only by the requirement that the Secretary, in his discretion, has determined such rules necessary clearly to reflect consolidated tax liability.

Patriots' Day

Notice 2002–12

This notice provides guidance regarding the impact of Patriots' Day on the April 15, 2002, due date for filing Federal tax returns (whether paper or electronic) and making Federal tax payments. If a filing or payment due date falls on a Saturday, Sunday or legal holiday (including Statewide legal holidays), individual income taxpayers have until the next business day to file and pay. *See* I.R.C. § 7503. Patriots' Day, which in 2002 falls on April 15, is a legal holiday in Massachusetts and Maine and, therefore, constitutes a Statewide legal holiday, under section 7503, for IRS offices located in Massachusetts and Maine.

Individual income taxpayers who otherwise are required to file returns at the Internal Revenue Service Center in Andover, Massachusetts (Andover Service Center) on April 15, 2002, are given an additional day, until April 16, 2002, to file and make their Federal tax payments (including the Form 1040 series, automatic extensions of time to file, and the payment of the first installment of estimated tax). The IRS, however, may direct certain taxpayers, who otherwise would be required to file at the Andover Service Center, to send their Federal tax returns elsewhere if they are making a payment with Form 1040–V. To avoid confusion, these taxpayers also are given until April 16, 2002, to file and make their Federal tax payments. Finally, because individual income taxpayers residing in Maine may elect to file their returns by hand at an IRS office located in Maine, these taxpayers also are given until April 16, 2002, to file and make their Federal tax payments.

Accordingly, for filing season 2002 (tax year 2001) individual income taxpayers in Massachusetts, Michigan, New York (all counties except for Nassau, Rockland, Suffolk, Westchester, and New York City), Rhode Island, and Maine have until Tuesday, April 16, 2002, to file their Federal income tax returns and make their payments. This includes the payment of the first installment of estimated tax for 2002.

The principal author of this notice is Marcy W. Mendelsohn of the Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice contact Ms. Mendelsohn at 202–622–4940 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters (Also Part I, § 1256(g)(9))

Rev. Proc. 2002–11

SECTION 1. PURPOSE

This Revenue Procedure contains procedures that an exchange may follow to enable the Internal Revenue Service to determine whether certain persons trading on that exchange qualify as "dealers" under section 1256(g)(9) of the Internal Revenue Code (the "Code"). It is expected that, after the issuance of a letter ruling to a specific exchange determining whether a specific category of persons trading securities futures contracts (and options on such contracts) on that exchange qualifies for dealer status under section 1256(g)(9), the Service will publish the same conclusion in a revenue ruling.

SECTION 2. BACKGROUND

The Commodity Futures Modernization Act of 2000, enacted as part of the Consolidated Appropriations Act, 2001 (Public Law 106–554, 114 Stat. 2763), authorizes the trading of securities futures contracts, a new type of derivative financial product. In general, gain or loss is recognized on securities futures contracts upon disposition, and the character of that gain or loss is determined by newly enacted section 1234B of the Code.

The timing and character of gains and losses on *dealer* securities futures contracts (and options on such contracts), however, is determined under section 1256. Dealer securities futures contracts are subject to mark-to-market treatment, and gains or losses are treated as 60 percent long-term capital gain or loss and 40 percent short-term capital gain or loss. Section 1256(a). For purposes of the application of section 1256 to dealer securities futures contracts (and options on such contracts), a person is a *dealer* if the Secretary of the Treasury determines that the person performs functions with respect to such options or contracts similar to the functions performed with respect to stock options by persons registered with a national securities exchange as a market maker or specialist in listed options.

In Notice 2001–27 (2001–13 I.R.B. 942), the Service and the Treasury Department requested comments and suggestions regarding both the substance of the required determinations and the manner in which they should be made. Numerous comments have been received regarding criteria that could be used to identify dealers in securities futures contracts (and options on such contracts). In addition, staff of the Service and Treasury initiated numerous conversations with both regulators and various exchanges. These ongoing conversations are expected to continue unabated.

The exchanges on which securities futures contracts and options may be traded, however, are still developing rules that will govern trading. In addition, certain of the regulatory requirements that will be imposed by the Securities and Exchange Commission and the Commodity Futures Trading Commission have not yet been issued in final form, and the rules promulgated by some exchanges may differ in important respects from those governing the trading of any other products.

During the current period, when trading rules are being developed, it is important for the Service and Treasury to provide certainty for taxpayers while at the same time not constraining the development of trading structures for the new markets. Given the likely diversity of trading platforms and the potential for new trading models, the Service and Treasury have determined that encouraging exchanges to apply for case-by-case determinations while they are developing their trading rules is preferable to either writing general rules before the trading structures are known or waiting until the structures are finally established and then making the exchanges wait for a general rule to be crafted.

The issuance at this time of general guidance for determining dealer status would risk constraining the development of the structures for the new markets. On the other hand, if general guidance is not issued now, the absence of an interim process for securing dealer determinations could impair the ability of the exchanges to adapt their proposed trading systems to the requirements for achieving dealer status for market participants. As a result of the flexibility inherent in the process of obtaining a letter ruling, an exchange will have an opportunity, if it so desires, to make adjustments in its proposed trading practices should those be needed to secure dealer status for particular groups of traders.

Under the procedures set forth below, if an exchange is one on which securities futures contracts (or options thereon) are, or are expected to be, traded, the exchange may request a letter ruling that, based on its specific rules and facts and circumstances, certain persons trading such contracts (or options thereon) on the exchange will be treated as "dealers" under section 1256(g)(9).

The Service expects that, once it has reached a decision regarding the request for ruling, the same conclusion will be published in a revenue ruling, which will serve as general guidance. The Service and Treasury are committed to expedited processing for both the letter ruling and the revenue ruling.

SECTION 3. PROCEDURES

.01 Procedures for submitting a ruling request. An exchange desiring a letter ruling concerning whether certain persons trading on that exchange will qualify as dealers with respect to specific contracts traded on that exchange is required to submit a letter ruling request under the procedures provided in Rev. Proc. 2002–1 (2002–1 I.R.B. 1) (or successor procedure).

.02 Time for submitting a ruling request. Ruling requests may be submitted prior to the date on which the exchange anticipates that trading in the securities futures contracts at issue will begin, provided the exchange has developed a substantially definite framework and set of rules within which these contracts are expected to trade and has undertaken significant actions to obtain necessary regulatory approvals and to establish requisite contractual arrangements and trading systems. The Service will not rule on requests involving alternative plans of proposed transactions or hypothetical situations. *See* section 7.02 of Rev. Proc. 2002–1 (2002–1 I.R.B. 1, 20).

.03 Information that should be included in each ruling request. In addition to the information required by Rev. Proc. 2002–1, the exchange must submit any relevant information that will help the Service to determine whether or not persons trading in securities futures contracts on that exchange qualify as dealers under section 1256(g)(9). References to securities futures contracts include options on such contracts. References to rules applicable to trading in securities futures contracts include rules that are not yet adopted in final form but that are expected to be applicable. The current status of such rules should be described. The ruling request should also include the following:

Copies of information filed with non-tax regulatory agencies regarding trading on that exchange in the securities futures contracts at issue.

Information regarding whether persons trading in such contracts on that exchange are required to register with the Securities and Exchange Commission or the Commodity Futures Trading Commission and the nature of any required registration.

A description of any books and records requirements under federal securities laws or commodities laws to which persons trading on that exchange are subject.

Information regarding whether persons trading in such contracts on that exchange will be required to be members of the exchange and, if such persons are not required to be members of the exchange, whether such persons are required to be lessees or delegates of other persons entitled to trade at member rates on the exchange.

References to the exchange's rules, if any, to which such persons will be subject when trading in such contracts.

A description of any books and records requirements the exchange will impose on such persons and any rules granting the exchange the right to monitor and/or examine a person's trading activities and financial stability.

Information regarding whether the exchange, the Securities and Exchange Commission, or the Commodity Futures Trading Commission imposes any licensing requirements on such persons, including a description of any such requirements.

Information regarding whether the exchange imposes net capital requirements on such persons, or imposes such requirements on a clearing member firm that clears a person's trades; whether clearing firms impose any capital requirements on persons clearing trades through those firms; and, in either case, a description of any net capital requirements.

Information regarding whether the exchange requires such persons to regularly and continuously hold themselves out as willing to buy and sell securities futures contracts, regardless of market conditions; and, if the exchange imposes no such affirmative obligation, whether those persons will in fact make a two-sided market because of other factors or obligations, including a description of any such other factors or obligations.

Information regarding whether the exchange anticipates that those persons expect to profit by entering into either side of a position to capture a portion of the bid-ask spread, or whether the exchange anticipates that those persons expect that most of their gross income from trading in these securities futures contracts will be attributable to profits from market price movements.

Information regarding whether the exchange anticipates that such persons will enter into transactions to hedge their risks with respect to the securities futures contracts traded on the exchanges and the nature of such hedges.

An estimate of the average gross trading volume that the exchange anticipates such persons will generate with regard to these contracts.

Information regarding whether the exchange anticipates that trading in these securities futures contracts will be a substantial part of the principal business activity of such persons. Such information might include, for example, an estimate of the average percentage of gross income that the exchange anticipates such persons will generate from trading in these securities futures contracts.

Information regarding whether the exchange will impose a substantial presence requirement or a trading activity requirement on such persons, including a description of any such requirements.

An estimate of the volume of proprietary trading, compared to the volume of trading for customers, that such persons are expected to generate on the exchange.

A description of the exchange's trading environment (*e.g.*, floor trading or screen trading) and any special features of such environment that differentiate the persons for whom dealer status is sought from other exchange participants.

A discussion of the nature, extent, and frequency of material changes that may occur in any of the above information after the requested ruling is issued. The exchange is encouraged to include suggestions for procedures to be followed by the exchange, its traders, and the Service in the event that material changes in the information occur. *See* section 12.10 of Rev. Proc. 2002–1 (2002–1 I.R.B. 1, 52); section 7.01 of Rev. Proc. 89–14 (1989–1 C.B. 814, 815).

The foregoing list of information should be provided with any ruling request, along with any additional information that may help the Service to make its determination. After its review of a request for ruling, the Service may require the exchange to submit additional information needed to make its determination. See section 10.06 and 10.07 of Rev. Proc. 2002–1 (2002–1 I.R.B. 1, 43–44).

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective February 4, 2002, the date this revenue procedure was made available to the public.

SECTION 5. DRAFTING INFORMATION

The principal drafter of this notice is Shawn Tetelman of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Shawn Tetelman at (202) 622–3930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

Disallowance of Deductions and Credits for Failure to File Timely Return

REG–107100–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the disallowance of deductions and credits for nonresident alien individuals and foreign corporations that fail to file a timely U.S. income tax return. The current regulations permit nonresident aliens and foreign corporations the benefit of deductions and credits only if they timely file a U.S. income tax return in accordance with subtitle F of the Internal Revenue Code, unless the Commissioner waives the filing deadlines. The temporary regulations revise the waiver standard. The text of the temporary regulations (T.D. 8981) on this subject in this issue of the Bulletin also serves as the text of these proposed regulations set forth in this cross-referenced notice of proposed rulemaking. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by April 29, 2002. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for June 3, 2002, at 10 a.m. must be received by May 13, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–107100–00), 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:ITA:RU (REG–107100–00), 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 at *http://www.irs.ustreas.gov/tax_regs/regslist.html*. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Nina E. Chowdhry, (202) 622–3880; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Donna Poindexter (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in the Rules and Regulations section of this issue of the Bulletin amend the Income Tax Regulations (26 CFR part1) relating to sections 874 and 882. These temporary regulations contain rules relating to the disallowance of deductions and credits for nonresident alien individuals and foreign corporations that fail to file a timely U.S. income tax return.

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. It has also 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 these regulations do not impose on small entities a collection of information requirement, 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 Internal Revenue 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 small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Treasury and the IRS request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for June 3, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Ave., NW, Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to this hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by April 29, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

According, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.874–1 also issued under 26 U.S.C. 874. * * *
Section 1.882–4 also issued under 26 U.S.C. 882(c). * * *

Par. 2. Section 1.874–1 is amended by:
1. Revising paragraph (b)(2).
2. Paragraphs (b)(3) and (b)(4) are redesignated as paragraphs (b)(5) and (b)(6), respectively.
3. New paragraphs (b)(3) and (b)(4) are added.

The revision and additions read as follows:

§ 1.874–1 Allowance of deductions and credits to nonresident alien individuals.

* * * * *

(b)(2) through (4) [The text of proposed paragraphs (b)(2), (3), and (4) is the same as the text of § 1.874–1T(b)(2), (3), and (4) published elsewhere in this issue of the **Federal Register**].

* * * * *

Par. 3. Section 1.882–4 is amended by:
1. Revising paragraph (a)(3)(ii).
2. Paragraphs (a)(3)(iii) through (a)(3)(v) are redesignated as paragraphs (a)(3)(v) through (a)(3)(vii), respectively.
3. New paragraphs (a)(3)(iii) and (iv) are added.

The revision and additions read as follows:

§ 1.882–4 Allowance of deductions and credits to foreign corporations.

* * * * *

(a)(3)(ii) through (iv) [The text of proposed paragraphs (a)(3)(ii) through (iv) is the same as the text of § 1.882–4T(a)(3)(ii) through (iv) published elsewhere in this issue of the **Federal Register**].

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 28, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 29, 2002, 67 F.R. 4217)

Notice of Proposed Rulemaking

Treatment of Community Income for Certain Individuals Not Filing Joint Returns

REG–115054–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the treatment of community income under section 66 for certain married individuals in community property states who do not file joint individual Federal income tax returns. The regulations also reflect changes in the law made by the Internal Revenue Service Restructuring and Reform Act of 1998.

DATES: Written or electronically generated comments and requests for a public hearing must be received by April 22, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–115054–01), 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:ITA:RU (REG–115054–01), room 5226, 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.ustreas.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robin M. Tuczak, 202–622–4940; concerning submissions of comments and requests for a public hearing, Guy Traynor, 202–622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR: MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by March 25, 2002.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in § 1.66–4. An individual who wishes to be relieved of the operation of community property law under § 1.66–4 must request relief from joint and several liability by timely filing

Form 8857, "*Request for Innocent Spouse Relief*" (or other specified form), or a written statement, signed under penalties of perjury, indicating why he or she should be relieved of the operation of community property law. This collection of information is required for an individual to request relief from the operation of community property law. This information will be used to carry out the internal revenue laws. The likely respondents are individuals.

The burden contained in § 1.66–4 is reflected in the burden of Form 8857.

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 or records relating to a 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

For married taxpayers living in community property states, income that is community property under the laws of the state or jurisdiction in which the spouses reside is generally taxed in equal shares to the husband and the wife. Thus, if a husband and wife do not elect to file a joint individual Federal income tax return (joint return) under section 6013, each spouse is generally required to report one-half of the community income on his or her married filing separate individual Federal income tax return (separate return). Section 66 contains four exceptions to the general rule that community income is taxed in equal shares to the husband and the wife.

Section 66(a) provides rules for the treatment of community income when the spouses live apart and do not share income for the entire taxable year. Section 66(b) authorizes the Secretary to disregard community property laws where one spouse is not notified of the nature and amount of items of community income. Section 66(c) directs the Secretary to prescribe regulations regarding relief from the operation of community property law in certain other cases. This provision is analogous to the relief provision in section 6015(b) relating to joint filers. Section 66(c) also authorizes the Secretary to grant equitable relief from the operation of community property laws where the other requirements of section 66(c) are not met. This provision is analogous to the equitable relief provision in section 6015(f) relating to joint filers.

The four exceptions in section 66 apply to community income that spouses receive while they are married. Thus, community income that is received during any taxable year in which the spouses are married at any time during that taxable year, including the taxable year during which the spouses divorce, may be subject, in whole or in part, to the provisions of section 66. If spouses file a joint return for a taxable year, section 66 does not apply to their community income for that taxable year. If a spouse files a joint return with a new spouse in the same year that the spouse divorces his or her former spouse, section 66 may be applicable to any community income of the spouse and former spouse earned prior to their divorce. For rules regarding relief from joint and several liability when a joint return is filed, see section 6015 and the regulations thereunder.

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) that are necessary to carry out the provisions of section 66.

Explanation of Provisions

Treatment of Community Income Under Section 66(a) Where Spouses Live Apart

Section 879(a) provides that under certain circumstances, community income is taxed to the spouse who earned the income rather than according to community property laws. Under section 66(a), a spouse may report community income in accordance with the rules provided by section 879(a) if the following requirements are satisfied: (1) the spouses must have been married to each other at some time during the calendar year; (2) the spouses must have lived apart at all times during the calendar year; (3) the spouses must not have filed a joint return under section 6013 for a taxable year beginning or ending in the calendar year; (4) at least one of the spouses must have earned income during the taxable year that is community income; and (5) the spouses must not have transferred any of the income (directly or indirectly) to each other before the close of the calendar year. The proposed regulations provide that *de minimis* amounts are not considered transfers for purposes of section 66(a). In addition, the proposed regulations provide that amounts that are transferred or paid to, or on behalf of, the couple's child are not considered indirect transfers to one spouse merely because such transfers satisfy a support obligation of that spouse. See H.R. Rep. No. 96–1278, 96th Cong., 2d Sess. 7 (1980).

Denial of Benefits of Community Property Law Under Section 66(b) Where Spouse Not Notified of Community Income

Section 66(b) provides the Secretary with the authority to deny the benefits of community property law to a spouse who does not notify the other spouse of the nature and amount of an item of community income and who acts as if solely entitled to such income. The proposed regulations provide that in such a case, the item of community income will be included in the gross income of the spouse for whom the benefits of community property law were denied.

Request for Relief From the Operation of Community Property Law Under Section 66(c)

Section 66(c) directs the Secretary to prescribe regulations regarding relief from the operation of community property law (specific relief) if: (1) the requesting spouse files a separate return for a taxable year; (2) the requesting spouse does not include in gross income for the taxable year an item of community income properly includible therein, which, in accordance with the rules contained in section 879(a), would be treated as the income of the nonrequesting spouse; (3) the requesting spouse establishes that he or she did not know, and had no reason to know, of the item of community income; and (4) taking into account all of the facts and circumstances, it is inequitable to include the item of community income in the gross income of the requesting spouse.

The proposed regulations provide that if a requesting spouse is relieved of the operation of community property law under section 66(c) for an item of community income, the item will be included in the gross income of the nonrequesting spouse, and not in the gross income of the requesting spouse. In addition, the proposed regulations provide that when a requesting spouse is granted relief from the operation of community property law under section 66(c), community income will be treated in accordance with the rules provided by section 879(a). The proposed regulations also provide that relief under section 66(c) is not available if one spouse transferred assets to the other spouse as part of a fraudulent scheme, or if the requesting spouse signed a closing agreement or offer in compromise for the taxable year for which relief from the operation of community property law is sought.

Request for Equitable Relief Under Section 66(c)

Section 66(c) also authorizes the Secretary to grant equitable relief from the operation of community property law to requesting spouses who do not otherwise meet the qualifications for relief set forth in section 66(c). This provision, which was added by section 3201(b) of the Internal Revenue Service Restructuring and Reform Act of 1998, is only available for liabilities that were unpaid as of July 22, 1998, or that arise after July 22, 1998.

Section 66(c) directs the Secretary to prescribe procedures regarding when equitable relief may be granted. Such procedures are detailed in Revenue Procedure 2000–15 (2000–1 C.B. 447). The proposed regulations provide general information on the equitable relief provision in section 66(c) and refer individuals seeking more detailed guidance to the relevant revenue rulings, revenue procedures, or other published guidance issued on this topic.

Time and Manner of Requesting Relief

Under the proposed regulations, a spouse seeking specific relief from the operation of community property law under section 66(c) generally may only seek relief after a deficiency for such year has been asserted. A deficiency is considered "asserted" on the date that the requesting spouse either receives a notification of an audit or a letter or notice from the Secretary indicating that there may be an outstanding liability with regard to that year.

The requesting spouse must notify the Secretary of the spouse's request for treatment under section 66(c) in a timely manner so that the Secretary can assess the tax on the community income against the nonrequesting spouse before the statute of limitations on making such an assessment under section 6501 expires. Thus, the proposed regulations provide that a requesting spouse seeking relief from the operation of community property law under section 66(c) must request such relief no later than 6 months before the statute of limitations on assessment of section 6501 expires with regard to the nonrequesting spouse. The proposed regulations further provide that if the examination of the requesting spouse's return commences during that 6 month period, the latest time for requesting relief under this section is 30 days after the commencement of the examination.

A spouse seeking equitable relief from the operation of community property law under section 66(c) for a liability that was properly reported but not paid may seek relief on or after the date the return for such year is filed.

In order to request either specific or equitable relief from the operation of community property law under section 66(c), the requesting spouse must file Form 8857, "*Request for Innocent Spouse Relief*" (or other specified form), or a written statement, signed under penalties of perjury, with the Secretary indicating why such treatment or relief is appropriate. The statement must also include the name of the nonrequesting spouse and the taxpayer identification number of the nonrequesting spouse, as well as any other information reasonably requested by the Secretary that will help the Secretary identify and locate the nonrequesting spouse.

Interests of the Nonrequesting Spouse

The legislative history of section 6015 indicates that the Secretary must consider the nonrequesting spouse's views when making a determination of relief from joint liability under that section. See H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 251, 255 (1998). Because the liability of the requesting spouse under section 66 will shift from the requesting spouse to the nonrequesting spouse, notification and participation requirements similar to those in section 6015 are appropriate for section 66 cases. In addition, information provided by a nonrequesting spouse may help to determine the appropriate amount of relief, if any.

The proposed regulations provide that the Secretary must notify the nonrequesting spouse of the requesting spouse's claim for relief and provide the nonrequesting spouse with an opportunity to participate in the administrative determination of whether relief is appropriate. The nonrequesting spouse may submit relevant information to the IRS employee making the determination.

In fashioning rules regarding the notification and participation of the nonrequesting spouse, the IRS and Treasury Department attempted to balance the rights and interests of both the requesting spouse and the nonrequesting spouse. The IRS and Treasury Department recognize that some spouses may be reluctant to apply for relief from the operation of community property law, or submit information regarding the other spouse's request for relief, due to privacy concerns or for fear of reprisal by the other spouse. To address this concern, the Internal Revenue Manual provides that the Service will omit from shared documents any information that could reasonably identify a spouse's location.

Special Analyses

It has been determined that these regulations are 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 Procedure Act (5 U.S.C. chapter 5) does not apply to the regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), 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 small businesses.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed regulations, and on how the proposed regulations can be made easier to understand. Although public comment is sought on all of the issues in the proposed regulations, the IRS and Treasury Department are particularly interested in receiving comments on the timing limitations that would be imposed on a request for relief under § 1.66–4(g)(2). All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of the regulations are Robin M. Tuczak and Bridget E. Finkenaur of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.66–4 also issued under 26 U.S.C. 66(c). * * *

Par. 2. Sections 1.66–1 through 1.66–5 are added to read as follows:

§ 1.66–1 Treatment of community income.

(a) *In general*. Married individuals in community property states who do not elect to file a joint individual Federal income tax return under section 6013 generally are required to report one-half of the total community income earned by the spouses during the taxable year unless one of the following exceptions applies:

(1) When the spouses live apart and meet the qualifications of § 1.66–2.

(2) When a requesting spouse qualifies for relief from the operation of community property law under § 1.66–3, because the nonrequesting spouse failed to notify the requesting spouse of the nature and amount of the income prior to the due date for filing the return.

(3) When a requesting spouse qualifies for relief from the operation of community property law under § 1.66–4(a).

(4) When a requesting spouse qualifies for equitable relief from the operation of community property law under § 1.66–4(b).

(b) *Marital status*. The rules of this section apply to the community income earned during a marriage for any taxable year beginning or ending during a calendar year in which the spouses are married, including the calendar year in which the spouses divorce. Section 66 does not apply to income earned after the spouses divorce.

(c) *Transferee liability*. The provisions of section 66 do not negate liability that arises under the operation of other laws. Therefore, a spouse who is not subject to income tax on community income under § 1.66–2 or 1.66–4 may nevertheless remain liable for the unpaid tax (including additions to tax, penalties, and interest) to the extent provided by Federal or state transferee liability or property laws (other than community property laws). For the rules regarding the liability of transferees, see sections 6901 through 6904 and the regulations thereunder.

§ 1.66–2 Treatment of community income where spouses live apart.

(a) Income of spouses residing in a community property state will be treated in accordance with the rules provided by section 879(a) if all of the following requirements are satisfied—

(1) The spouses are married at any time during the calendar year;

(2) The spouses live apart at all times during the calendar year;

(3) The spouses each file a separate Federal income tax return for a taxable year beginning or ending in the calendar year on which the taxpayer reports his or her income in accordance with section 66(a);

(4) One or both spouses have earned income for the calendar year which is community income and which was earned during the spouses' marriage; and

(5) No portion of such earned income is transferred (directly or indirectly) between such spouses before the close of the taxable year.

(b) *Transferred income*. For purposes of this section, transferred income does not include a *de minimis* amount of earned income that is transferred between the spouses. In addition, any amount of earned income transferred or paid to, or for the benefit of, the spouses' child will not be treated as an indirect transfer to one spouse solely because the payment or transfer satisfies an obligation of support imposed on that spouse.

§ 1.66–3 Denial of benefits of community property law where spouse not notified.

The Secretary may deny the benefits of community property law to any spouse with respect to any item of community income if that spouse acted as if he or she was solely entitled to the item of income and failed to notify the other spouse of the nature and amount of the income before the due date (including extensions) for filing the return for the taxable year in which the income was derived. Such item of community income will be included, in its entirety, in the gross income of the spouse for whom the benefits of community property law were denied. The tax liability arising from such item of community income must be assessed in accordance with section 6212 against the spouse for whom the benefits of community property law were denied.

§ 1.66–4 Request for relief from the operation of community property law.

(a) *Specific relief*—(1)*In general*. A requesting spouse will be relieved of the operation of community property law for an item of community income if—

(i) The requesting spouse filed a separate return for the taxable year for which relief is sought;

(ii) The requesting spouse did not include in gross income for the taxable year an item of community income properly includible therein, which, in accordance with the rules contained in section 879(a), would be treated as the income of the nonrequesting spouse;

(iii) The requesting spouse establishes that he or she did not know of, and had no reason to know of, such item of community income; and

(iv) Taking into account all of the facts and circumstances, it is inequitable to include such item of community income in the requesting spouse's individual gross income.

(2) *Knowledge or reason to know*. A requesting spouse has knowledge or reason to know of an understatement if he or she either actually knew of the understatement, or if a reasonable person in similar circumstances would have known of the understatement. All of the facts and circumstances are considered in determining whether a requesting spouse had reason to know of an understatement. The facts and circumstances that are considered include, but are not limited to, the nature of the erroneous item and the amount of the erroneous item relative to other items; the couple's financial situation; the requesting spouse's educational background and business experience; the extent of the requesting spouse's participation in the activity that resulted in the erroneous item; whether the requesting spouse failed to inquire, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question; and whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns (*e.g.*, omitted income from an investment regularly reported on prior years' returns).

(3) *Inequitable*. All of the facts and circumstances are also considered in determining whether it is inequitable to hold a requesting spouse jointly and severally liable for an understatement. One relevant factor for this purpose is whether the requesting spouse significantly benefitted, directly or indirectly, from the omitted income. A significant benefit is any benefit in excess of normal support. Evidence of direct or indirect benefit may consist of transfers of property or rights to property, including transfers that may be received several years after the year of the understatement. Thus, for example, if a requesting spouse receives property (including life insurance proceeds) from the nonrequesting spouse that is beyond normal support and traceable to items omitted from gross income that are attributable to the nonrequesting spouse, the requesting spouse will be considered to have received significant benefit from those items. Other factors that may also be taken into account, if the situation warrants, include the fact that the requesting spouse has been deserted by the nonrequesting spouse, the fact that the spouses have been divorced or separated, or that the requesting spouse received benefit on the return from the understatement. For more information on factors relevant to determining whether it is inequitable to hold a requesting spouse liable, see Revenue Procedure 2000–15 (2000–1 C.B. 447), or other guidance subsequently published by the Secretary. Relief under this paragraph (a) only applies to deficiencies arising out of items of omitted income.

(b) *Equitable relief*. Equitable relief may be available when the four requirements of paragraph (a) of this section are not satisfied but it would be inequitable to include the item of community income in the requesting spouse's gross income. For the criteria to be used in making a determination under this paragraph, see Revenue Procedure 2000–15 (2000–1 C.B. 447), and other guidance subsequently published by the Secretary. Relief under this paragraph (b) applies only to deficiencies arising out of items of omitted income or any unpaid tax arising from community income attributable to the nonrequesting spouse and is only available for liabilities that were unpaid as of July 22, 1998, and for liabilities that arise after July 22, 1998.

(c) *Effect of relief*. (1) When the requesting spouse qualifies for relief under paragraph (a) or (b) of this section, the item of community income will be included in the nonrequesting spouse's individual gross income and will not be included in the requesting spouse's individual gross income. The tax liability arising from such item of community income must be assessed against the nonrequesting spouse in accordance with section 6212.

(2) If a requesting spouse is granted relief from the operation of community property law with respect to an item of community income under paragraph (a) or (b) of this section, any community income of the spouses will be treated in accordance with the rules provided by section 879(a). Thus, if a requesting spouse is granted relief under paragraph (a) or (b) of this section, any item of community income that is attributable to the requesting spouse will be included, in its entirety, in the requesting spouse's gross income for such taxable year, and will not be included in the nonrequesting spouse's gross income for such taxable year. If additional tax were to result upon granting relief under this section, the requesting spouse may withdraw his or her request for relief.

(3) *Example*. The following example illustrates the rule of this paragraph (c):

Example. H and W are married and live in State Z (a community property state). Both H and W file returns for taxable year 2002 as "married filing separately" on April 15, 2003. H earns $56,000 in wages, and W earns $46,000 in wages in 2002. H reports half of his wage income as shown on his Form W-2, in the amount of $28,000, and half of W's wage income as shown on her Form W-2, in the amount of $23,000. W reports half of her wage income as shown on her W-2, in the amount of $23,000, and half of H's wage income as shown on his Form W-2, in the amount of $28,000. Neither H nor W reports W's income from her sole proprietorship of $34,000 or W's investment income of $5,000 for taxable year 2002. The Internal Revenue Service proposes deficiencies with respect to H's and W's taxable year 2002 returns due to the omission of W's income from her sole proprietorship and investments. H timely files a claim for relief under section 66(c). Because the Internal Revenue Service determines that H satisfies the four requirements of section 66(c) with respect to W's omitted income, the Internal Revenue Service grants H's claim for relief. Thus, the income of H and W will be treated in accordance with the rules provided by section 879(a). H is liable for the tax on his earned income, as shown on his Form W-2, in the amount of $56,000. (See section 879(a)(1).) W is liable for the tax on her earned income, as shown on her Form W-2, in the amount of $46,000, and on the trade or business income from her sole proprietorship, in the amount of $34,000. (See section 879(a)(1) and (2).) W's investment income will be treated as provided under the community property laws of State Z. (See section 879(a)(3) and (4).)

(d) *Fraudulent scheme*. If the Secretary establishes that a spouse transferred assets to the other spouse as part of a fraudulent scheme, relief is not available under this section. For purposes of this section, a fraudulent scheme includes a scheme to defraud the Secretary or another third party, including, but not limited to, creditors, ex-spouses, and business partners.

(e) *Definitions*–(1) *Requesting spouse*. A requesting spouse is an individual who does not file a joint individual Federal income tax return with the nonrequesting spouse for the taxable year in question, and who requests relief from the operation of community property law under this section for the portion of the liability arising from his or her share of community income for such taxable year.

(2) *Nonrequesting spouse*. A nonrequesting spouse is the individual to whom the requesting spouse was married when the community income which gave rise to the claim for relief was earned.

(f) *Effect of prior closing agreement or offer in compromise*. A requesting spouse is not entitled to relief from the operation of community property law under section 66 for any taxable year for which the requesting spouse has entered into a closing agreement (other than an agreement entered into pursuant to section 6224(c) relating to partnership items) with the Commissioner that disposes of the same liability that is the subject of the claim for relief. In addition, a requesting spouse is not entitled to relief from the operation of community property law under section 66 for any taxable year for which the requesting spouse has entered into an offer in compromise with the Commissioner. For rules relating to the effect of closing agreements and offers in compromise, see sections 7121 and 7122, and the regulations thereunder.

(g) *Time and manner for requesting relief*–(1) *Requesting relief*. To request relief from the operation of community property law under this section, a requesting spouse must file, within the time period prescribed in paragraph (g)(2) of this section, Form 8857, "*Request for Innocent Spouse Relief*" (or other specified form), or other written request, signed under penalties of perjury, indicating why such relief is appropriate. The requesting spouse must include the nonrequesting spouse's name and taxpayer identification number in the written request. The requesting spouse must also comply with any of the Secretary's reasonable requests for information that will assist the Secretary in identifying and locating the nonrequesting spouse.

(2) *Time period for filing a request for relief*—(i) *Specific relief*. The earliest time for submitting a request for relief from the operation of community property law under paragraph (a) of this section for an amount that was underreported on, or omitted from, the requesting spouse's separate return, is the date that a deficiency for the taxable year for which relief is sought is asserted against the requesting spouse. The latest time for requesting relief under paragraph (a) of this section is 6 months before the expiration of the statute of limitations on assessment, including extensions, against the nonrequesting spouse for the taxable year that is the subject of the claim for relief, unless the examination of the requesting spouse's return commences during that 6-month period. If the examination of the requesting spouse's return commences during that 6-month period, the latest time for requesting relief under this section is 30 days after the commencement of the examination.

(ii) *Equitable relief*. The earliest time for submitting a request for relief from the operation of community property law under paragraph (b) of this section for an amount that was underreported on, or omitted from, the requesting spouse's separate return, is the date that a deficiency for the taxable year for which relief is sought is asserted against the requesting spouse. Requests for equitable relief from the operation of community property law under paragraph (b) of this section for a liability that is properly reported but unpaid may be submitted with the requesting spouse's individual Federal income tax return, or after the requesting spouse's individual Federal income tax return is filed.

(iii) *Premature requests for relief*. (A) The Secretary will not consider premature claims for relief under this section. In the case of a claim for specific relief, a premature claim is a claim for relief from an item of community income that is omitted from the requesting spouse's individual Federal income tax return that is filed for a taxable year prior to the date that a deficiency for such year is asserted. A deficiency is considered asserted as of the date the requesting spouse receives a notification of an audit or a letter or notice from the Secretary indicating that there may be an outstanding liability with regard to that year. Such notices or letters do not include notices issued pursuant to section 6223 relating to TEFRA partnership proceedings.

(B) In the case of a claim for equitable relief, a premature claim is a claim for relief from an item of community income that is received prior to the date that the requesting spouse files an individual Federal income tax return for the taxable year in question.

(h) *Nonrequesting spouse's notice and opportunity to participate in administrative proceedings*—(1) *In general*. When the Secretary receives a request for relief from the operation of community property law under this section, the Secretary must send a notice to the nonrequesting spouse's last known address that informs the nonrequesting spouse of the requesting spouse's claim for relief. The notice must provide the nonrequesting spouse with an opportunity to submit any information that should be considered in determining whether the requesting spouse should be granted relief from the operation of community property law. The Secretary will share with both spouses the information submitted by the other spouse, unless the Secretary determines that the sharing of such information will impair tax administration.

(2) *Information submitted*. The Secretary will consider all of the information (as relevant to the particular relief provision) that the nonrequesting spouse submits in determining whether relief from the operation of community property law under this section is appropriate.

§ 1.66–5 Effective date.

Sections 1.66–1 through 1.66–4 are applicable on the date final regulations are published in the **Federal Register**.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 18, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 22, 2002, 67 F.R. 2841)

Guidance Regarding Deduction and Capitalization of Expenditures

Announcement 2002–9

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document describes and explains rules and standards that the IRS and Treasury Department expect to propose in 2002 in a notice of proposed rulemaking that will clarify the application of section 263(a) of the Internal Revenue Code to expenditures incurred in acquiring, creating, or enhancing certain intangible assets or benefits. This document also invites comments from the public regarding these standards. All materials submitted will be available for public inspection and copying.

DATES: Written and electronic comments must be submitted by March 25, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–125638–01), 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:ITA:RU (REG–125638–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, DC. Alternatively, taxpayers may send submissions electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or directly to the IRS Internet site at *http://www.irs.ustreas.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Guy Traynor (202) 622–7180; concerning the proposals, Andrew J. Keyso (202) 927–9397 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

The IRS and Treasury Department are reviewing the application of section 263(a) of the Internal Revenue Code to expenditures that result in taxpayers acquiring, creating, or enhancing intangible assets or benefits. This document describes and explains rules and standards that the IRS and Treasury Department expect to propose in 2002 in a notice of proposed rulemaking.

A fundamental purpose of section 263(a) is to prevent the distortion of taxable income through current deduction of expenditures relating to the production of income in future taxable years. See *Commissioner v. Idaho Power Co.*, 418 U.S. 1, 16 (1974). Thus, the Supreme Court has held that expenditures that create or enhance separate and distinct assets or produce certain other future benefits of a significant nature must be capitalized under section 263(a). See *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992); *Commissioner v. Lincoln Savings & Loan Ass'n*, 403 U.S. 345 (1971).

The difficulty of translating general capitalization principles into clear, consistent, and administrable standards has been recognized for decades. See *Welch v. Helvering*, 290 U.S. 111, 114–15 (1933). Because courts focus on particular facts before them, the results reached by the courts are often difficult to reconcile and, particularly in recent years, have contributed to substantial uncertainty and controversy. The IRS and Treasury Department are concerned that the current level of uncertainty and controversy is neither fair to taxpayers nor consistent with sound and efficient tax administration.

Recently, much of the uncertainty and controversy in the capitalization area has related to expenditures that create or enhance intangible assets or benefits. To clarify the application of section 263(a), the forthcoming notice of proposed rulemaking will describe the specific categories of expenditures incurred in acquiring, creating, or enhancing intangible assets or benefits that taxpayers are required to capitalize. In addition, the forthcoming notice of proposed rulemaking will recognize that many expenditures that create or enhance intangible assets or benefits do not create the type of future benefits for which capitalization under section 263(a) is appropriate, particularly when the administrative and recordkeeping costs associated with capitalization are weighed against the potential distortion of income.

To reduce the administrative and compliance costs associated with section 263(a), the forthcoming notice of proposed rulemaking is expected to provide safe harbors and simplifying assumptions including a "one-year rule," under which expenditures relating to intangible assets or benefits whose lives are of a relatively short duration are not required to be capitalized, and "*de minimis* rules," under which certain types of expenditures less than a specified dollar amount are not required to be capitalized. The IRS and Treasury Department are also considering additional administrative relief, for example, by providing a "regular and recurring rule," under which transaction costs incurred in transactions that occur on a regular and recurring basis in the routine operation of a taxpayer's trade or business are not required to be capitalized.

The proposed standards and rules described in this document will not alter the manner in which provisions of the law other than section 263(a) (*e.g.*, sections 195, 263(g), 263(h), or 263A) apply to determine the correct tax treatment of an item. Moreover, these standards and rules will not address the treatment of costs other than those to acquire, create, or enhance intangible assets or benefits, such as costs to repair or improve tangible property. The IRS and Treasury Department are considering separate guidance to address these other costs.

The following discussion describes the specific expenditures to acquire, create, or enhance intangible assets or benefits for which the IRS and Treasury Department expect to require capitalization in the forthcoming notice of proposed rulemaking. The IRS and Treasury Department anticipate that other expenditures to acquire, create, or enhance intangible assets or benefits generally will not be subject to capitalization under section 263(a).

A. *Amounts Paid to Acquire Intangible Property*

1. *Amounts paid to acquire financial interests.*

Under the expected regulations, capitalization will be required for an amount paid to purchase, originate, or otherwise acquire a security, option, any other financial interest described in section 197(e)(1), or any evidence of indebtedness. For a discussion of related transaction costs, see section C of this document.

For example, a financial institution that acquires portfolios of loans from another person or originates loans to borrowers would be required to capitalize the amounts paid for the portfolios or the amounts loaned to borrowers.

2. *Amounts paid to acquire intangible property from another person.*

Under the expected regulations, capitalization will be required for an amount paid to another person to purchase or otherwise acquire intangible property from that person. For a discussion of related transaction costs see section C of this document.

For example, an amount paid to another person to acquire an amortizable section 197 intangible from that person would be capitalized. Thus, a taxpayer that acquires a customer base from another person would be required to capitalize the amount paid to that person in exchange for the customer base. On the other hand, a taxpayer that incurs costs to create its own customer base through advertising or other expenditures that create customer goodwill would not be required to capitalize such costs under this rule.

B. *Amounts Paid to Create or Enhance Certain Intangible Rights or Benefits*

1. *12-month rule.*

The IRS and Treasury Department expect to propose a 12-month rule applicable to expenditures paid to create or enhance certain intangible rights or benefits. Under the rule, capitalization under section 263(a) would not be required for an expenditure described in the following paragraphs 2 through 8 unless that expenditure created or enhanced intangible rights or benefits for the taxpayer that extend beyond the earlier of (i) 12 months after the first date on which the taxpayer realizes the rights or benefits attributable to the expenditure, or (ii) the end of the taxable year following the taxable year in which the expenditure is incurred.

The IRS and Treasury Department request comments on how the 12-month rule might apply to expenditures paid to create or enhance rights of indefinite duration and contracts subject to termination provisions. For example, comments are requested on whether costs to create contract rights that are terminable at will without substantial penalties would not be subject to capitalization as a result of the 12-month rule.

2. *Prepaid items.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of an amount prepaid for goods, services, or other benefits (such as insurance) to be received in the future.

For example, a taxpayer that prepays the premium for a 3-year insurance policy would be required to capitalize such amount under the rule.

Similarly, a calendar year taxpayer that pays its insurance premium on December 1, 2002, for a 12-month policy beginning the following February would be required to capitalize the amount of the expenditure. The 12-month rule would not apply because the benefit attributable to the expenditure would extend beyond the end of the taxable year following the taxable year in which the expenditure was incurred. On the other hand, if the insurance contract had a term beginning on December 15, 2002, the taxpayer could deduct the premium expenditure under the 12-month rule because the benefit neither extends more than 12 months beyond December 15, 2002 (the first date the benefit is realized by the taxpayer) nor beyond the taxable year following the year the expenditure was incurred.

3. *Certain market entry payments.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of an amount paid to an organization to obtain or renew a membership or privilege from that organization.

For example, subject to the 12-month rule, the rule would require capitalization of costs to obtain a stock trading privilege, admission to practice medicine at a hospital, and access to the multiple listing service. The rule does not contemplate requiring capitalization for costs to obtain ISO 9000 certification or similar costs.

4. *Amounts paid to obtain certain rights from a governmental agency.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of an amount paid to a governmental agency for a trade name, trademark, copyright, license, permit, or other right granted by that governmental agency.

For example, under the rule, a restaurant would be required to capitalize the amount paid to a state to obtain a license to serve alcoholic beverages that is valid indefinitely.

5. *Amounts paid to obtain or modify contract rights.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of amounts in excess of a specified dollar amount (*e.g.*, $5,000) paid to another person to induce that person to enter into, renew, or renegotiate an agreement that produces contract rights enforceable by the taxpayer, including payments for leases, covenants not to compete, licenses to use intangible property, customer contracts and supplier contracts. The IRS and Treasury Department request comments on whether there are standards other than the standard described above that would be more appropriate for determining whether expenditures related to the creation or enhancement of contractual rights should be capitalized.

Subject to the 12-month rule, this rule would require a lessee to capitalize an amount paid to a lessor in exchange for the lessor's agreement to enter into a lease. This rule also would require a lessee to capitalize an amount paid to a lessor in exchange for the lessor's agreement to terminate a lease and enter into a new lease. *See, e.g., U.S. Bancorp v. Commissioner*, 111 T.C. 231 (1998). However, this rule would not require a lessee to capitalize an amount paid to a lessor to terminate a lease where the parties do not enter into a new or renegotiated agreement. This rule also would not require a taxpayer to capitalize a payment that does not create enforceable contract rights but, for example, merely creates an expectation that a customer or supplier will maintain its business relationship with the taxpayer. *See, e.g., Van Iderstine Co. v. Commissioner*, 261 F.2d 211 (2nd Cir. 1958).

6. *Amounts paid to terminate certain contracts.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of an amount paid by a lessor to a lessee to induce the lessee to terminate a lease of real or tangible personal property or by a taxpayer to terminate a contract that grants another person the exclusive right to conduct business in a defined geographic area.

For example, under the rule, a lessor that pays a lessee to terminate a lease of real property with a remaining term of 24 months would be required to capitalize such payment. *See, e.g., Peerless Weighing and Vending Machine Corp. v. Commissioner*, 52 T.C. 850 (1969). On the other hand, if the lease had a remaining term of 6 months, the 12-month rule would apply, and the taxpayer would not be required to capitalize the termination payment under the rule.

As a further example, where a taxpayer grants another person the exclusive right to develop the taxpayer's motel chain in four states, and the taxpayer later pays that other person to terminate such right at a time when the remaining useful life of the right is 5 years, the taxpayer would be required to capitalize the termination payment under the rule. *See Rodeway Inns of America v. Commissioner*, 63 T.C. 414 (1974).

7. *Amounts paid in connection with tangible property owned by another.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of amounts in excess of a specified dollar amount paid to facilitate the acquisition, production, or installation of tangible property that is owned by a person other than the taxpayer where the acquisition, production, or installation of the tangible property results in the type of intangible future benefit to the taxpayer for which capitalization is appropriate. This rule would apply even though there is no contractual relationship between the taxpayer and the other person. This rule is intended to require capitalization of expenditures that produce intangible future benefits similar to those that were in issue in *Kauai Terminal Ltd. v. Commissioner*, 36 B.T.A. 893 (1937) (expenditure incurred to construct a publicly owned breakwater for the purpose of increasing taxpayer's freight lighterage operation). The IRS and Treasury Department request comments on standards that can be established to ensure that the expenditures described in this rule result in the type of future benefits that are similar to those in *Kauai Terminal* and therefore should be capitalized. The IRS and Treasury Department also request comments on whether safe harbors or dollar thresholds should be used to determine whether capitalization of such expenditures is appropriate under section 263(a).

8. *Defense or perfection of title to intangible property.*

Subject to the 12-month rule, the IRS and Treasury Department expect to propose a rule that requires capitalization of amounts paid to defend or perfect title to intangible property.

For example, under the rule, if a taxpayer and another person both claim title to a particular trademark, the taxpayer must capitalize any amount paid to the other person for relinquishment of such claim. *See, e.g., J.J. Case Company v. United States*, 32 F.Supp. 754 (Ct. Cl. 1940).

C. *Transaction Costs*

The IRS and Treasury Department expect to propose a rule that requires a taxpayer to capitalize certain transaction costs that facilitate the taxpayer's acquisition, creation, or enhancement of intangible assets or benefits described above (regardless of whether a payment described in sections A or B of this document is made). In addition, this rule would require a taxpayer to capitalize transaction costs that facilitate the taxpayer's acquisition, creation, restructuring, or reorganization of a business entity, an applicable asset acquisition within the meaning of section 1060(c), or a transaction involving the acquisition of capital, including a stock issuance, borrowing, or recapitalization. However, this rule would not require capitalization of employee compensation (except for bonuses and commissions that are paid with respect to the transaction), fixed overhead (*e.g.*, rent, utilities and depreciation), or costs that do not exceed a specified dollar amount, such as $5,000. The IRS and Treasury Department request comments on how expenditures should be aggregated for purposes of applying the *de minimis* exception, whether the *de minimis* exception should allow a deduction for the threshold amount where the aggregate transaction costs exceed the threshold amount, and whether there are certain expenditures for which the *de minimis* exception should not apply (*e.g.*, commissions).

The IRS and Treasury Department are considering alternative approaches to minimize uncertainty and to ease the administrative burden of accounting for transaction costs. For example, the rules could allow a deduction for all employee compensation (including bonuses and commissions that are paid with respect to the transaction), be based on whether the transaction is regular or recurring, or follow the financial or regulatory accounting treatment of the transaction. The IRS and Treasury Department request comments on whether the recurring or nonrecurring nature of a transaction is an appropriate consideration in determining whether an expenditure to facilitate the transaction must be capitalized under section 263(a) and, if so, what criteria should be applied in distinguishing between recurring and nonrecurring transactions. In addition, the IRS and Treasury Department request comments on whether a taxpayer's treatment of transaction costs for financial or regulatory accounting purposes should be taken into account when developing simplifying assumptions.

For example, under the rule described above, a taxpayer would be required to capitalize legal fees in excess of the threshold dollar amount paid to its outside attorneys for services rendered in drafting a 3-year covenant not to compete because such costs facilitated the creation of the covenant not to compete. Similarly, the rule would require a taxpayer to capitalize legal fees in excess of the threshold dollar amount paid to its outside attorneys for services rendered in defending a trademark owned by the taxpayer.

Conversely, a taxpayer that originates a loan to a borrower in the course of its lending business would not be required to capitalize amounts paid to secure a credit history and property appraisal to facilitate the loan where the total amount paid with respect to that loan does not exceed the threshold dollar amount. The taxpayer also would not be required to capitalize the amount of salaries paid to employees or overhead costs of the taxpayer's loan origination department.

In addition, the rule would require a corporate taxpayer to capitalize legal fees in excess of the threshold dollar amount paid to its outside counsel to facilitate an acquisition of all of the taxpayer's outstanding stock by an acquirer. *See, e.g., INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992). However, the rule would not require capitalization of the portion of officers' salaries that is allocable to time spent by the officers negotiating the acquisition. Cf. *Wells Fargo & Co. v. Commissioner*, 224 F.3d 874 (8th Cir. 2000).

The rule also would not require capitalization of post-acquisition integration costs or severance payments made to employees as a result of an acquisition transaction because such costs do not facilitate the acquisition.

D. *Other Items on Which Public Comment is Requested*

1. *Other costs of creating, acquiring or enhancing intangible assets or benefits that require capitalization.*

The IRS and Treasury Department are considering what general principles of capitalization should be used to identify the costs of acquiring, creating, or enhancing intangible assets or benefits that should be capitalized under section 263(a) but are not described above. The IRS and Treasury Department anticipate that these general principles will apply in rare and unusual circumstances to require capitalization of costs that are similar to those described above. Comments are requested on capitalization principles (for example, a separate and distinct asset test or a significant future benefit test) that can be used to identify other costs that should be capitalized under section 263(a) and the administrability of such principles. The IRS and Treasury Department also request comments on other categories of costs associated with intangible assets or benefits that should be capitalized under section 263(a), but are not described above.

2. *Book-Tax conformity.*

The IRS and Treasury Department request comments on whether there are types of expenditures other than those discussed above for which the taxpayer's treatment for financial or regulatory accounting purposes should be taken into account in determining the treatment for federal income tax purposes or to simplify tax reporting.

3. *Amortization periods.*

Certain intangibles have readily ascertainable useful lives that can be determined with reasonable accuracy, while others do not. The IRS and Treasury Department expect to provide safe harbor recovery periods and methods for certain capitalized expenditures that do not have readily ascertainable useful lives. Comments are requested regarding whether guidance should provide one uniform period or multiple recovery periods and what the recovery periods and methods should be.

4. *De minimis rules.*

The IRS and Treasury Department request comments on whether there are types of expenditures other than those discussed above for which it would be appropriate to prescribe *de minimis* rules that would not require capitalization under section 263(a). If there are such categories or thresholds, comments are requested on how expenditures would be aggregated in applying these *de minimis* rules.

5. *Costs of Software.*

The IRS and Treasury Department request comments on what rules and principles should be used to distinguish acquired software from developed software and the administrability of those rules and principles. See Rev. Proc. 2000–50 (2000–2 C.B. 601).

Heather C. Maloy,
Associate Chief Counsel
(Income Tax & Accounting).

(Filed by the Office of the Federal Register on January 23, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 24, 2002, 67 F.R. 3461)

New Form 720X, Amended Quarterly Federal Excise Tax Return

Announcement 2002–10

New Form 720X is available. Form 720X is used to make adjustments to liability reported on Forms 720 you have filed for previous quarters. Form 720X replaces Part I of Schedule C (Form 720).

You can obtain Form 720X by telephone or by using IRS electronic information services.

Request by	Number or address
Personal computer:	
IRS Web Site	***www.irs.gov***
File transfer protocol	**ftp.irs.gov**
Telephone	**1–800–TAX-FORM**
	(1–800–829–3676)

Federal Rates; Adjusted Federal Rates; Adjusted Federal Long-Term Rate and the Long-Term Exempt Rate

Announcement 2002–13

Rev. Rul. 2002–2 (2002–2 I.R.B. 271), which set forth the applicable federal rates and various other rates for January 2002, incorrectly labeled table 6 "Rate Under Section 7520 for January 2002". The title should read, "Deemed Rate for Transfers to New Pooled Income Funds During 2002".

The principal author of this announcement is Pat Monahan of the Office of Chief Counsel (Financial Institutions and Products). For further information regarding this announcement contact Ms. Monahan at (202) 622–4431 (not a toll-free call).

Allocation of Loss With Respect to Stock and Other Personal Property; Correction

Announcement 2002-14

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8973, 2002-4 I.R.B. 391) which were published in the **Federal Register** on Friday, December 28, 2001 (66 FR 67081). The final regulations relate to the allocation of loss recognized on the disposition of stock and other personal property under sections 861 and 865.

DATES: This correction is effective January 8, 2002.

FOR FURTHER INFORMATION CONTACT: David A. Juster (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under sections 861 and 865 of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 8973) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of final regulations (T.D. 8973), which was the subject of FR Doc. 01-31819, is corrected as follows:

§ 1.861–8T [Corrected]

1. On page 67083, column 3, § 1.861–8T, line 3 of the paragraph heading, the language "for other sources and activities (temporary)." is corrected to read "from other sources and activities (temporary)."

§ 1.865–2 [Corrected]

2. On page 67086, column 2, § 1.865–2(a)(4)(iv), *Example 3*. (i), line 10, the language "country X for $1,000. On January 2, 2002, R" is corrected to read "Country X for $1,000. On January 2, 2002, R".

LaNita VanDyke,
Acting Chief, Regulations Unit,
Associate Chief Counsel
(Income Tax & Accounting).

(Filed by the Office of the Federal Register on January 25, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 28, 2002, 67 F.R. 3811)

Certain Transfers of Property to Regulated Investment Companies and Real Estate Investment Trusts; Correction

Announcement 2002–15

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains a correction to REG–142299–01 and REG–209135–88 (2002–4 I.R.B. 418) that was published in the **Federal Register** on January 2, 2002 (67 FR 48). These regulations apply to certain transactions or events that result in a Regulated Investment Company [RIC] or Real Estate Investment Trust [REIT] owning property that has a basis determined by reference to a C corporation's basis in the property.

DATES: This correction is effective January 2, 2002.

FOR FURTHER INFORMATION CONTACT: Lisa A. Fuller (202) 622–7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking that is the subject of these corrections is under section 337(d) of the Internal Revenue Code.

Need for Correction

As published, REG–142299–01 and REG 209135–88 contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication REG–142299–01 and REG–209135–88, which is the subject of FR. Doc. 01–25909, is corrected as follows:

On page 52677, column 2, in the preamble under the paragraph heading "*Background*", lines 14 and 15, the language "property to a RIC or REIT, then the RIC or REIT will be subject either to section", is corrected to read "property to a RIC or REIT, then either the RIC or REIT will be subject to section".

LaNita Van Dyke,
Acting Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on January 28, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 29, 2002, 67 F.R. 4218)

Foundations Status of Certain Organizations

Announcement 2002–16

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

25 Sanchez Tennants Association, San Francisco, CA
A.H.T., Inc., Covina, CA
AIDS Information Resources & Services, Hood River, OR
AIDS — Sidalerte International, San Francisco, CA
Alaska Nellies Historical Society, Inc., Moose Pass, AK
Allen Temple Housing Corporation IV, Oakland, CA
Alternative Therapies Resources, San Francisco, CA
American Institute of International Studies, Union City, CA
American Stroke Association, San Juan Capistrano, CA
Anchornet, Incorporated, Anchorage, AK
Anioma Association of Northern California, Oakland, CA
Anthony J. Maxwell Center, Oakland, CA
Anthony Newman & J.J. Birden Instructional Football Camp, West Linn, OR
Anti-Tobacco Industry Coalition, Milwaukie, OR
Art Abram Swing Machine, Estacada, OR
Association for Intergenerational Cooperation AIC, Bellingham, WA
Bay Area Young Entrepreneurs, San Francisco, CA
Belle Haven Against Drugs, Menlo Park, CA
Blue Eagle Foundation, Redwood City, CA
Brokers Development Company, Inc., Oakland, CA
Cans for Christ Ministries, Long Beach, CA
Cedco Charities Foundation, Inc., North Bend, OR
Center for Bioregional Conflict Resolution, Santa Cruz, CA
Chaparral Youth Ranch, Inc., Palmer, AK
Chinese-American Benevolent Association, Eugene, OR
Cinema Preservation Society, San Francisco, CA
Classical Music of Northern California, Billings, MT
Columbia County Community Network, Dayton, WA
Compassion Works, Mountain View, CA
Congress of Community Organizations, Menlo Park, CA
Decennium Community Development Network, San Francisco, CA
Donor Network, Oakland, CA
Earth Net, Inc., Eugene, OR
Eastburn Family Ministry, McKinleyville, CA
Ecocorps, San Francisco, CA
Economic Opportunities Corporation, Portland, OR
Educational Video Foundation, Silverton, OR
Equi-Therapy Resources, Portland, OR
Fairnet, Inc., Fairbanks, AK
Faith of our Fathers Radio Broadcast, Tiller, OR
Fall Creek Ranch Foundation, Inc., Glide, OR
Flower Company, Portland, OR
Gil Mendelsohn Memorial Theater, San Francisco, CA
Gold Star Alaska Races, Inc., Wasilla, AK
Gospel Music Hall of Fame Museum Foundation, San Francisco, CA
Harold Stump Architectural Foundation, Berkely, CA
Harvestshare, Eugene, OR
Healing our Mother Earth, Torrance, CA
Helen Palmer Enneagram Archive Project, Oakland, CA
Helping Others Win, Inc., Portland, OR
Hieu Liem-Eccar Incorporation, Portland, OR
Holistic Village, Oakland, CA
Honey Bear Child Care Corporation, Oakland, CA
House of Rahab, Portland, OR
Hub City Music Association, Inc., Albany, OR
Inner Mountain Wilderness Education Center, Haines, AK
Institute of Native Culture and Communication, Sausalito, CA
International Hotel Senior Housing, Inc., San Francisco, CA
International Special Effects Museum, San Francisco, CA
International Wisdom Hsiang Kung Association, Inc., San Francisco, CA
Jami-Douglas Housing Corp., Juneau, AK
Jenny Lind Prospectors, Valley Springs, CA
Joma, Inc., Oakland, CA
Ketchikan Housing, Inc., Ketchikan, AK
Ketchikan Urban Forest, Inc., Ketchikan, AK
Klamath Basin Amateur Softball Association, Klamath Falls, OR
Klamath Unit Donation Fund, Klamath Falls, OR
Korean-American Pride Association Foundation, Santa Clara, CA
L & L Childrens Home, Inc., Oakland, CA
Lady of Grace Shrine, Portland, OR
Latin American Film Society, San Francisco, CA
Legacy From the Heart, Eugene, CA
Liberty National Monument, Inc., Salinas, CA
Lois Thompson Housing Project for Challenged Citizens, Portland, OR
Love Living Communities, Portland, OR
Loving Hearts and Helping Hands, Eugene, OR
Lyle Baker Veterinary Scholarship Board, Sonora, CA
Mackenzie Ministries, Oklahoma City, OK
Malheur Butte Productions, Ontario, OR
Marysues McKenzie Meals, Walterville, OR
Mercer Island Recreation Services Foundation, Mercer Island, WA

Michael Dorcy Rehabilitation Center, Oakland, CA
Ministers Wives and Widows of San Francisco and Adjacent Cities, San Francisco, CA
Mutual After Life Foundation, Westminster, CA
New Leaf Institute, Oakland, CA
North Street Soccer Club, Inc., Portland, OR
Northern California SGML Users Group, San Francisco, CA
Northwest Heritage Resources, Olympia, WA
Northwest Youth Theatre, Hillsboro, OR
Oakland Charities, Oakland, CA
Off-Off Road Los Angeles, Tujunga, CA
One Sky International Production, Inc., Anchorage, AK
Open Heart Theatre, Corvallis, OR
Oregon City Rotary Club Foundation, Oregon City, OR
Oregon City Youth Sports, Inc., Oregon City, OR
Oregon Korean Christian Community Center, Beaverton, OR
Pact, Inc., Moorpark, CA
Palmdale Youth Soccer League, Palmdale, CA
Parents Helping Parents San Francisco, San Francisco, CA
Pittsburg Alliance Ministerial, Pittsburg, CA
Pray U S A, St. Petersburg, FL
Project Moscow Medicine, Santa Maria, CA
Rancho Folclorico Centro Social Portugues, El Sobrante, CA
Random Acts of Love, Inc., Anchorage, AK
Redwood Empire Hunter-Jumpers, Fortuna, CA
Restoration House, Inc., Belmont, CA
Rogue River Roundup, Ashland, OR
San Andreas Youth Soccer Organization, Inc., Belmont, CA
San Juan Childrens Fund, Friday Harbor, WA
Searching the Scriptures, Sherwood, OR
Sennin Foundation, Richmond, CA
Shiloh Ranch Family Outreach, Grants Pass, OR
Snell Development Group, San Leandro, CA
Social Remotivations, Inc., Lafayette, CA
Society for Ortho Molecular Health Medicine-America, San Francisco, CA
Southern Oregon Barter Fair, Williams, OR
Springfield Community Concert Band, Eugene, CA
Stanford Alumni of Theta Delta Chi, Palo Alto, CA
Steady Course, Portland, OR
Supporters and Friends of Recovery Scholarship Fund, Beaverton, OR
Survival Exchange Network, San Francisco, CA
Tanana Valley Abate, Inc., Fairbanks, AK
Terrell Brandon City Kids Fan Club, Inc., Portland, OR
Tomorrow for Children, San Francisco, CA
Trans Pacific Foundation, Inc., Portland, OR
Ustawi a Non-Profit Corporation, Seattle, CA
Valley Institute for Cancer Research, Inc., Northridge, CA
Venus Art Literature Foundation, San Mateo, CA
Vietnamese World Christian Fellowship, Garden Grove, CA
Watch-Islam, Sunol, CA
Whiteaker Foundation, Eugene, OR
Workaholics Anonymous World Service Organization, Inc., Menlo Park, CA
Wrangell Fire Fighters Association, Wrangell, AK

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Amended Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

This announcement serves notice to donors that on July 26, 1999, the Court of Appeals for the Eleventh Circuit affirmed the decision of the United States Tax Court which was entered on August 28, 1998. The courts agreed with the Service that the organization listed below is not described in section 501(c)(3) and is not exempt from taxation under section 501(a), effective October 1, 1982.

Anclote Phychiatric Center, Inc., now known as River Foundation
Tarpon Springs, FL

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of its status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1).

In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Greatwood Family First Order of Consecration and True Family Church
Irvine, UT

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.—Intemal 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.
Z—Corporation.

Numerical Finding List[1]

Bulletins 2002–1 through 2002–6

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

Finding List of Current Actions on Previously Published Items[2]

Bulletins 2002–1 through 2002–6

Notices:

98–43
Modified and superseded by
Notice 2002–5, 2002–3 I.R.B. *320*

2001–10
Revoked by
Notice 2002–8, 2002–4 I.R.B. *398*

2000–11
Obsoleted by
Notice 2002–3, 2002–2 I.R.B. *289*

Proposed Regulations:

REG–105344–01
Corrected by
Ann. 2002–7, 2002–5 I.R.B. *459*

Revenue Procedures:

84–37
Modified by
Rev. Proc. 2002–1, 2002–1 I.R.B. *1*

84–57
Obsoleted by
T.D. 8976, 2002–5 I.R.B. *421*

87–50
Modified by
Rev. Proc. 2002–10, 2002–4 I.R.B. *400*

96–13
Modified by
Rev. Proc. 2002–1, 2002–1 I.R.B. *1*

98–49
Obsoleted by
T.D. 8976, 2002–5 I.R.B. *421*

99–49
Modified and superseded by
Rev. Proc. 2002–9, 2002–3 I.R.B. *327*

2002–6
Modified by
Notice 2002–1, 2002–2 I.R.B. *283*

2002–8
Modified by
Notice 2002–1, 2002–2 I.R.B. *283*

2000–20
Modified by
Rev. Proc. 2002–6, 2002–1 I.R.B. *203*

2001–1
Superseded by
Rev. Proc. 2002–1, 2002–1 I.R.B. *1*

Revenue Procedures:—Continued

2001–2
Superseded by
Rev. Proc. 2002–2, 2002–1 I.R.B. *82*

2001–3
Superseded by
Rev. Proc. 2002–3, 2002–1 I.R.B. *117*

2001–4
Superseded by
Rev. Proc. 2002–4, 2002–1 I.R.B. *127*

2001–5
Superseded by
Rev. Proc. 2002–5, 2002–1 I.R.B. *173*

2001–6
Superseded by
Rev. Proc. 2002–6, 2002–1 I.R.B. *203*

2001–7
Superseded by
Rev. Proc. 2002–7, 2002–1 I.R.B. *249*

2001–8
Superseded by
Rev. Proc. 2002–8, 2002–1 I.R.B. *252*

2001–13
Corrected by
Ann. 2002–5, 2002–4 I.R.B. *420*

2001–36
Superseded by
Rev. Proc. 2002–3, 2002–1 I.R.B. *117*

2001–41
Superseded by
Rev. Proc. 2002–2, 2002–1 I.R.B. *82*

2001–51
Superseded by
Rev. Proc. 2002–3, 2002–1 I.R.B. *117*

Revenue Rulings:

55–747
Revoked by
Notice 2002–8, 2002–4 I.R.B. *398*

61–146
Distinguished by
Rev. Rul. 2002–3, 2002–3 I.R.B. *316*

64–328
Modified by
Notice 2002–8, 2002–4 I.R.B. *398*

66–110
Modified by
Notice 2002–8, 2002–4 I.R.B. *398*

Revenue Rulings:—Continued

89–29
Obsoleted by
T.D. 8976, 2002–5 I.R.B. *421*

[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.