

### **Revocation of 501(c)(3) Status Stemming From Excess Benefit Transactions**

On March 28, 2008, the U.S. Department of the Treasury released new final regulations clarifying when violations of the excess benefit transaction regulations (also known as intermediate sanctions) may lead to revocation of exempt status. Under intermediate sanctions the IRS can impose excise taxes on managers and other influential persons in tax-exempt organizations who receive excessive economic benefits from the organization, rather than punishing the organization itself by revoking its tax-exempt status.<sup>1</sup> Prior to the enactment of intermediate sanctions, the only enforcement action available to the Internal Revenue Service (IRS) for an excess benefit transaction was loss of the organization's tax-exempt status.

The final regulations provide several factors that the IRS will consider in determining whether an applicable tax-exempt organization risks losing its tax-exempt status as a result of one or more excess benefit transactions.<sup>2</sup> These considerations include, but are not limited to, the following list:

- (1) the size and scope of the organization's regular and ongoing activities that further exempt purposes (i.e. its nonprofit program activities) before and after the excess benefit transaction or transactions occurred;
- (2) the size and scope of the excess benefit transactions in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (3) whether the organization has been involved in multiple<sup>3</sup> excess benefit transactions with one or more persons;
- (4) whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions (either before or after an excess benefit transaction occurs); and
- (5) whether the excess benefit transaction has been corrected (as defined by Internal Revenue Code Section 4958(f)(6) and Treasury Regulation §53.4958-7) or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefitted from the excess benefit transaction.

Although all factors, as well as any additional relevant facts and circumstances, will be considered in combination, the final regulations state that the IRS may place more weight upon certain factors, including an emphasis upon factors (4) and (5) in instances where the organization has taken action to remedy the excess benefit transaction(s) and institute safeguards before the IRS has discovered the transaction(s). However, the simple correction of an excess benefit transaction after discovery by the IRS would be insufficient to retain the organization's tax-exempt status. To clarify how the factors may be applied by the IRS, the text of the final

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<sup>1</sup> See 26 C.F.R. 53.4958.

<sup>2</sup> See T.D. 9390, 2008 FEDREG47,026

<sup>3</sup> "Multiple" refers to both (i) repeated instances of the same (or substantially similar) excess benefit transaction, regardless of whether the same person(s) is involved and (2) the presence of more than one excess benefit transaction, regardless of whether the transactions are substantially similar and involve the same person(s).

regulations provide numerous examples that illustrate how certain facts and circumstances will affect the IRS's determination.

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