

INTERNAL REVENUE CODE SECTION 4958 PRIMER

Transactions between certain tax-exempt organizations and “disqualified persons” (i.e., persons who are deemed to be in a position to exercise substantial influence over the affairs of the organization) are subject to special rules designed to reduce the likelihood that the exempt organization will be used to provide “excess benefits” to such disqualified persons. Internal Revenue Code (“Code”) Section 4958 imposes substantial penalties on a disqualified person who receives excess benefits and, in some cases, on the exempt organization’s decision makers.

DISQUALIFIED PERSONS

Generally, for purposes of Code Section 4958 disqualified persons include, but are not limited to, the following:

1. The directors and most officers of the tax-exempt organization;
2. Any person who has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration or operations of the organization;
3. Certain family members of any of the above, and
4. All entities in which at least 35% of the ownership, control, or beneficial interest is held by one or more of the persons identified above.

Any person that has a special relationship with the organization, even if they do not fall within one of the categories above, could also be deemed to be a disqualified person with respect to the organization.

EXCESS BENEFITS

An excess benefit is defined as the amount by which the value received by the disqualified person outweighs the value received by the organization. If the amount of the excess benefit is significant or if the organization does not correct the excess benefit upon discovering it, the organization’s tax-exempt status could be jeopardized.

REBUTTABLE PRESUMPTION OF REASONABLENESS

An exempt organization can establish a rebuttable presumption that a transaction between it and a disqualified person is reasonable and does not provide an excess benefit to the disqualified person. If a rebuttable presumption is established, the Internal Revenue Service (IRS) would have the burden of proving that the transaction or arrangement is not reasonable.

ESTABLISHING THE REBUTTABLE PRESUMPTION

In order to establish the rebuttable presumption of reasonableness for any transaction between A tax exempt organization and a disqualified person the following steps must be taken.

1. An authorized body (e.g., the board or a committee of the board, or some other body authorized by the board) composed entirely of individuals who do not have a conflict of interest (as discussed further below) with respect to the transaction must approve the terms of the transaction in advance of the transaction;

2. The authorized body must obtain and rely upon appropriate comparability data (as discussed further below) prior to making its determination;
3. The authorized body must adequately document the basis for its determination concurrently with making that determination. To satisfy this step, the authorized body's written or electronic records must:
 - a. Include the terms of the approved transaction and the date it was approved;
 - b. Include the members of the authorized body who were present during debate on the approved transaction and those who voted for it;
 - c. Include the comparability data described and how the data was obtained;
 - d. Include 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; and
 - e. Be prepared before the later of (i) the next meeting of the authorized body or (ii) 60 days after the authorized body's final action with respect to the transaction is taken, and the records must be approved shortly thereafter.

CONFLICTS OF INTEREST

A member of the authorized body does not have a conflict of interest with respect to the transaction if the member:

1. Is not a disqualified person, or a family member of a disqualified person, who is participating in, or benefiting economically from, the transaction;
2. Is not in an employment relationship subject to the direction or control of any disqualified person participating in, or economically benefiting from, the transaction;
3. Does not receive compensation or other payments subject to approval by any disqualified person participating in, or economically benefiting from, the transaction;
4. Has no material financial interest affected by the transaction; and
5. Does not approve a transaction providing economic benefits to any disqualified person participating in the transaction who, in turn, has approved or will approve a transaction providing economic benefits to the member.

COMPARABILITY DATA

For compensation arrangements, an authorized body has appropriate comparability data if, given the members' knowledge and expertise, it has information sufficient to determine whether the compensation arrangement is reasonable in its entirety. Relevant information includes, but is not limited to:

1. Compensation paid by similarly situated organizations (both taxable and tax-exempt) for functionally comparable positions;
2. The availability of similar services in the geographic area;
3. Current compensation surveys compiled by independent firms; and
4. Actual written offers from similar institutions competing for the services of the disqualified person.