

## Internal Revenue Service, Treasury

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### EXEMPT ORGANIZATIONS

## General Rule

### § 1.501(a)-1 Exemption from taxation.

(a) *In general; proof of exemption.* (1) Section 501(a) provides an exemption

from income taxes for organizations which are described in section 501 (c) or (d) and section 401(a), unless such organization is a *feeder organization* (see section 502), or unless it engages in a transaction described in section 503. However, the exemption does not extend to *unrelated business taxable income* of such an organization (see part III (Section 511 and following), subchapter F, chapter 1 of the Code).

(2) An organization, other than an employees' trust described in section 401(a), is not exempt from tax merely because it is not organized and operated for profit. In order to establish its exemption, it is necessary that every such organization claiming exemption file an application form as set forth below with the appropriate office as designated by the Commissioner in guidance published in the Internal Revenue Bulletin, forms, or instructions to the applicable forms. Subject only to the Commissioner's inherent power to revoke rulings, including with retroactive effect as permitted under section 7805(b), because of a change in the law or regulations or for other good cause, an organization that has been determined by the Commissioner (or previously by a district director) to be exempt under section 501(a) or the corresponding provision of prior law may rely upon such determination so long as there are no substantial changes in the organization's character, purposes, or methods of operation. An organization that has been determined to be exempt under the provisions of the Internal Revenue Code of 1939 or prior law is not required to secure a new determination of exemption merely because of the enactment of the Internal Revenue Code of 1954 unless affected by substantive changes in law made by such Code.

(3) An organization claiming exemption under section 501(a) and described in any paragraph of section 501(c) (other than section 501(c)(1) shall file the form of application prescribed by the Commissioner and shall include thereon such information as required by such form and the instructions issued with respect thereto. For rules relating to the obtaining of a determination of exempt status by an employees' trust described in section

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401(a), see the regulations under section 401.

(b) *Additional proof by particular classes of organizations.* (1) Unless otherwise prescribed by applicable regulations or other guidance published in the Internal Revenue Bulletin, organizations mentioned below shall submit with and as a part of their applications the following information:

(i) Mutual insurance companies shall submit copies of the policies or certificates of membership issued by them.

(ii) In the case of title holding companies described in section 501(c)(2), if the organization for which title is held has not been specifically notified in writing by the Internal Revenue Service that it is held to be exempt under section 501(a), the title holding company shall submit the information indicated herein as necessary for a determination of the status of the organization for which title is held.

(iii) An organization described in section 501(c)(3) shall submit with, and as a part of, an application filed after July 26, 1959, a detailed statement of its proposed activities.

(2) In addition to the information specifically called for by this section, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 501(a), and when deemed advisable in the interest of an efficient administration of the internal revenue laws, he may in the cases of particular types of organizations prescribe the form in which the proof of exemption shall be furnished.

(3) An organization claiming to be specifically exempted by section 6033(a) from filing annual returns shall submit with and as a part of its application (or in such other manner as is prescribed in guidance published in the Internal Revenue Bulletin) a statement of all the facts on which it bases its claim.

(c) *Private shareholder or individual defined.* The words *private shareholder or individual* in section 501 refer to persons having a personal and private interest in the activities of the organization.

(d) *Requirement of annual returns.* For the annual return requirements of or-

ganizations exempt under section 501(a), see section 6033 and § 1.6033-1.

(e) *Certain Puerto Rican pension, etc., trusts.* Effective for taxable years beginning after December 31, 1973, section 1022(i)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 942) provides that trusts under certain Puerto Rican pension, etc., plans (as defined under P.R. Laws Ann. tit. 13, section 3165, and the articles thereunder), all of the participants of which are residents of the Commonwealth of Puerto Rico, are to be treated only for purposes of section 501(a) as trusts described in section 401(a). The practical effect of section 1022(i)(1) is to exempt these trusts from U.S. income tax on income from their U.S. investments. For purposes of section 1022(i)(1), the term *residents of the Commonwealth of Puerto Rico* means bona fide residents of Puerto Rico, and persons who perform labor or services primarily within the Commonwealth of Puerto Rico, regardless of residence for other purposes, and the term *participants* is restricted to current employees who are not excluded under the eligibility provisions of the plan.

(f) *Effective/applicability date.* Paragraphs (a)(2), (b)(1), and (b)(3) of this section apply on and after July 1, 2014.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7428, 41 FR 34619, Aug. 16, 1976; T.D. 7859, 47 FR 54298, Dec. 2, 1982; T.D. 9674, 79 FR 37631, July 2, 2014; T.D. 9819, 82 FR 29732, June 30, 2017]

### **§ 1.501(c)(2)-1 Corporations organized to hold title to property for exempt organizations.**

(a) A corporation described in section 501(c)(2) and otherwise exempt from tax under section 501(a) is taxable upon its unrelated business taxable income. For taxable years beginning before January 1, 1970, see § 1.511-2(c)(4). Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than income which is treated as unrelated business taxable income solely because of the applicability of section 512(a)(3)(C); or debt financed income

which is treated as unrelated business taxable income solely because of section 514; or certain interest, annuities, royalties, or rents which are treated as unrelated business taxable income solely because of section 512(b)(3)(B)(ii) or (13). Similarly, exempt status under section 501(c)(2) shall not be affected where certain rents from personal property leased with real property are treated as unrelated business taxable income under section 512(b)(3)(A)(ii) solely because such rents attributable to such personal property are more than incidental when compared to the total rents received or accrued under the lease, or under section 512(b)(3)(B)(i) solely because such rents attributable to such personal property exceed 50 percent of the total rents received or accrued under the lease.

(b) A corporation described in section 501(c)(2) cannot accumulate income and retain its exemption, but it must turn over the entire amount of such income, less expenses, to an organization which is itself exempt from tax under section 501(a).

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7658, 45 FR 33972, May 21, 1980]

**§ 1.501(c)(3)-1 Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.**

(a) *Organizational and operational tests.* (1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

(2) The term *exempt purpose or purposes*, as used in this section, means any purpose or purposes specified in section 501(c)(3), as defined and elaborated in paragraph (d) of this section.

(b) *Organizational test*—(1) *In general.* (i) An organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its *articles*)

as defined in subparagraph (2) of this paragraph:

(A) Limit the purposes of such organization to one or more exempt purposes; and

(B) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

(ii) In meeting the organizational test, the organization's purposes, as stated in its articles, may be as broad as, or more specific than, the purposes stated in section 501(c)(3). Therefore, an organization which, by the terms of its articles, is formed *for literary and scientific purposes within the meaning of section 501(c)(3) of the Code* shall, if it otherwise meets the requirements in this paragraph, be considered to have met the organizational test. Similarly, articles stating that the organization is created solely *to receive contributions and pay them over to organizations which are described in section 501(c)(3) and exempt from taxation under section 501(a)* are sufficient for purposes of the organizational test. Moreover, it is sufficient if the articles set for the purpose of the organization to be the operation of a school for adult education and describe in detail the manner of the operation of such school. In addition, if the articles state that the organization is formed for *charitable purposes*, such articles ordinarily shall be sufficient for purposes of the organizational test (see subparagraph (5) of this paragraph for rules relating to construction of terms).

(iii) An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3). Thus, an organization that is empowered by its articles *to engage in a manufacturing business*, or *to engage in the operation of a social club* does not meet the organizational test regardless of the fact that its articles may state

that such organization is created for charitable purposes within the meaning of section 501(c)(3) of the Code.

(iv) In no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such organization is created are broader than the purposes specified in section 501(c)(3). The fact that the actual operations of such an organization have been exclusively in furtherance of one or more exempt purposes shall not be sufficient to permit the organization to meet the organizational test. Similarly, such an organization will not meet the organizational test as a result of statements or other evidence that the members thereof intend to operate only in furtherance of one or more exempt purposes.

(v) Unless otherwise prescribed by applicable regulations or other guidance published in the Internal Revenue Bulletin, an organization must, in order to establish its exemption, submit a detailed statement of its proposed activities with and as a part of its application for exemption (see § 1.501(a)-1(b)).

(2) *Articles of organization.* For purposes of this section, the term *articles of organization* or *articles* includes the trust instrument, the corporate charter, the articles of association, or any other written instrument by which an organization is created.

(3) *Authorization of legislative or political activities.* An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it:

(i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise; or

(ii) Directly or indirectly to participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of or in opposition to any candidate for public office; or

(iii) To have objectives and to engage in activities which characterize it as an *action* organization as defined in paragraph (c)(3) of this section.

The terms used in subdivisions (i), (ii), and (iii) of this subparagraph shall have the meanings provided in para-

graph (c)(3) of this section. An organization's articles will not violate the provisions of paragraph (b)(3)(i) of this section even though the organization's articles expressly empower it to make the election provided for in section 501(h) with respect to influencing legislation and, only if it so elects, to make lobbying or grass roots expenditures that do not normally exceed the ceiling amounts prescribed by section 501(h)(2) (B) and (D).

(4) *Distribution of assets on dissolution.* An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal Government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

(5) *Construction of terms.* The law of the State in which an organization is created shall be controlling in construing the terms of its articles. However, any organization which contends that such terms have under State law a different meaning from their generally accepted meaning must establish such special meaning by clear and convincing reference to relevant court decisions, opinions of the State attorney-general, or other evidence of applicable State law.

(6) *Applicability of the organizational test.* A determination by the Commissioner that an organization is described in section 501(c)(3) and exempt under section 501(a) will not be granted after July 26, 1959, regardless of when the application is filed, unless such organization meets the organizational test prescribed by this paragraph (b). If, before

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July 27, 1959, an organization has been determined by the Commissioner or district director to be exempt as an organization described in section 501(c)(3) or in a corresponding provision of prior law and such determination has not been revoked before such date, the fact that such organization does not meet the organizational test prescribed by this paragraph (b) shall not be a basis for revoking such determination. Accordingly, an organization that has been determined to be exempt before July 27, 1959, and which does not seek a new determination of exemption is not required to amend its articles of organization to conform to the rules of this paragraph (b), but any organization that seeks a determination of exemption after July 26, 1959, must have articles of organization that meet the rules of this paragraph (b). For the rules relating to whether an organization determined to be exempt before July 27, 1959, is organized exclusively for one or more exempt purposes, see 26 CFR (1939) 39.101(6)-1 (Regulations 118) as made applicable to the Code by Treasury Decision 6091, approved August 16, 1954 (19 FR 5167; 1954-2 CB 47).

(c) *Operational test*—(1) *Primary activities*. An organization will be regarded as *operated exclusively* for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

(2) *Distribution of earnings*. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. For the definition of the words *private shareholder* or *individual*, see paragraph (c) of §1.501(a)-1.

(3) *Action organizations*. (i) An organization is not operated exclusively for one or more exempt purposes if it is an *action* organization as defined in subdivisions (ii), (iii), or (iv) of this subparagraph.

(ii) An organization is an *action* organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise.

For this purpose, an organization will be regarded as attempting to influence legislation if the organization:

(a) Contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or

(b) Advocates the adoption or rejection of legislation.

The term *legislation*, as used in this subdivision, includes action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. An organization will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation. An organization for which the expenditure test election of section 501(h) is in effect for a taxable year will not be considered an *action* organization by reason of this paragraph (c)(3)(ii) for that year if it is not denied exemption from taxation under section 501(a) by reason of section 501(h).

(iii) An organization is an *action* organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

The term *candidate for public office* means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate.

(iv) An organization is an *action* organization if it has the following two characteristics: (a) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of

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such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered.

(v) An *action* organization, described in subdivisions (ii) or (iv) of this subparagraph, though it cannot qualify under section 501(c)(3), may nevertheless qualify as a social welfare organization under section 501(c)(4) if it meets the requirements set out in paragraph (a) of § 1.501(c)(4)-1.

(d) *Exempt purposes*—(1) *In general.* (i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- (a) Religious,
- (b) Charitable,
- (c) Scientific,
- (d) Testing for public safety,
- (e) Literary,
- (f) Educational, or
- (g) Prevention of cruelty to children or animals.

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

(iii) *Examples.* The following examples illustrate the requirement of paragraph (d)(1)(ii) of this section that an organization serve a public rather than a private interest:

*Example 1.* (i) O is an educational organization the purpose of which is to study history and immigration. O's educational activities include sponsoring lectures and publishing a journal. The focus of O's historical studies is the genealogy of one family, tracing the descent of its present members. O actively solicits for membership only individuals who are members of that one family. O's research

is directed toward publishing a history of that family that will document the pedigrees of family members. A major objective of O's research is to identify and locate living descendants of that family to enable those descendants to become acquainted with each other.

(ii) O's educational activities primarily serve the private interests of members of a single family rather than a public interest. Therefore, O is operated for the benefit of private interests in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

*Example 2.* (i) O is an art museum. O's principal activity is exhibiting art created by a group of unknown but promising local artists. O's activity, including organized tours of its art collection, promotes the arts. O is governed by a board of trustees unrelated to the artists whose work O exhibits. All of the art exhibited is offered for sale at prices set by the artist. Each artist whose work is exhibited has a consignment arrangement with O. Under this arrangement, when art is sold, the museum retains 10 percent of the selling price to cover the costs of operating the museum and gives the artist 90 percent.

(ii) The artists in this situation directly benefit from the exhibition and sale of their art. As a result, the principal activity of O serves the private interests of these artists. Because O gives 90 percent of the proceeds from its sole activity to the individual artists, the direct benefits to the artists are substantial and O's provision of these benefits to the artists is more than incidental to its other purposes and activities. This arrangement causes O to be operated for the benefit of private interests in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

*Example 3.* (i) O is an educational organization the purpose of which is to train individuals in a program developed by P, O's president. The program is of interest to academics and professionals, representatives of whom serve on an advisory panel to O. All of the rights to the program are owned by Company K, a for-profit corporation owned by P. Prior to the existence of O, the teaching of the program was conducted by Company K. O licenses, from Company K, the right to conduct seminars and lectures on the program and to use the name of the program as part of O's name, in exchange for specified royalty payments. Under the license agreement, Company K provides O with the services of trainers and with course materials on the program. O may develop and copyright new course materials on the program but all such

materials must be assigned to Company K without consideration if and when the license agreement is terminated. Company K sets the tuition for the seminars and lectures on the program conducted by O. O has agreed not to become involved in any activity resembling the program or its implementation for 2 years after the termination of O's license agreement.

(ii) O's sole activity is conducting seminars and lectures on the program. This arrangement causes O to be operated for the benefit of P and Company K in violation of the restriction on private benefit in paragraph (d)(1)(ii) of this section, regardless of whether the royalty payments from O to Company K for the right to teach the program are reasonable. Based on these facts and circumstances, O is not operated exclusively for exempt purposes and, therefore, is not described in section 501(c)(3).

(iv) Since each of the purposes specified in subdivision (i) of this subparagraph is an exempt purpose in itself, an organization may be exempt if it is organized and operated exclusively for any one or more of such purposes. If, in fact, an organization is organized and operated exclusively for an exempt purpose or purposes, exemption will be granted to such an organization regardless of the purpose or purposes specified in its application for exemption. For example, if an organization claims exemption on the ground that it is *educational*, exemption will not be denied if, in fact, it is *charitable*.

(2) *Charitable defined.* The term *charitable* is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of *charity* as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated

for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an *action* organization of any one of the types described in paragraph (c)(3) of this section.

(3) *Educational defined*—(i) *In general.* The term *educational*, as used in section 501(c)(3), relates to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or

(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

(ii) *Examples of educational organizations.* The following are examples of organizations which, if they otherwise meet the requirements of this section, are educational:

*Example 1.* An organization, such as a primary or secondary school, a college, or a professional or trade school, which has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on.

*Example 2.* An organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs. Such programs may be on radio or television.

*Example 3.* An organization which presents a course of instruction by means of correspondence or through the utilization of television or radio.

*Example 4.* Museums, zoos, planetariums, symphony orchestras, and other similar organizations.

(4) *Testing for public safety defined.* The term *testing for public safety*, as used in section 501(c)(3), includes the testing of consumer products, such as electrical products, to determine whether they are safe for use by the general public.

(5) *Scientific defined.* (i) Since an organization may meet the requirements of section 501(c)(3) only if it serves a public rather than a private interest, a *scientific* organization must be organized and operated in the public interest (see subparagraph (1)(ii) of this paragraph). Therefore, the term *scientific*, as used in section 501(c)(3), includes the carrying on of scientific research in the public interest. Research when taken alone is a word with various meanings; it is not synonymous with *scientific*; and the nature of particular research depends upon the purpose which it serves. For research to be *scientific*, within the meaning of section 501(c)(3), it must be carried on in furtherance of a *scientific* purpose. The determination as to whether research is *scientific* does not depend on whether such research is classified as *fundamental* or *basic* as contrasted with *applied* or *practical*. On the other hand, for purposes of the exclusion from unrelated business taxable income provided by section 512(b)(9), it is necessary to determine whether the organization is operated primarily for purposes of carrying on *fundamental*, as contrasted with *applied*, research.

(ii) Scientific research does not include activities of a type ordinarily carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc.

(iii) Scientific research will be regarded as carried on in the public interest:

(a) If the results of such research (including any patents, copyrights, processes, or formulae resulting from such research) are made available to the public on a nondiscriminatory basis;

(b) If such research is performed for the United States, or any of its agen-

cies or instrumentalities, or for a State or political subdivision thereof; or

(c) If such research is directed toward benefiting the public. The following are examples of scientific research which will be considered as directed toward benefiting the public, and, therefore, which will be regarded as carried on in the public interest: (1) Scientific research carried on for the purpose of aiding in the scientific education of college or university students; (2) scientific research carried on for the purpose of obtaining scientific information, which is published in a treatise, thesis, trade publication, or in any other form that is available to the interested public; (3) scientific research carried on for the purpose of discovering a cure for a disease; or (4) scientific research carried on for the purpose of aiding a community or geographical area by attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area. Scientific research described in this subdivision will be regarded as carried on in the public interest even though such research is performed pursuant to a contract or agreement under which the sponsor or sponsors of the research have the right to obtain ownership or control of any patents, copyrights, processes, or formulae resulting from such research.

(iv) An organization will not be regarded as organized and operated for the purpose of carrying on scientific research in the public interest and, consequently, will not qualify under section 501(c)(3) as a *scientific* organization, if:

(a) Such organization will perform research only for persons which are (directly or indirectly) its creators and which are not described in section 501(c)(3), or

(b) Such organization retains (directly or indirectly) the ownership or control of more than an insubstantial portion of the patents, copyrights, processes, or formulae resulting from its research and does not make such patents, copyrights, processes, or formulae available to the public. For purposes of this subdivision, a patent, copyright, process, or formula shall be considered as made available to the



public if such patent, copyright, process, or formula is made available to the public on a nondiscriminatory basis. In addition, although one person is granted the exclusive right to the use of a patent, copyright, process, or formula, such patent, copyright, process, or formula shall be considered as made available to the public if the granting of such exclusive right is the only practicable manner in which the patent, copyright, process, or formula can be utilized to benefit the public. In such a case, however, the research from which the patent, copyright, process, or formula resulted will be regarded as carried on in the public interest (within the meaning of subdivision (iii) of this subparagraph) only if it is carried on for a person described in subdivision (iii)(b) of this subparagraph or if it is scientific research described in subdivision (iii)(c) of this subparagraph.

(v) The fact that any organization (including a college, university, or hospital) carries on research which is not in furtherance of an exempt purpose described in section 501(c)(3) will not preclude such organization from meeting the requirements of section 501(c)(3) so long as the organization meets the organizational test and is not operated for the primary purpose of carrying on such research (see paragraph (e) of this section, relating to organizations carrying on a trade or business). See paragraph (a)(5) of §1.513-2, with respect to research which constitutes an unrelated trade or business, and section 512(b) (7), (8), and (9), with respect to income derived from research which is excludable from the tax on unrelated business income.

(vi) The regulations in this subparagraph are applicable with respect to taxable years beginning after December 31, 1960.

(e) *Organizations carrying on trade or business—(1) In general.* An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section

513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3) even though it has certain religious purposes, its property is held in common, and its profits do not inure to the benefit of individual members of the organization. See, however, section 501(d) and §1.501(d)-1, relating to religious and apostolic organizations.

(2) *Taxation of unrelated business income.* For provisions relating to the taxation of unrelated business income of certain organizations described in section 501(c)(3), see sections 511 to 515, inclusive, and the regulations thereunder.

(f) *Interaction with section 4958—(1) Application process.* An organization that applies for recognition of exemption under section 501(a) as an organization described in section 501(c)(3) must establish its eligibility under this section. The Commissioner may deny an application for exemption for failure to establish any of section 501(c)(3)'s requirements for exemption. Section 4958 does not apply to transactions with an organization that has failed to establish that it satisfies all of the requirements for exemption under section 501(c)(3). See §53.4958-2.

(2) *Substantive requirements for exemption still apply to applicable tax-exempt organizations described in section 501(c)(3)—(i) In general.* Regardless of whether a particular transaction is subject to excise taxes under section 4958, the substantive requirements for tax exemption under section 501(c)(3) still apply to an applicable tax-exempt organization (as defined in section 4958(e) and §53.4958-2) described in section 501(c)(3) whose disqualified persons or organization managers are subject to excise taxes under section 4958. Accordingly, an organization will no longer meet the requirements for tax-exempt status under section 501(c)(3) if

the organization fails to satisfy the requirements of paragraph (b), (c) or (d) of this section. See § 53.4958-8(a).

(ii) *Determination of whether revocation of tax-exempt status is appropriate when section 4958 excise taxes also apply.* In determining whether to continue to recognize the tax-exempt status of an applicable tax-exempt organization (as defined in section 4958(e) and § 53.4958-2) described in section 501(c)(3) that engages in one or more excess benefit transactions (as defined in section 4958(c) and § 53.4958-4) that violate the prohibition on inurement under section 501(c)(3), the Commissioner will consider all relevant facts and circumstances, including, but not limited to, the following—

(A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;

(B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;

(C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;

(D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and

(E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and § 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction.

(iii) All factors will be considered in combination with each other. Depending on the particular situation, the Commissioner may assign greater or lesser weight to some factors than to others. The factors listed in paragraphs (f)(2)(ii)(D) and (E) of this section will weigh more heavily in favor of continuing to recognize exemption where the organization discovers the excess benefit transaction or transactions and takes action before the Commissioner discovers the excess benefit trans-

action or transactions. Further, with respect to the factor listed in paragraph (f)(2)(ii)(E) of this section, correction after the excess benefit transaction or transactions are discovered by the Commissioner, by itself, is never a sufficient basis for continuing to recognize exemption.

(iv) *Examples.* The following examples illustrate the principles of paragraph (f)(2)(ii) of this section. For purposes of each example, assume that O is an applicable tax-exempt organization (as defined in section 4958(e) and § 53.4958-2) described in section 501(c)(3). The examples read as follows:

*Example 1.* (i) O was created as a museum for the purpose of exhibiting art to the general public. In Years 1 and 2, O engages in fundraising and in selecting, leasing, and preparing an appropriate facility for a museum. In Year 3, a new board of trustees is elected. All of the new trustees are local art dealers. Beginning in Year 3 and continuing to the present, O uses a substantial portion of its revenues to purchase art solely from its trustees at prices that exceed fair market value. O exhibits and offers for sale all of the art it purchases. O's Form 1023, "Application for Recognition of Exemption," did not disclose the possibility that O would purchase art from its trustees.

(ii) O's purchases of art from its trustees at more than fair market value constitute excess benefit transactions between an applicable tax-exempt organization and disqualified persons under section 4958. Therefore, these transactions are subject to the applicable excise taxes provided in that section. In addition, O's purchases of art from its trustees at more than fair market value violate the prescription against inurement under section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. Beginning in Year 3, O does not engage primarily in regular and ongoing activities that further exempt purposes because a substantial portion of O's activities consists of purchasing art from its trustees and dealing in such art in a manner similar to a commercial art gallery. The size and scope of the excess benefit transactions collectively are significant in relation to the size and scope of any of O's ongoing activities that further exempt purposes. O has been involved in multiple excess benefit transactions, namely, purchases of art from its trustees at more than fair market value. O has not implemented safeguards that are reasonably calculated to prevent such improper purchases in the future. The excess benefit transactions have not been corrected, nor has O made good faith efforts to seek

correction from the disqualified persons who benefited from the excess benefit transactions (the trustees). The trustees continue to control O's Board. Based on the application of the factors to these facts, O is no longer described in section 501(c)(3) effective in Year 3.

*Example 2.* (i) The facts are the same as in *Example 1*, except that in Year 4, O's entire board of trustees resigns, and O no longer offers all exhibited art for sale. The former board is replaced with members of the community who are not in the business of buying or selling art and who have skills and experience running charitable and educational programs and institutions. O promptly discontinues the practice of purchasing art from current or former trustees, adopts a written conflicts of interest policy, adopts written art valuation guidelines, hires legal counsel to recover the excess amounts O had paid its former trustees, and implements a new program of activities to further the public's appreciation of the arts.

(ii) O's purchases of art from its former trustees at more than fair market value constitute excess benefit transactions between an applicable tax-exempt organization and disqualified persons under section 4958. Therefore, these transactions are subject to the applicable excise taxes provided in that section. In addition, O's purchases of art from its trustees at more than fair market value violate the proscription against inurement under section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. In Year 3, O does not engage primarily in regular and ongoing activities that further exempt purposes. However, in Year 4, O elects a new board of trustees comprised of individuals who have skills and experience running charitable and educational programs and implements a new program of activities to further the public's appreciation of the arts. As a result of these actions, beginning in Year 4, O engages in regular and ongoing activities that further exempt purposes. The size and scope of the excess benefit transactions that occurred in Year 3, taken collectively, are significant in relation to the size and scope of O's regular and ongoing exempt function activities that were conducted in Year 3. Beginning in Year 4, however, as O's exempt function activities grow, the size and scope of the excess benefit transactions that occurred in Year 3 become less and less significant as compared to the size and scope of O's regular and ongoing exempt function activities. O was involved in multiple excess benefit transactions in Year 3. However, by discontinuing its practice of purchasing art from its current and former trustees, by replacing its former board with independent members of the community, and by adopting a conflicts of interest policy and art valuation

guidelines, O has implemented safeguards that are reasonably calculated to prevent future violations. In addition, O has made a good faith effort to seek correction from the disqualified persons who benefited from the excess benefit transactions (its former trustees). Based on the application of the factors to these facts, O continues to meet the requirements for tax exemption under section 501(c)(3).

*Example 3.* (i) O conducts educational programs for the benefit of the general public. Since its formation, O has employed its founder, C, as its Chief Executive Officer. Beginning in Year 5 of O's operations and continuing to the present, C caused O to divert significant portions of O's funds to pay C's personal expenses. The diversions by C significantly reduced the funds available to conduct O's ongoing educational programs. The board of trustees never authorized C to cause O to pay C's personal expenses from O's funds. Certain members of the board were aware that O was paying C's personal expenses. However, the board did not terminate C's employment and did not take any action to seek repayment from C or to prevent C from continuing to divert O's funds to pay C's personal expenses. C claimed that O's payments of C's personal expenses represented loans from O to C. However, no contemporaneous loan documentation exists, and C never made any payments of principal or interest.

(ii) The diversions of O's funds to pay C's personal expenses constitute excess benefit transactions between an applicable tax-exempt organization and a disqualified person under section 4958. Therefore, these transactions are subject to the applicable excise taxes provided in that section. In addition, these transactions violate the proscription against inurement under section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. O has engaged in regular and ongoing activities that further exempt purposes both before and after the excess benefit transactions occurred. However, the size and scope of the excess benefit transactions engaged in by O beginning in Year 5, collectively, are significant in relation to the size and scope of O's activities that further exempt purposes. Moreover, O has been involved in multiple excess benefit transactions. O has not implemented any safeguards that are reasonably calculated to prevent future diversions. The excess benefit transactions have not been corrected, nor has O made good faith efforts to seek correction from C, the disqualified person who benefited from the excess benefit transactions. Based on the application of the factors to these facts, O is no longer described in section 501(c)(3) effective in Year 5.

*Example 4.* (i) O conducts activities that further exempt purposes. O uses several buildings in the conduct of its exempt activities. In Year 1, O sold one of the buildings to Company K for an amount that was substantially below fair market value. The sale was a significant event in relation to O's other activities. C, O's Chief Executive Officer, owns all of the voting stock of Company K. When O's board of trustees approved the transaction with Company K, the board did not perform due diligence that could have made it aware that the price paid by Company K to acquire the building was below fair market value. Subsequently, but before the IRS commences an examination of O, O's board of trustees determines that Company K paid less than the fair market value for the building. Thus, O concludes that an excess benefit transaction occurred. After the board makes this determination, it promptly removes C as Chief Executive Officer, terminates C's employment with O, and hires legal counsel to recover the excess benefit from Company K. In addition, O promptly adopts a conflicts of interest policy and new contract review procedures designed to prevent future recurrences of this problem.

(ii) The sale of the building by O to Company K at less than fair market value constitutes an excess benefit transaction between an applicable tax-exempt organization and a disqualified person under section 4958 in Year 1. Therefore, this transaction is subject to the applicable excise taxes provided in that section. In addition, this transaction violates the proscription against inurement under section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. O has engaged in regular and ongoing activities that further exempt purposes both before and after the excess benefit transaction occurred. Although the size and scope of the excess benefit transaction were significant in relation to the size and scope of O's activities that further exempt purposes, the transaction with Company K was a one-time occurrence. By adopting a conflicts of interest policy and new contract review procedures and by terminating C, O has implemented safeguards that are reasonably calculated to prevent future violations. Moreover, O took corrective actions before the IRS commenced an examination of O. In addition, O has made a good faith effort to seek correction from Company K, the disqualified person who benefited from the excess benefit transaction. Based on the application of the factors to these facts, O continues to be described in section 501(c)(3).

*Example 5.* (i) O is a large organization with substantial assets and revenues. O conducts activities that further its exempt purposes. O employs C as its Chief Financial Officer. During Year 1, O pays \$2,500 of C's personal

expenses. O does not make these payments pursuant to an accountable plan, as described in § 53.4958-4(a)(4)(ii). In addition, O does not report any of these payments on C's Form W-2, "Wage and Tax Statement," or on a Form 1099-MISC, "Miscellaneous Income," for C for Year 1, and O does not report these payments as compensation on its Form 990, "Return of Organization Exempt From Income Tax," for Year 1. Moreover, none of these payments can be disregarded as non-taxable fringe benefits under § 53.4958-4(c)(2) and none consisted of fixed payments under an initial contract under § 53.4958-4(a)(3). C does not report the \$2,500 of payments as income on his individual Federal income tax return for Year 1. O does not repeat this reporting omission in subsequent years and, instead, reports all payments of C's personal expenses not made under an accountable plan as income to C.

(ii) O's payment in Year 1 of \$2,500 of C's personal expenses constitutes an excess benefit transaction between an applicable tax-exempt organization and a disqualified person under section 4958. Therefore, this transaction is subject to the applicable excise taxes provided in that section. In addition, this transaction violates the proscription against inurement in section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. O engages in regular and ongoing activities that further exempt purposes. The payment of \$2,500 of C's personal expenses represented only a de minimis portion of O's assets and revenues; thus, the size and scope of the excess benefit transaction were not significant in relation to the size and scope of O's activities that further exempt purposes. The reporting omission that resulted in the excess benefit transaction in Year 1 occurred only once and is not repeated in subsequent years. Based on the application of the factors to these facts, O continues to be described in section 501(c)(3).

*Example 6.* (i) O is a large organization with substantial assets and revenues. O furthers its exempt purposes by providing social services to the population of a specific geographic area. O has a sizeable workforce of employees and volunteers to conduct its work. In Year 1, O's board of directors adopted written procedures for setting executive compensation at O. O's executive compensation procedures were modeled on the procedures for establishing a rebuttable presumption of reasonableness under § 53.4958-6. In accordance with these procedures, the board appointed a compensation committee to gather data on compensation levels paid by similarly situated organizations for functionally comparable positions. The members of the compensation committee were disinterested within the meaning of § 53.4958-

6(c)(1)(iii). Based on its research, the compensation committee recommended a range of reasonable compensation for several of O's existing top executives (the Top Executives). On the basis of the committee's recommendations, the board approved new compensation packages for the Top Executives and timely documented the basis for its decision in board minutes. The board members were all disinterested within the meaning of § 53.4958-6(c)(1)(iii). The Top Executives were not involved in setting their own compensation. In Year 1, even though payroll expenses represented a significant portion of O's total operating expenses, the total compensation paid to O's Top Executives represented only an insubstantial portion of O's total payroll expenses. During a subsequent examination, the IRS found that the compensation committee relied exclusively on compensation data from organizations that perform similar social services to O. The IRS concluded, however, that the organizations were not similarly situated because they served substantially larger geographic regions with more diverse populations and were larger than O in terms of annual revenues, total operating budget, number of employees, and number of beneficiaries served. Accordingly, the IRS concluded that the compensation committee did not rely on "appropriate data as to comparability" within the meaning of § 53.4958-6(c)(2) and, thus, failed to establish the rebuttable presumption of reasonableness under § 53.4958-6. Taking O's size and the nature of the geographic area and population it serves into account, the IRS concluded that the Top Executives' compensation packages for Year 1 were excessive. As a result of the examination, O's board added new members to the compensation committee who have expertise in compensation matters and also amended its written procedures to require the compensation committee to evaluate a number of specific factors, including size, geographic area, and population covered by the organization, in assessing the comparability of compensation data. O's board renegotiated the Top Executives' contracts in accordance with the recommendations of the newly constituted compensation committee on a going forward basis. To avoid potential liability for damages under state contract law, O did not seek to void the Top Executives' employment contracts retroactively to Year 1 and did not seek correction of the excess benefit amounts from the Top Executives. O did not terminate any of the Top Executives.

(ii) O's payments of excessive compensation to the Top Executives in Year 1 constituted excess benefit transactions between an applicable tax-exempt organization and

disqualified persons under section 4958. Therefore, these payments are subject to the applicable excise taxes provided under that section, including second-tier taxes if there is no correction by the disqualified persons. In addition, these payments violate the proscription against inurement under section 501(c)(3) and paragraph (c)(2) of this section.

(iii) The application of the factors in paragraph (f)(2)(ii) of this section to these facts is as follows. O has engaged in regular and ongoing activities that further exempt purposes both before and after the excess benefit transactions occurred. The size and scope of the excess benefit transactions, in the aggregate, were not significant in relation to the size and scope of O's activities that further exempt purposes. O engaged in multiple excess benefit transactions. Nevertheless, prior to entering into these excess benefit transactions, O had implemented written procedures for setting the compensation of its top management that were reasonably calculated to prevent the occurrence of excess benefit transactions. O followed these written procedures in setting the compensation of the Top Executives for Year 1. Despite the board's failure to rely on appropriate comparability data, the fact that O implemented and followed these written procedures in setting the compensation of the Top Executives for Year 1 is a factor favoring continued exemption. The fact that O amended its written procedures to ensure the use of appropriate comparability data and renegotiated the Top Executives' compensation packages on a going-forward basis are also factors favoring continued exemption, even though O did not void the Top Executives' existing contracts and did not seek correction from the Top Executives. Based on the application of the factors to these facts, O continues to be described in section 501(c)(3).

(3) *Applicability.* The rules in paragraph (f) of this section will apply with respect to excess benefit transactions occurring after March 28, 2008.

(g) *Applicability of regulations in this section.* The regulations in this section are, except as otherwise expressly provided, applicable with respect to taxable years beginning after July 26, 1959. For the rules applicable with respect to taxable years beginning before July 27, 1959, see 26 CFR (1939) 39.101(6)-1 (Regulations 118) as made applicable to the Code by Treasury Decision 6091, approved August 16, 1954 (19 FR 5167; C.B. 1954-2, 47).

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(h) *Effective/applicability date.* Paragraphs (b)(1)(v) and (b)(6) of this section apply on and after July 1, 2014.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6525, 26 FR 189, Jan. 11, 1961; T.D. 6939, 32 FR 17661, Dec. 12, 1967; T.D. 7428, 41 FR 34620, Aug. 16, 1976; T.D. 8308, 55 FR 35587, Aug. 31, 1990; T.D. 9390, 73 FR 16521, Mar. 28, 2008; T.D. 9390, 73 FR 23069, Apr. 29, 2008; T.D. 9674, 79 FR 37631, July 2, 2014; T.D. 9819, 82 FR 29732, June 30, 2017]

### § 1.501(c)(4)-1 Civic organizations and local associations of employees.

(a) *Civic organizations*—(1) *In general.* A civic league or organization may be exempt as an organization described in section 501(c)(4) if—

(i) It is not organized or operated for profit; and

(ii) It is operated exclusively for the promotion of social welfare.

(2) *Promotion of social welfare*—(i) *In general.* An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A *social welfare* organization will qualify for exemption as a charitable organization if it falls within the definition of *charitable* set forth in paragraph (d)(2) of § 1.501(c)(3)-1 and is not an *action* organization as set forth in paragraph (c)(3) of § 1.501(c)(3)-1.

(ii) *Political or social activities.* The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit. See, however, section 501(c)(6) and § 1.501(c)(6)-1, relating to business leagues and similar organizations. A social welfare organization that is not, at any time after October 4, 1976, exempt from taxation as an organization described in section

501(c)(3) may qualify under section 501(c)(4) even though it is an *action* organization described in § 1.501(c)(3)-1(c)(3)(ii) or (iv), if it otherwise qualifies under this section. For rules relating to an organization that is, after October 4, 1976, exempt from taxation as an organization described in section 501(c)(3), see section 504 and § 1.504-1.

(b) *Local associations of employees.* Local associations of employees described in section 501(c)(4) are expressly entitled to exemption under section 501(a). As conditions to exemption, it is required (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. The word *local* is defined in paragraph (b) of § 1.501(c)(12)-1. See paragraph (d) (2) and (3) of § 1.501(c)(3)-1 with reference to the meaning of *charitable* and *educational* as used in this section.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8308, 55 FR 35588, Aug. 31, 1990]

### § 1.501(c)(5)-1 Labor, agricultural, and horticultural organizations.

(a) The organizations contemplated by section 501(c)(5) as entitled to exemption from income taxation are those which:

(1) Have no net earnings inuring to the benefit of any member, and

(2) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

(b)(1) *General rule.* An organization is not an organization described in section 501(c)(5) if the principal activity of the organization is to receive, hold, invest, disburse or otherwise manage funds associated with savings or investment plans or programs, including pension or other retirement savings plans or programs.

(2) *Exception.* Paragraph (b)(1) of this section shall not apply to an organization which—

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(i) Is established and maintained by another labor organization described in section 501(c)(5) (determined without regard to this paragraph (b)(2));

(ii) Is not directly or indirectly established or maintained in whole or in part by one or more—

(A) Employers;

(B) Governments or agencies or instrumentalities thereof; or

(C) Government controlled entities;

(iii) Is funded by membership dues from members of the labor organization described in this paragraph (b)(2) and earnings thereon; and

(iv) Has not at any time after September 2, 1974 (the date of enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 88 Stat. 829) provided for, permitted or accepted employer contributions.

(3) *Example.* The principles of this paragraph (b) are illustrated by the following example:

*Example.* Trust A is organized in accordance with a collective bargaining agreement between labor union K and multiple employers. Trust A forms part of a plan that is established and maintained pursuant to the agreement and which covers employees of the signatory employers who are members of K. Representatives of both the employers and K serve as trustees. A receives contributions from the employers who are subject to the agreement. Retirement benefits paid to K's members as specified in the agreement are funded exclusively by the employers' contributions and accumulated earnings. A also provides information to union members about their retirement benefits and assists them with administrative tasks associated with the benefits. Most of A's activities are devoted to these functions. From time to time, A also participates in the renegotiation of the collective bargaining agreement. A's principal activity is to receive, hold, invest, disburse, or otherwise manage funds associated with a retirement savings plan. In addition, A does not satisfy all the requirements of the exception described in paragraph (b)(2) of this section. (For example, A accepts contributions from employers.) Therefore, A is not a labor organization described in section 501(c)(5).

(c) Organizations described in section 501(c)(5) and otherwise exempt from tax under section 501(a) are taxable upon their unrelated business taxable income. See part II (section 511 and fol-

lowing), subchapter F, chapter 1 of the Code, and the regulations thereunder.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8726, 62 FR 40449, July 29, 1997]

### § 1.501(c)(6)-1 Business leagues, chambers of commerce, real estate boards, and boards of trade.

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax. Organizations otherwise exempt from tax under this section are taxable upon their unrelated business taxable income. See part II (section 511 and following), subchapter F, chapter 1 of the Code, and the regulations thereunder.

### § 1.501(c)(7)-1 Social clubs.

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and

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recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

**§ 1.501(c)(8)-1 Fraternal beneficiary societies.**

(a) A fraternal beneficiary society is exempt from tax only if operated under the *lodge system* or for the exclusive benefit of the members so operating. *Operating under the lodge system* means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7061, 35 FR 14770, Sept. 23, 1970]

**§ 1.501(c)(9)-1 Voluntary employees' beneficiary associations, in general.**

To be described in section 501(c)(9) an organization must meet all of the following requirements:

(a) The organization is an employees' association,

(b) Membership in the association is voluntary,

(c) The organization provides for the payment of life, sick, accident, or other benefits to its members or their

dependents or designated beneficiaries, and substantially all of its operations are in furtherance of providing such benefits, and

(d) No part of the net earnings of the organization inures, other than by payment of the benefits referred to in paragraph (c) of this section, to the benefit of any private shareholder or individual.

[T.D. 7750, 45 FR 1721, Jan. 7, 1981]

**§ 1.501(c)(9)-2 Membership in a voluntary employees' beneficiary association; employees; voluntary association of employees.**

(a) *Membership*—(1) *In general.* The membership of an organization described in section 501(c)(9) must consist of individuals who become entitled to participate by reason of their being employees and whose eligibility for membership is defined by reference to objective standards that constitute an employment-related common bond among such individuals. Typically, those eligible for membership in an organization described in section 501(c)(9) are defined by reference to a common employer (or affiliated employers), to coverage under one or more collective bargaining agreements (with respect to benefits provided by reason of such agreement(s)), to membership in a labor union, or to membership in one or more locals of a national or international labor union. For example, membership in an association might be open to all employees of a particular employer, or to employees in specified job classifications working for certain employers at specified locations and who are entitled to benefits by reason of one or more collective bargaining agreements. In addition, employees of one or more employers engaged in the same line of business in the same geographic locale will be considered to share an employment-related bond for purposes of an organization through which their employers provide benefits. Employees of a labor union also will be considered to share an employment-related common bond with members of the union, and employees of an association will be considered to share an employment-related common bond with members of the association. Whether a



group of individuals is defined by reference to a permissible standard or standards is a question to be determined with regard to all the facts and circumstances, taking into account the guidelines set forth in this paragraph. Exemption will not be denied merely because the membership of an association includes some individuals who are not employees (within the meaning of paragraph (b) of this section), provided that such individuals share an employment-related bond with the employee-members. Such individuals may include, for example, the proprietor of a business whose employees are members of the association. For purposes of the preceding two sentences, an association will be considered to be composed of employees if 90 percent of the total membership of the association on one day of each quarter of the association's taxable year consists of employees (within the meaning of paragraph (b) of this section).

(2) *Restrictions*—(i) *In general*. Eligibility for membership may be restricted by geographic proximity, or by objective conditions or limitations reasonably related to employment, such as a limitation to a reasonable classification of workers, a limitation based on a reasonable minimum period of service, a limitation based on maximum compensation, or a requirement that a member be employed on a full-time basis. Similarly, eligibility for benefits may be restricted by objective conditions relating to the type or amount of benefits offered. Any objective criteria used to restrict eligibility for membership or benefits may not, however, be selected or administered in a manner that limits membership or benefits to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Similarly, eligibility for benefits may not be subject to conditions or limitations that have the effect of entitling officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association to benefits that are disproportionate in relation to benefits to which other members of the association are entitled. See § 1.501(c)(9)-4(b). Whether the selection

or administration of objective conditions has the effect of providing disproportionate benefits to officers, shareholders, or highly compensated employees generally is to be determined on the basis of all the facts and circumstances.

(ii) *Generally permissible restrictions or conditions*. In general the following restrictions will not be considered to be inconsistent with § 1.501(c)(9)-2(a)(2)(i) or § 1.501(c)(9)-4(b):

(A) In the case of an employer-funded organization, a provision that excludes or has the effect of excluding from membership in the organization or participation in a particular benefit plan employees who are members of another organization or covered by a different plan, funded or contributed to by the employer, to the extent that such other organization or plan offers similar benefits on comparable terms to the excluded employees.

(B) In the case of an employer funded-organization, a provision that excludes from membership, or limits the type or amount of benefits provided to, individuals who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that the benefit or benefits provided by the organization were the subject of good faith bargaining between such employee representatives and such employer or employers.

(C) Restrictions or conditions on eligibility for membership or benefits that are determined through collective bargaining, by trustees designated pursuant to a collective bargaining agreement, or by the collective bargaining agents of the members of an association or trustees named by such agent or agents.

(D) The allowance of benefits only on condition that a member or recipient contribute to the cost of such benefits, or the allowance of different benefits based solely on differences in contributions, provided that those making equal contributions are entitled to comparable benefits.

(E) A requirement that a member (or a member's dependents) meet a reasonable health standard related to eligibility for a particular benefit.

(F) The provision of life benefits in amounts that are a uniform percentage of the compensation received by the individual whose life is covered.

(G) The provision of benefits in the nature of wage replacement in the event of disability in amounts that are a uniform percentage of the compensation of the covered individuals (either before or after taking into account any disability benefits provided through social security or any similar plan providing for wage replacement in the event of disability).

(3) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example 1.* Pursuant to a collective bargaining agreement entered into by X Corporation and W, a labor union which represents all of X Corporation's hourly-paid employees, the X Corporation Union Benefit Plan is established to provide life insurance benefits to employees of X represented by W. The Plan is funded by contributions from X, and is jointly administered by X and W. In order to provide its non-unionized employees with comparable life insurance benefits, X also establishes and funds the X Corporation Life Insurance Trust. The Trust will not be ineligible for exemption as an organization described in section 501(c)(9) solely because membership is restricted to those employees of X who are not members of W.

*Example 2.* The facts are the same as in Example 1 except that the life insurance benefit provided to the non-unionized employees of X differs from the life insurance benefit provided to the unionized employees of X pursuant to the collective bargaining agreement. The trust will not be ineligible for exemption as an organization described in section 501(c)(9) solely because the life insurance benefit provided to X's nonunionized employees is not same as the life insurance benefit provided to X's unionized employees.

*Example 3.* S corporation established a plan to provide health benefits to all its employees. In accordance with the provisions of the plan each employee may secure insurance coverage by making an election under which the employee agrees to contribute periodically to the plan an amount which is determined solely by whether the employee elects a high option coverage or a low option coverage and on whether the employee is unmarried or has a family. As an alternative, the employee may elect high or low options, self only or self and family, coverage

through a local prepaid group medical plan. The contributions required of those electing the prepaid group medical plan also vary with the type of coverage selected, and differ from those required of employees electing insurance. The difference between the amount contributed by employees electing the various coverages and the actual cost of purchasing the coverage is made up through contributions by S to the plan, and under the plan, S provides approximately the same proportion of the cost for each coverage. To fund the plan, S established an arrangement in the nature of a trust under applicable local law and contributes all employee contributions, and all amounts which by the terms of the plan it is required to contribute, to the trust. The terms of the plan do not provide for disproportionate benefits to the employees of S and will not be considered inconsistent with § 1.501(c)(9)-2(a)(2)(i).

*Example 4.* The facts are the same as in Example 3 except that, for those employees or former employees covered by Medicare, the plan provides a distinct coverage which supplements Medicare benefits. Eligibility for Medicare is an objective condition relating to a type of benefit offered, and the provision of separate coverage for those eligible for Medicare will not be considered inconsistent with § 1.501(c)(9)-2(a)(2)(i).

(b) *Meaning of employee.* Whether an individual is an *employee* is determined by reference to the legal and bona fide relationship of employer and employee. The term *employee* includes the following:

(1) An individual who is considered an employee:

(i) For employment tax purposes under subtitle C of the Internal Revenue Code and the regulations thereunder, or

(ii) For purposes of a collective bargaining agreement,

whether or not the individual could qualify as an employee under applicable common law rules. This would include any person who is considered an employee for purposes of the Labor Management Relations Act of 1947, 61 Stat. 136, *as amended*, 29 U.S.C. 141 (1979).

(2) An individual who became entitled to membership in the association by reason of being or having been an employee. Thus, an individual who would otherwise qualify under this paragraph will continue to qualify as an employee even though such individual is on leave of absence, works temporarily for another employer or as

an independent contractor, or has been terminated by reason of retirement, disability or layoff. For example, an individual who in the normal course of employment is employed intermittently by more than one employer in an industry characterized by short-term employment by several different employers will not, by reason of temporary unemployment, cease to be an employee within the meaning of this paragraph.

(3) The surviving spouse and dependents of an employee (if, for purposes of the 90-percent test of § 1.501(c)(9)-2(a)(1) they are considered to be members of the association).

(c) *Description of voluntary association of employees*—(1) *Association*. To be described in section 501(c)(9) and this section there must be an entity, such as a corporation or trust established under applicable local law, having an existence independent of the member-employees or their employer.

(2) *Voluntary*. Generally, membership in an association is voluntary if an affirmative act is required on the part of an employee to become a member rather than the designation as a member due to employee status. However, an association shall be considered voluntary although membership is required of all employees, provided that the employees do not incur a detriment (for example, in the form of deductions from pay) as the result of membership in the association. An employer is not deemed to have imposed involuntary membership on the employee if membership is required as the result of a collective bargaining agreement or as an incident of membership in a labor organization.

(3) *Of employees*. To be described in this section, an organization must be controlled—

- (i) By its membership,
- (ii) By independent trustee(s) (such as a bank), or
- (iii) By trustees or other fiduciaries at least some of whom are designated by, or on behalf of, the membership. Whether control by or on behalf of the membership exists is a question to be determined with regard to all of the facts and circumstances, but generally such control will be deemed to be present when the membership (either

directly or through its representative) elects, appoints or otherwise designates a person or persons to serve as chief operating officer(s), administrator(s), or trustee(s) of the organization. For purposes of this paragraph an organization will be considered to be controlled by independent trustees if it is an *employee welfare benefit plan*, as defined in section 3(1) of the Employee Retirement Income Security Act of 1974 (ERISA), and, as such, is subject to the requirements of parts 1 and 4 of subtitle B, title I of ERISA. Similarly, a plan will be considered to be controlled by its membership if it is controlled by one or more trustees designated pursuant to a collective bargaining agreement (whether or not the bargaining agent of the represented employees bargained for and obtained the right to participate in selecting the trustees).

(4) *Examples*. The provisions of this section may be illustrated by the following examples:

*Example 1*. X, a labor union, represents all the hourly-paid employees of Y Corporation. A health insurance benefit plan was established by X and Y as the result of a collective bargaining agreement entered into by them. The plan established the terms and conditions of membership in, and the benefits to be provided by, the plan. In accordance with the terms of the agreement, Y Corporation is obligated to establish a trust fund and make contributions thereto at specified rates. The trustees, some of whom are designated by X and some by Y, are authorized to hold and invest the assets of the trust and to make payments on instructions issued by Y Corporation in accordance with the conditions contained in the plan. The interdependent benefit plan agreement and trust indenture together create a voluntary employees' beneficiary association over which the employees possess the requisite control through the trustees designated by their representative, X.

*Example 2*. Z Corporation unilaterally established an educational benefit plan for its employees. The purpose of the plan is to provide payments for job-related educational or training courses, such as apprenticeship training programs, for Z Corporation employees, according to objective criteria set forth in the plan. Z establishes a separate bank account which it uses to fund payments to the plan. Contributions to the account are to be made at the discretion of and solely by Z Corporation, which also administers the plan and retains control over the assets in the fund. Z Corporation's educational benefit

plan and the related account do not constitute an association having an existence independent of Z Corporation and therefore do not constitute a voluntary employees' beneficiary association.

*Example 3.* A, an individual, is the incorporator and chief operating officer of Lawyers' Beneficiary Association (LBA). LBA is engaged in the business of providing medical benefits to members of the Association and their families. Membership is open only to practicing lawyers located in a particular metropolitan area who are neither self-employed nor partners in a law firm. Membership in LBA is solicited by insurance agents under the control of X Corporation (owned by A) which, by contract with LBA, is the exclusive sales agent. Medical benefits are paid from a trust account containing periodic contributions paid by the members, together with proceeds from the investment of those contributions. Contribution and benefit levels are set by LBA. The members of LBA do not hold meetings, have no right to elect officers or directors of the Association, and no right to replace trustees. Collectively, the subscribers for medical benefits from LBA cannot be said to control the association and membership is neither more than nor different from the purchase of an insurance policy from a stock insurance company. LBA is not a voluntary employees' beneficiary association.

*Example 4.* U corporation unilaterally established a plan to provide benefits to its employees. In accordance with the provisions of the plan, each employee may secure insurance or benefit coverage by making an election under which the employee agrees to contribute to the plan an amount which is determined solely by whether the employee elects a high option coverage or a low option coverage and on whether the employee elects self only or self and family coverage. The difference between the amount contributed by employees electing the various coverages and the actual cost of the coverage is made up through contributions by U to the plan. To fund the plan, U established an arrangement in the nature of a trust under applicable local law and contributed all employee contributions, and all amounts which by the term of the plan it was required to provide to the plan, to the trust. The trust constitutes an *employee welfare benefit plan* within the meaning of, and subject to relevant requirements of, ERISA. It will be considered to meet the requirements of § 1.501(c)(9)-2(c)(3).

[T.D. 7750, 46 FR 1723, Jan. 7, 1981]

**§ 1.501(c)(9)-3 Voluntary employees' beneficiary associations; life, sick, accident, or other benefits.**

(a) *In general.* The life, sick, accident, or other benefits provided by a vol-

untary employees' beneficiary association must be payable to its members, their dependents, or their designated beneficiaries. For purposes of section 501(c)(9), *dependent* means the member's spouse; any child of the member or the member's spouse who is a minor or a student (within the meaning of section 151(e)(4)); any other minor child residing with the member; and any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in section 152(a). Life, sick, accident, or other benefits may take the form of cash or noncash benefits. A voluntary employees' beneficiary association is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. Further, an organization is not described in this section if it systematically and knowingly provides benefits (of more than a *de minimis* amount) that are not permitted by paragraphs (b), (c), (d), or (e) of this section.

(b) *Life benefits.* The term *life benefits* means a benefit (including a burial benefit or a wreath) payable by reason of the death of a member or dependent. A *life benefit* may be provided directly or through insurance. It generally must consist of current protection, but also may include a right to convert to individual coverage on termination of eligibility for coverage through the association, or a permanent benefit as defined in, and subject to the conditions in, the regulations under section 79. A *life benefit* also includes the benefit provided under any life insurance contract purchased directly from an employee-funded association by a member or provided by such an association to a member. The term *life benefit* does not include a pension, annuity or similar benefit, except that a benefit payable by reason of the death of an insured may be settled in the form of an annuity to the beneficiary in lieu of a lump-sum death benefit (whether or not the contract provides for settlement in a lump sum).

(c) *Sick and accident benefits.* The term *sick and accident benefits* means amounts furnished to or on behalf of a member or a member's dependents in

the event of illness or personal injury to a member or dependent. Such benefits may be provided through reimbursement to a member or a member's dependents for amounts expended because of illness or personal injury, or through the payment of premiums to a medical benefit or health insurance program. Similarly, a sick and accident benefit includes an amount paid to a member in lieu of income during a period in which the member is unable to work due to sickness or injury. Sick benefits also include benefits designed to safeguard or improve the health of members and their dependents. Sick and accident benefits may be provided directly by an association to or on behalf of members and their dependents, or may be provided indirectly by an association through the payment of premiums or fees to an insurance company, medical clinic, or other program under which members and their dependents are entitled to medical services or to other sick and accident benefits. Sick and accident benefits may also be furnished in noncash form, such as, for example, benefits in the nature of clinical care services by visiting nurses, and transportation furnished for medical care.

(d) *Other benefits.* The term *other benefits* includes only benefits that are similar to life, sick, or accident benefits. A benefit is similar to a life, sick, or accident benefit if:

(1) It is intended to safeguard or improve the health of a member or a member's dependents, or

(2) It protects against a contingency that interrupts or impairs a member's earning power.

(e) *Examples of other benefits.* Paying vacation benefits, providing vacation facilities, reimbursing vacation expenses, and subsidizing recreational activities such as athletic leagues are considered *other benefits*. The provision of child-care facilities for preschool and school-age dependents are also considered *other benefits*. The provision of job readjustment allowances, income maintenance payments in the event of economic dislocation, temporary living expense loans and grants at times of disaster (such as fire or flood), supplemental unemployment compensation benefits (as defined in section

501(c)(17)(D)(i) of the Code), severance benefits (under a severance pay plan within the meaning of 29 CFR 2510.3-2(b)) and education or training benefits or courses (such as apprentice training programs) for members, are considered *other benefits* because they protect against a contingency that interrupts earning power. Personal legal service benefits which consist of payments or credits to one or more organizations or trusts described in section 501(c)(20) are considered *other benefits*. Except to the extent otherwise provided in these regulations, as amended from time to time, *other benefits* also include any benefit provided in the manner permitted by paragraphs (5) *et seq.* of section 302(c) of the Labor Management Relations Act of 1947, 61 Stat. 136, as amended, 29 U.S.C. 186(c) (1979).

(f) *Examples of nonqualifying benefits.* Benefits that are not described in paragraphs (d) or (e) of this section are not *other benefits*. Thus, *other benefits* do not include the payment of commuting expenses, such as bridge tolls or train fares, the provision of accident or homeowner's insurance benefits for damage to property, the provision of malpractice insurance, or the provision of loans to members except in times of distress (as permitted by §1.501(c)(9)-3(e)). *Other benefits* also do not include the provision of savings facilities for members. The term *other benefits* does not include any benefit that is similar to a pension or annuity payable at the time of mandatory or voluntary retirement, or a benefit that is similar to the benefit provided under a stock bonus or profit-sharing plan. For purposes of section 501(c)(9) and these regulations, a benefit will be considered similar to that provided under a pension, annuity, stock bonus or profit-sharing plan if it provides for deferred compensation that becomes payable by reason of the passage of time, rather than as the result of an unanticipated event. Thus, for example, supplemental unemployment benefits, which generally become payable by reason of unanticipated lay-off, are not, for purposes of these regulations, considered similar to the benefit provided under a pension, annuity, stock bonus or profit-sharing plan.

(g) *Examples.* The provisions of this section may be further illustrated by the following examples:

*Example 1.* V was organized in connection with a vacation plan created pursuant to a collective bargaining agreement between M, a labor union, which represents certain hourly paid employees of T corporation, and T. The agreement calls for the payment by T to V of a specified sum per hour worked by T employees who are covered by the collective bargaining agreement. T includes the amounts in the covered employees' wages and withholds income and FICA taxes. The amounts are paid by T to V to provide vacation benefits provided under the collective bargaining agreement. Generally, each covered employee receives a check in payment of his or her vacation benefit during the year following the year in which contributions were made by T to V. The amount of the vacation benefit is determined by reference to the contributions during the prior year to V by T on behalf of each employee, and is distributed in cash to each such employee. If the earnings on investments by V during the year preceding distribution are sufficient after deducting the expenses of administering the plan, each recipient of a vacation benefit is paid an amount, in addition to the contributions on his or her behalf, equal to his/her ratable share of the net earnings of V during such year. The plan provides a vacation benefit that constitutes an eligible *other benefit* described in section 501(c)(9) and § 1.501(c)(9)-3(e).

*Example 2.* The facts are the same as in Example 1, except that each covered employee of T is entitled, at his or her discretion, to contribute up to an additional \$1,000 each year to V, which agrees in respect of such sum to pay interest at a stated rate from the time of contribution until the time at which the contributing employee's vacation benefit is distributed. In addition, each employee may elect to leave all or a portion of his/her distributable benefit on deposit past the time of distribution, in which case interest will continue to accrue. Because the plan more closely resembles a savings arrangement than a vacation plan, the benefit payable to the covered employees of T is not a *vacation benefit* and is not an eligible *other benefit* described in section 501(c)(9) and § 1.501(c)(9)-3 (d) or (e).

[T.D. 7750, 46 FR 1724, Jan. 7, 1981]

**§ 1.501(c)(9)-4 Voluntary employees' beneficiary associations; inurement.**

(a) *General rule.* No part of the net earnings of an employees' association may inure to the benefit of any private shareholder or individual other than through the payment of benefits per-

mitted by § 1.501(c)(9)-3. The disposition of property to, or the performance of services for, a person for less than the greater of fair market value or cost (including indirect costs) to the association, other than as a life, sick, accident or other permissible benefit, constitutes prohibited inurement. Generally, the payment of unreasonable compensation to the trustees or employees of the association, or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest, will constitute prohibited inurement. Whether prohibited inurement has occurred is a question to be determined with regard to all of the facts and circumstances, taking into account the guidelines set forth in this section. The guidelines and examples contained in this section are not an exhaustive list of the activities that may constitute prohibited inurement, or the persons to whom the association's earnings could impermissibly inure. See § 1.501(a)-1(c).

(b) *Disproportionate benefits.* For purposes of subsection (a), the payment to any member of disproportionate benefits, where such payment is not pursuant to objective and nondiscriminatory standards, will not be considered a benefit within the meaning of § 1.501(c)(9)-3 even though the benefit otherwise is one of the type permitted by that section. For example, the payment to highly compensated personnel of benefits that are disproportionate in relation to benefits received by other members of the association will constitute prohibited inurement. Also, the payment to similarly situated employees of benefits that differ in kind or amount will constitute prohibited inurement unless the difference can be justified on the basis of objective and reasonable standards adopted by the association or on the basis of standards adopted pursuant to the terms of a collective bargaining agreement. In general, benefits paid pursuant to standards or subject to conditions that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees will not be considered disproportionate. See § 1.501(c)(9)-2(a) (2) and (3).

(c) *Rebates.* The rebate of excess insurance premiums, based on the mortality or morbidity experience of the insurer to which the premiums were paid, to the person or persons whose contributions were applied to such premiums, does not constitute prohibited inurement. A voluntary employees' beneficiary association may also make administrative adjustments strictly incidental to the provision of benefits to its members.

(d) *Termination of plan or dissolution of association.* It will not constitute prohibited inurement if, on termination of a plan established by an employer and funded through an association described in section 501(c)(9), any assets remaining in the association, after satisfaction of all liabilities to existing beneficiaries of the plan, are applied to provide, either directly or through the purchase of insurance, life, sick, accident or other benefits within the meaning of § 1.501(c)(9)-3 pursuant to criteria that do not provide for disproportionate benefits to officers, shareholders, or highly compensated employees of the employer. See § 1.501(c)(9)-2(a)(2). Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement if the amount distributed to members are determined pursuant to the terms of a collective bargaining agreement or on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association. Except as otherwise provided in the first sentence of this paragraph, if the association's corporate charter, articles of association, trust instrument, or other written instrument by which the association was created, as amended from time to time, provides that on dissolution its assets will be distributed to its members' contributing employers, or if in the absence of such provision the law of the state in which the association was created provides for such distribution to the contributing employers, the association is not described in section 501(c)(9).

(e) *Example.* The provisions of this section may be illustrated by the following example:

*Example.* Employees A, B and C, members of the X voluntary employees' beneficiary association, are unemployed. They receive unemployment benefits from X. Those to A include an amount in addition to those provided to B and C, to provide for A's retraining. B has been found pursuant to objective and reasonable standards not to qualify for the retraining program. C, although eligible for retraining benefits has declined. X's additional payment to A for retraining does not constitute prohibited inurement.

[T.D. 7750, 46 FR 1725, Jan. 7, 1981]

**§ 1.501(c)(9)-5 Voluntary employees' beneficiary associations; record-keeping requirements.**

(a) *Records.* In addition to such other records which may be required (for example, by section 512(a)(3) and the regulations thereunder), every organization described in section 501(c)(9) must maintain records indicating the amount contributed by each member and contributing employer, and the amount and type of benefits paid by the organization to or on behalf of each member.

(b) *Cross reference.* For provisions relating to annual information returns with respect to payments, see section 6041 and the regulations thereunder.

[T.D. 7750, 46 FR 1725, Jan. 7, 1981]

**§ 1.501(c)(9)-6 Voluntary employees' beneficiary associations; benefits includible in gross income.**

(a) *In general.* Cash and noncash benefits realized by a person on account of the activities of an organization described in section 501(c)(9) shall be included in gross income to the extent provided in the Internal Revenue Code of 1954, including, but not limited to, sections 61, 72, 101, 104 and 105 of the Code and regulations thereunder.

(b) *Availability of statutory exclusions from gross income.* The availability of any statutory exclusion from gross income with respect to contributions to, or the payment of benefits from, an organization described in section 501(c)(9) is determined by the statutory provision conferring the exclusion, and the regulations and rulings thereunder, not by whether an individual is eligible for

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membership in the organization or by the permissibility of the benefit paid. Thus, for example, if a benefit is paid by an employer-funded organization described in section 501(c)(9) to a member who is not an *employee*, a statutory exclusion from gross income that is available only for *employees* would be unavailable in the case of a benefit paid to such individual. Similarly, the fact that, for example, under some circumstances educational benefits constitute *other benefits* does not of itself mean that such benefits are eligible for the exclusion of either section 117 or section 127 of the Code.

[T.D. 7750, 46 FR 1725, Jan. 7, 1981]

**§ 1.501(c)(9)-7 Voluntary employees' beneficiary associations; section 3(4) of ERISA.**

The term *voluntary employees' beneficiary association* in section 501(c)(9) of the Internal Revenue Code is not necessarily coextensive with the term *employees' beneficiary association* as used in section 3(4) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1002(4), and the requirements which an organization must meet to be an *employees' beneficiary association* within the meaning of section 3(4) of ERISA are not necessarily identical to the requirements that an organization must meet in order to be a *voluntary employees' beneficiary association* within the meaning of section 501(c)(9) of the Code.

[T.D. 7750, 46 FR 1725, Jan. 7, 1981]

**§ 1.501(c)(9)-8 Voluntary employees' beneficiary associations; effective date.**

(a) *General rule.* Except as otherwise provided in this section, the provisions of §§ 1.501(c)(9)-1 through 1.501(c)(9)-7 shall apply with respect to taxable years beginning after December 31, 1954.

(b) *Pre-1970 taxable years.* For taxable years beginning before January 1, 1970, section 501(c)(9)(B) (relating to the requirement that 85 percent or more of the association's income consist of amounts collected from members and contributed by employers), as in effect for such years, shall apply.

(c) *Existing associations.* Except as otherwise provided in paragraph (d),

the provisions of § 1.501(c)(9)-2(a)(1) and (c)(3) shall apply with respect to taxable years beginning after December 31, 1980.

(d) *Collectively-bargained plans.* In the case of a voluntary employees' beneficiary association which receives contributions from one or more employers pursuant to one or more collective bargaining agreements in effect on December 31, 1980, the provisions of §§ 1.501(c)(9)-1 through 1.501(c)(9)-5 shall apply with respect to taxable years beginning after the date on which the agreement terminates (determined without regard to any extension thereof agreed to after December 31, 1980).

(e) *Election.* Notwithstanding paragraphs (c) and (d) of this section, an organization may choose to be subject to all or a portion of one or more of the provisions of these regulations for any taxable year beginning after December 31, 1954.

[T.D. 7750, 46 FR 1725, Jan. 7, 1981; 46 FR 11971, Feb. 12, 1981]

**§ 1.501(c)(10)-1 Certain fraternal beneficiary societies.**

(a) For taxable years beginning after December 31, 1969, an organization will qualify for exemption under section 501(c)(10) if it:

(1) Is a domestic fraternal beneficiary society order, or association, described in section 501(c)(8) and the regulations thereunder except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and

(2) Devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes

Any organization described in section 501(c)(7), such as, for example, a national college fraternity, is not described in section 501(c)(10) and this section.

[T.D. 7172, 37 FR 5618, Mar. 17, 1972]

**§ 1.501(c)(12)-1 Local benevolent life insurance associations, mutual irrigation and telephone companies, and like organizations.**

(a) An organization described in section 501(c)(12) must receive at least 85 percent of its income from amounts



collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 percent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

(b) The phrase of a *purely local character* applies to benevolent life insurance associations, and not to the other organizations specified in section 501(c)(12). It also applies to any organization seeking exemption on the ground that it is an organization similar to a benevolent life insurance association. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions. If the activities of an organization are limited only by the borders of a State it cannot be considered to be purely local in character.

(c) For taxable years of a mutual or cooperative telephone company beginning after December 31, 1974, the 85 percent member-income test described in paragraph (a) of this section is applied without taking into account income received or accrued from another telephone company for the performance of communication services involving the completion of long distance calls to, from, or between members of the mutual or cooperative telephone company. For example, if, in one year, a cooperative telephone company receives \$85x from its members for telephone calls, \$15x as interest income, and \$20x as credits under long distance interconnection agreements with other telephone companies for the performance of communication services involving the completion of long distance calls to, from, or between the cooperative's members (whether or not the credits may be offset, in whole or in

part, by amounts due the other companies under the interconnection agreements), the member-income fraction is calculated without taking into account, either in the numerator or denominator, the \$20x credits received from the other telephone companies. In this example, the 85 percent member-income test is satisfied because at least 85 percent

$$\frac{\text{member income}}{\text{total income}} = \frac{85x}{85x + 15x} = \frac{85}{100} = 85\%$$

of the cooperative's total income is derived from member income.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended at 44 FR 59523, Oct. 16, 1979]

#### § 1.501(c)(13)-1 Cemetery companies and crematoria.

(a) *Nonprofit mutual cemetery companies.* A nonprofit cemetery company may be entitled to exemption if it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for the purpose of resale. A mutual cemetery company which also engages in charitable activities, such as burial of paupers, will be regarded as operating in conformity with this standard. Further, the fact that a mutual cemetery company limits its membership to a particular class of individuals, such as members of a family, will not affect its status as mutual so long as all the other requirements of section 501(c)(13) are met.

(b) *Nonprofit cemetery companies and crematoria.* Any nonprofit corporation, chartered solely for the purpose of the burial, or (for taxable years beginning after December 31, 1970) the cremation of bodies, and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

(c) *Preferred stock*—(1) *In general.* Except as provided in subparagraph (3) of this paragraph, a cemetery company or crematorium is not described in section 501(c)(13) if it issues preferred stock on or after November 28, 1978.

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(2) *Transitional rule for preferred stock issued prior to November 28, 1978.* In the case of preferred stock issued prior to November 28, 1978, a cemetery company or crematorium which issued such stock shall not fail to be exempt from income tax solely because it issued preferred stock which entitled the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, if its articles of incorporation require:

(i) That the preferred stock be retired at par as rapidly as funds therefor become available from operations, and

(ii) That all funds not required for the payment of dividends upon or for the retirement of preferred stock be used by the company for the care and improvement of the cemetery property. The term *legal rate of interest* shall mean the rate of interest prescribed by law in the State of incorporation which prevails in the absence of an agreement between contracting parties fixing a rate.

(3) *Transitional rule for preferred stock issued on or after November 28, 1978.* In the case of preferred stock issued on or after November 28, 1978, a cemetery company or crematorium shall not fail to be exempt from income tax if its articles of incorporation and the preferred stock meet the requirements of paragraph (c)(2) and if such stock is issued pursuant to a plan which has been reduced to writing and adopted prior to November 28, 1978. The adoption of the plan must be shown by the acts of the duly constituted responsible officers and appear upon the official records of the cemetery company or crematorium.

(d) *Sales to exempt cemetery companies and crematoria.* Except as provided in paragraph (c)(2) or (c)(3) of this section (relating to transitional rules for preferred stock), no person may have any interest in the net earnings of a tax-exempt cemetery company or crematorium. Thus, a cemetery company or crematorium is not exempt from tax if property is transferred to such organization in exchange for an interest in the net earnings of the organization so long as such interest remains out-

standing. An interest in a cemetery company or crematorium that constitutes an equity interest within the meaning of section 385 will be considered an interest in the net earnings of the cemetery. However, an interest in a cemetery company or crematorium that does not constitute an equity interest within the meaning of section 385 may nevertheless constitute an interest in the net earnings of the organization. Thus, for example, a bond or other evidence of indebtedness issued by a cemetery company or crematorium which provides for a fixed rate of interest but which, in addition, provides for additional interest payments contingent upon the revenues or income of the organization is considered an interest in the net earnings of the organization. Similarly, a convertible debt obligation issued by a cemetery company or crematorium after July 7, 1975, is considered an interest in the net earnings of the organization.

[T.D. 7698, 45 FR 33972, May 21, 1980]

**§ 1.501(c)(14)-1 Credit unions and mutual insurance funds.**

Credit unions (other than Federal credit unions described in section 501(c)(1)) without capital stock, organized and operated for mutual purposes and without profit, are exempt from tax under section 501(a). Corporations or associations without capital stock organized before September 1, 1951 and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of, shares or deposits in:

(a) Domestic building and loan associations as defined in section 7701(a)(19).

(b) Cooperative banks without capital stock organized and operated for mutual purposes and without profit, or

(c) Mutual savings banks not having capital stock represented by shares

are also exempt from tax under section 501(a). In addition, corporations or associations of the type described in the preceding sentence which were organized on or after September 1, 1951, but before September 1, 1957, are exempt

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from tax under section 501(a) for taxable years beginning after December 31, 1959.

[T.D. 6493, 25 FR 9219, Sept. 27, 1960]

**§ 1.501(c)(15)-1 Mutual insurance companies or associations.**

(a) *Taxable years beginning after December 31, 1962.* An insurance company or association described in section 501(c)(15) is exempt under section 501(a) if it is a mutual company or association (other than life or marine) or if it is a mutual interinsurer or reciprocal underwriter (other than life or marine) and if the gross amount received during the taxable year from the sum of the following items does not exceed \$150,000:

(1) The gross amount of income during the taxable year from:

(i) Interest (including tax-exempt interest and partially tax-exempt interest), as described in §1.61-7. Interest shall be adjusted for amortization of premium and accrual of discount in accordance with the rules prescribed in section 822(d)(2) and the regulations thereunder.

(ii) Dividends, as described in §1.61-9.

(iii) Rents and royalties, as described in §1.61-8.

(iv) The entering into of any lease, mortgage, or other instrument or agreement from which the company may derive interest, rents, or royalties.

(v) The alteration or termination of any instrument or agreement described in subdivision (iv) of this subparagraph.

(2) The gross income from any trade or business (other than an insurance business) carried on by the company or association, or by a partnership of which the company or association is a partner.

(3) Premiums (including deposits and assessments).

(b) *Taxable years beginning after December 31, 1954, and before January 1, 1963.* An insurance company or association described in section 501(c)(15) and paragraph (a) of this section is exempt under section 501(a) if the gross amount received during the taxable year from the sum of the items described in paragraph (a) (1), (2), and (3) of this section does not exceed \$75,000.

(c) *No double inclusion of income.* In computing the gross income from any trade or business (other than an insurance business) carried on by the company or association, or by a partnership of which the company or association is a partner, any item described in section 822(b)(1) (A), (B), or (C) and paragraph (a)(1) of this section shall not be considered as gross income arising from the conduct of such trade or business, but shall be taken into account under section 822(b)(1) (A), (B), or (C) and paragraph (a)(1) of this section.

(d) *Taxable years beginning after December 31, 1953, and before January 1, 1955.* An insurance company or association described in section 501(c)(15) is exempt under section 501(a) if it is a mutual company or association (other than life or marine) or if it is a mutual interinsurer or reciprocal underwriter (other than life or marine) and if the gross amount received during the taxable year from the sum of the following items does not exceed \$75,000:

(1) The gross amount of income during the taxable year from—

(i) Interest (including tax-exempt interest and partially tax-exempt interest), as described in §1.61-7. Interest shall be adjusted for amortization of premium and accrual of discount in accordance with the rules prescribed in section 822(d)(2) and §1.822-3.

(ii) Dividends, as described in §1.61-9.

(iii) Rents (but excluding royalties), as described in §1.61-8.

(2) Premiums (including deposits and assessments).

(e) *Exclusion of capital gains.* Gains from sales or exchanges of capital assets to the extent provided in subchapter P (section 1201 and following, relating to capital gains and losses), chapter 1 of the Code, shall be excluded from the amounts described in this section.

[T.D. 6662, 28 FR 6972, July 29, 1963]

**§ 1.501(c)(16)-1 Corporations organized to finance crop operations.**

A corporation organized by a farmers' cooperative marketing or purchasing association, or the members thereof, for the purpose of financing the ordinary crop operations of such members or other producers is exempt, provided the marketing or purchasing

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association is exempt under section 521 and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of § 1.521-1 relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this section.

#### § 1.501(c)(17)-1 Supplemental unemployment benefit trusts.

(a) *Requirements for qualification.* (1) A supplemental unemployment benefit trust may be exempt as an organization described in section 501(c)(17) if the requirements of subparagraphs (2) through (6) of this paragraph are satisfied.

(2) The trust is a valid, existing trust under local law and is evidenced by an executed written document.

(3) The trust is part of a written plan established and maintained by an employer, his employees, or both the employer and his employees, solely for the purpose of providing supplemental unemployment compensation benefits (as defined in section 501(c)(17)(D) and paragraph (b)(1) of § 1.501(c)(17)-1).

(4) The trust is part of a plan which provides that the corpus and income of the trust cannot (in the taxable year, and at any time thereafter, before the satisfaction of all liabilities to employees covered by the plan) be used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits. Thus, if the plan provides for the payment of any benefits other than supplemental unemployment compensation benefits as defined in paragraph (b) of this section, the trust will not be entitled to exemption as an organization described in section 501(c)(17). However, the payment of any necessary or appropriate expenses in connection with the administration of a plan providing supplemental unemployment compensation benefits shall be considered a payment to provide such benefits and shall not affect the qualification of the trust.

(5) The trust is part of a plan whose eligibility conditions and benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. See

sections 401(a)(3)(B) and 401(a)(4) and §§ 1.401-3 and 1.401(a)(4)-0 through 1.401(a)(4)-13. However, a plan is not discriminatory within the meaning of section 501(c)(17)(A)(iii), relating to the requirement that the benefits paid under the plan be nondiscriminatory, merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan. Accordingly, the benefits provided for highly paid employees may be greater than the benefits provided for lower paid employees if the benefits are determined by reference to their compensation; but, in such a case, the plan will not qualify if the benefits paid to the higher paid employees bear a larger ratio to their compensation than the benefits paid to the lower paid employees bear to their compensation. In addition, section 501(c)(17)(B) sets forth certain other instances in which a plan will not be considered discriminatory (see paragraph (c) of § 1.501(c)(17)-2).

(6) The trust is part of a plan which requires that benefits are to be determined according to objective standards. Thus, a plan may provide similarly situated employees with benefits which differ in kind and amount, but may not permit such benefits to be determined solely in the discretion of the trustees.

(b) *Meaning of terms.* The following terms are defined for purposes of section 501(c)(17):

(1) *Supplemental unemployment compensation benefits.* The term *supplemental unemployment compensation benefits* means only:

(i) Benefits paid to an employee because of his involuntary separation from the employment of the employer, whether or not such separation is temporary, but only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions; and

(ii) Sick and accident benefits subordinate to the benefits described in subdivision (i) of this subparagraph.

(2) *Employee.* The term *employee* means an individual whose status is that of an employee under the usual

common-law rules applicable in determining the employer-employee relationship. The term *employee* also includes an individual who qualifies as an *employee* under the State or Federal unemployment compensation law covering his employment, whether or not such an individual could qualify as an employee under such common-law rules.

(3) *Involuntary separation from the employment of the employer.* Whether a separation from the employment of the employer occurs is a question to be decided with regard to all the facts and circumstances. However, for purposes of section 501(c)(17), the term *separation* includes both a temporary separation and a permanent severance of the employment relationship. Thus, for example, an employee may be separated from the employment of his employer even though at the time of separation it is believed that he will be reemployed by the same employer. Whether or not an employee is *involuntarily* separated from the employment of the employer is a question of fact. However, normally, an employee will not be deemed to have separated himself voluntarily from the employment of his employer merely because his collective bargaining agreement provides for the termination of his services upon the happening of a condition subsequent and that condition does in fact occur. For example, if the collective bargaining agreement provides that the employer may automate a given department and thereby dislocate several employees, the fact that the employees' collective bargaining agent has consented to such a condition will not render any employee's subsequent unemployment for such cause voluntary.

(4) *Other similar conditions.* Involuntary separation directly resulting from *other similar conditions* includes, for example, involuntary separation from the employment of the employer resulting from cyclical, seasonal, or technological causes. Some causes of involuntary separation from the employment of the employer which are not similar to those enumerated in section 501(c)(17)(D)(i) are separation for disciplinary reasons or separation because of age.

(5) *Subordinate sick and accident benefits.* In general, a sick and accident benefit payment is an amount paid to an employee in the event of his illness or personal injury (whether or not such illness or injury results in the employee's separation from the service of his employer). In addition, the phrase *sick and accident benefits* includes amounts provided under the plan to reimburse an employee for amounts he expends because of the illness or injury of his spouse or a dependent (as defined in section 152). Sick and accident benefits may be paid by a trust described in section 501(c)(17) only if such benefits are subordinate to the separation payments provided under the plan of which the trust forms a part. Whether the sick and accident benefits provided under a supplemental unemployment compensation benefit plan are subordinate to the separation benefits provided under such plan is a question to be decided with regard to all the facts and circumstances.

[T.D. 6972, 33 FR 12900, Sept. 12, 1968, as amended by T.D. 9849, 84 FR 9235, Mar. 14, 2019]

#### § 1.501(c)(17)-2 General rules.

(a) *Supplemental unemployment compensation benefits.* Supplemental unemployment compensation benefits as defined in section 501(c)(17)(D) and paragraph (b)(1) of § 1.501(c)(17)-1 may be paid in a lump sum or installments. Such benefits may be paid to an employee who has, subsequent to his separation from the employment of the employer, obtained other part-time, temporary, or permanent employment. Furthermore, such payments may be made in cash, services, or property. Thus, supplemental unemployment compensation benefits provided to involuntarily separated employees may include, for example, the following: Furnishing of medical care at an established clinic, furnishing of food, job training and schooling, and job counseling. If such benefits are furnished in services or property, the fair market value of the benefits must satisfy the requirements of section 501(c)(17)(A)(iii), relating to non-discrimination as to benefits. However, supplemental unemployment compensation benefits may be provided

only to an employee and only under circumstances described in paragraph (b)(1) of § 1.501(c)(17)-1. Thus, a trust described in section 501(c)(17) may not provide, for example, for the payment of a death, vacation, or retirement benefit.

(b) *Sick and accident benefits.* If a trust described in section 501(c)(17) provides for the payment of sick and accident benefits, such benefits may only be provided for employees who are eligible for receipt of separation benefits under the plan of which the trust is a part. However, the sick and accident benefits need not be provided for all the employees who are eligible for receipt of separation benefits, so long as the plan does not discriminate in favor of persons with respect to whom discrimination is proscribed in section 501(c)(17)(A) (ii) and (iii). Furthermore, the portion of the plan which provides for the payment of sick and accident benefits must satisfy the nondiscrimination requirements of section 501(c)(17)(A) (ii) and (iii) without regard to the portion of the plan which provides for the payment of benefits because of involuntary separation.

(c) *Correlation with other plans.* (1) In determining whether a plan meets the requirements of section 501(c)(17)(A) (ii) and (iii), any benefits provided under any other plan shall not be taken into consideration except in the particular instances enumerated in section 501(c)(17)(B) (i), (ii), and (iii). In general, these three exceptions permit a plan providing for the payment of supplemental unemployment compensation benefits to satisfy the nondiscrimination requirements in section 501(c)(17)(A) (ii) and (iii) if the plan is able to satisfy such requirements when it is correlated with one or more of the plans described in section 501(c)(17)(B).

(2) Under section 501(c)(17)(B)(i), a plan will not be considered discriminatory merely because the benefits under the plan which are first determined in a nondiscriminatory manner (within the meaning of section 501(c)(17)(A)) are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law, or are reduced by a portion of these benefits if determined in a nondiscriminatory manner. Under this ex-

ception, a plan may, for example, satisfy the requirements of section 501(c)(17)(A)(iii) if it provides for the payment of an unemployment benefit and the amount of such benefit is determined as a percentage of the employee's compensation which is then reduced by any unemployment benefit which the employee receives under a State plan. In addition, a plan could provide for the reduction of such a plan benefit by a percentage of the State benefit. Furthermore, a plan may also satisfy the requirements of section 501(c)(17)(A) if it provides for the payment to an employee of an amount which when added to any State unemployment benefit equals a percentage of the employee's compensation.

(3) Under section 501(c)(17)(B)(ii), a plan will not be considered discriminatory merely because the plan provides benefits only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law. In such a case, however, the benefits provided under the plan seeking to satisfy the requirements of section 501(c)(17) must be the same benefits, or a portion of the same benefits if determined in a nondiscriminatory manner, which such ineligible employees would receive under State or Federal law if they were eligible for such benefits. Under this exception, for example, an employer may establish a plan only for employees who have exhausted their benefits under the State law, and, if the plan provides for such employees the same benefits which they would receive under the State plan, the State plan and the plan of the employer will be considered as one plan in determining whether the requirements relating to nondiscrimination in section 501(c)(17)(A) are satisfied. Furthermore, such a plan could also qualify even though it does not provide all of the benefits provided under the State plan. Thus, a plan could provide for the payment of a reduced amount of the benefits, or for the payment of only certain of the types of benefits, provided by the State plan. For example, if the State plan provides for the payment of sick, accident, and separation benefits, the plan of the employer may provide for

the payment of only separation benefits, or for the payment of an amount equal to only one-half of the State provided benefit. However, if a plan provides benefits for employees who are not eligible to receive the benefits provided under a State plan and such benefits are greater or of a different type than those under the State plan, the plan of the employer must satisfy the requirements of section 501(c)(17)(A) without regard to the benefits and coverage provided by the State plan.

(4) Under section 501(c)(17)(B)(iii), a plan is not considered discriminatory merely because the plan provides benefits only for employees who are not eligible to receive benefits under another plan which satisfies the requirements of section 501(c)(17)(A) and which is funded solely by contributions of the employer. In such a case, the plan seeking to qualify under section 501(c)(17) must provide the same benefits, or a portion of such benefits if determined in a nondiscriminatory manner, as are provided for the employees under the plan funded solely by employer contributions. Furthermore, this exception only applies if the employees eligible to receive benefits under both plans would satisfy the requirements in section 501(c)(17)(A)(ii), relating to nondiscrimination as to coverage. The plan of the employer which is being correlated with the plan seeking to satisfy the requirements of section 501(c)(17) may be a plan which forms part of a voluntary employees' beneficiary association described in section 501(c)(9), if such plan satisfies all the requirements of section 501(c)(17)(A). Under this exception, for example, if an employer has established a plan providing for the payment of supplemental unemployment compensation benefits for his hourly wage employees and such plan satisfies the requirements of section 501(c)(17)(A) (even though the plan forms part of a voluntary employees' beneficiary association described in section 501(c)(9)), the salaried employees of such employee may establish a plan for themselves, and, if such plan provides for the same benefits as the plan covering hourly-wage employees, both plans may be considered as one plan in determining whether the plan covering the

salaried employees satisfies the requirement that is be nondiscriminatory as to coverage. The foregoing example would also be applicable if the benefits provided for the salaried employees were funded solely or in part by employer contributions.

(d) *Permanency of the plan.* A plan providing for the payment of supplemental unemployment compensation benefits contemplates a permanent as distinguished from a temporary program. Thus, although there may be reserved the right to change or terminate the plan, and to discontinue contributions thereunder, the abandonment of the plan for any reason other than business necessity within a few years after it has taken effect will be evidence that the plan from its inception was not a bona fide program for the purpose of providing supplemental unemployment compensation benefits to employees. Whether or not a particular plan constitutes a permanent arrangement will be determined by all of the surrounding facts and circumstances. However, merely because a collective bargaining agreement provides that a plan may be modified at the termination of such agreement, or that particular provisions of the plan are subject to renegotiation during the duration of such agreement, does not necessarily imply that the plan is not a permanent arrangement. Moreover, the fact that the plan provides that the assets remaining in the trust after the satisfaction of all liabilities (including contingent liabilities) under the plan may be returned to the employer does not imply that the plan is not a permanent arrangement nor preclude the trust from qualifying under section 501(c)(17).

(e) *Portions of years.* A plan must satisfy the requirements of section 501(c)(17) throughout the entire taxable year of the trust in order for the trust to be exempt for such year. However, section 501(c)(17)(C) provides that a plan will satisfy the nondiscrimination as to classification requirements of section 501(c)(17)(A) if on at least one day in each quarter of the taxable year of the trust it satisfies such requirements.

(f) *Several trusts constituting one plan.* Several trusts may be designated as

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constituting part of one plan which is intended to satisfy the requirements of section 501(c)(17), in which case all of such trusts taken as a whole must meet the requirements of such section. The fact that a combination of trusts fails to satisfy the requirements of section 501(c)(17) as one plan does not prevent such of the trusts as satisfy the requirements of section 501(c)(17) from qualifying for exemption under that section.

(g) *Plan of several employers.* A trust forming part of a plan of several employers, or the employees of several employers, will be a supplemental unemployment benefit trust described in section 501(c)(17) if all the requirements of that section are otherwise satisfied.

(h) *Investment of trust funds.* No specific limitations are provided in section 501(c)(17) with respect to investments which may be made by the trustees of a trust qualifying under that section. Generally, the contributions may be used by the trustees to purchase any investments permitted by the trust agreement to the extent allowed by local law. However, the tax-exempt status of the trust will be forfeited if the investments made by the trustees constitute *prohibited transactions* within the meaning of section 503. See section 503 and the regulations thereunder. In addition, such a trust will be subject to tax under section 511 with respect to any *unrelated business taxable income* (as defined in section 512) realized by it from its investments. See sections 511 to 515, inclusive, and the regulations thereunder.

(i) *Allocations.* If a plan which provides sick and accident benefits is financed solely by employer contributions to the trust, and such sick and accident benefits are funded by payment of premiums on an accident or health insurance policy (whether on a group or individual basis) or by contributions to a separate fund which pays such sick and accident benefits, the plan must specify that portion of the contributions to be used to fund such benefits. If a plan which is financed in whole or in part by employee contributions provides sick and accident benefits, the plan must specify the portion, if any, of employee contribu-

tions allocated to the cost of funding such benefits, and must allocate the cost of funding such benefits between employer contributions and employee contributions.

(j) *Required records and returns.* Every trust described in section 501(c)(17) must maintain records indicating the amount of separation benefits and sick and accident benefits which have been provided to each employee. If a plan is financed, in whole or in part, by employee contributions to the trust, the trust must maintain records indicating the amount of each employee's total contributions allocable to separation benefits. In addition, every trust described in section 501(c)(17) which makes one or more payments totaling \$600 or more in 1 year to an individual must file an annual information return in the manner described in paragraph (b)(1) of § 1.6041-2. However, if the payments from such trust are subject to income tax withholding under section 3402(o) and the regulations thereunder, the trust must file, in lieu of such annual information return, the returns of income tax withheld from wages required by section 6011 and the regulations thereunder. In such circumstances, the trust must also furnish the statements to the recipients of trust distributions required by section 6051 and the regulations thereunder.

[T.D. 6972, 33 FR 12901, Sept. 12, 1968, as amended by T.D. 7068, 35 FR 17328, Nov. 11, 1970]

#### § 1.501(c)(17)-3 Relation to other sections of the Code.

(a) *Taxability of benefit distributions—*  
(1) *Separation benefits.* If the separation benefits described in section 501(c)(17)(D)(i) are funded entirely by employer contributions, then the full amount of any separation benefit payment received by an employee is includible in his gross income under section 61(a). If any such separation benefit is funded by both employer and employee contributions, or solely by employee contributions, the amount of any separation benefit payment which is includible in the gross income of the employee is the amount by which such



distribution and any prior distributions of such separation payments exceeds the employee's total contributions to fund such separation benefits.

(2) *Sick and accident benefits.* Any benefit payment received from the trust under the part of the plan, if any, which provides for the payment of sick and accident benefits must be included in gross income under section 61(a), unless specifically excluded under section 104 or 105 and the regulations thereunder. See section 105(b) and §1.105-2 for benefit payments expended for medical care, benefit payments in excess of actual medical expenses, and benefit payments which an employee is entitled to receive irrespective of whether or not he incurs expenses for medical care. See section 213 and §1.213-1(g) for benefit payments representing reimbursement for medical expenses paid in prior years. See §1.501(c)(17)-2(i) for the requirement that a trust described in section 501(c)(17) which receives employee contributions must be part of a written plan which provides for the allocation of the cost of funding sick and accident benefits.

(b) *Exemption as a voluntary employees' beneficiary association.* Section 501(c)(17)(E) contemplates that a trust forming part of a plan providing for the payment of supplemental unemployment compensation benefits may, if it qualifies, apply for exemption from income tax under section 501(a) either as a voluntary employees' beneficiary association described in section 501(c)(9) or as a trust described in section 501(c)(17).

(c) *Returns.* A trust which is described in section 501(c)(17) and which is exempt from tax under section 501(a) must file a return in accordance with section 6033 and the regulations thereunder. If such a trust realizes any unrelated business taxable income, as defined in section 512, the trust is also required to file a return with respect to such income.

(d) *Effective date.* Section 501(c)(17) shall apply to taxable years beginning after December 31, 1959, and shall apply to supplemental unemployment benefit trusts regardless of when created or organized.

[T.D. 6972, 33 FR 12902, Sept. 12, 1968]

### § 1.501(c)(18)-1 Certain funded pension trusts.

(a) *In general.* Organizations described in section 501(c)(18) are trusts created before June 25, 1959, forming part of a plan for the payment of benefits under a pension plan funded only by contributions of employees. In order to be exempt, such trusts must also meet the requirements set forth in section 501(c)(18) (A), (B), and (C), and in paragraph (b) of this section.

(b) *Requirements for qualification.* A trust described in section 501(c)(18) must meet the following requirements:

(1) *Local law.* The trust must be a valid, existing trust under local law, and must be evidenced by an executed written document.

(2) *Funding.* The trust must be funded solely from contributions of employees who are members of the plan. For purposes of this section, the term *contributions of employees* shall include earnings on, and gains derived from, the assets of the trust which were contributed by employees.

(3) *Creation before June 25, 1959—(i) In general.* The trust must have been created before June 25, 1959. A trust created before June 25, 1959 is described in section 501(c)(18) and this section even though changes in the makeup of the trust have occurred since that time so long as these are not fundamental changes in the character of the trust or in the character of the beneficiaries of the trust. Increases in the beneficiaries of the trust by the addition of employees in the same or related industries, whether such additions are of individuals or of units (such as local units of a union) will generally not be considered a fundamental change in the character of the trust. A merger of a trust created after June 25, 1959 into a trust created before such date is not in itself a fundamental change in the character of the latter trust if the two trusts are for the benefit of employees of the same or related industries.

(ii) *Examples.* The provisions of this subparagraph may be illustrated by the following examples:

*Example 1.* Assume that trust C, for the benefit of members of participating locals of National Union X, was established in 1950 and adopted by 29 locals before June 25, 1959.

The subsequent adoption of trust C by additional locals of National Union X in 1962 will not constitute a fundamental change in the character of trust C, since such subsequent adoption is by employees in a related industry.

*Example 2.* Assume the facts as stated in example 1, except that in 1965 National Union X merged with National Union Y, whose members are engaged in trades related to those engaged in by X's members. Assume further that trust D, the employee funded pension plan and fund for employees of Y, was subsequently merged into trust C. The merger of trust D into trust C would not in itself constitute a fundamental change in the character of trust C, since both C and D are for the benefit of employees of related industries.

(4) *Payment of benefits.* The trust must provide solely for the payment of pension or retirement benefits to its beneficiaries. For purposes of this section, the term *retirement benefits* is intended to include customary and incidental benefits, such as death benefits within the limits permissible under section 401.

(5) *Diversion.* The trust must be part of a plan which provides that, before the satisfaction of all liabilities to employees covered by the plan, the corpus and income of the trust cannot (within the taxable year and at any time thereafter) be used for, or diverted to, any purpose other than the providing of pension or retirement benefits. Payment of expenses in connection with the administration of a plan providing pension or retirement benefits shall be considered a payment to provide such benefits and shall not affect the qualification of the trust.

(6) *Discrimination.* The trust must be part of a plan whose eligibility conditions and benefits do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. See sections 401(a)(3)(B) and 401(a)(4) and §§1.401-3 and 1.401(a)(4)-0 through 1.401(a)(4)-13. However, a plan is not discriminatory within the meaning of section 501(c)(18) merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan. Accordingly, the benefits provided for

highly paid employees may be greater than the benefits provided for lower paid employees if the benefits are determined by reference to their compensation; but, in such a case, the plan will not qualify if the benefits paid to the higher paid employees are a larger portion of compensation than the benefits paid to lower paid employees.

(7) *Objective standards.* The trust must be part of a plan which requires that benefits be determined according to objective standards. Thus, while a plan may provide similarly situated employees with benefits which differ in kind and amount, these benefits may not be determined solely in the discretion of the trustees.

(c) *Effective date.* The provisions of section 501(c)(18) and this section shall apply with respect to taxable years beginning after December 31, 1969.

[T.D. 7172, 37 FR 5618, Mar. 17, 1972, as amended by T.D. 9849, 84 FR 9235, Mar. 14, 2019]

#### § 1.501(c)(19)-1 War veterans organizations.

(a) *In general.* (1) For taxable years beginning after December 31, 1969, a veterans post or organization which is organized in the United States or any of its possessions may be exempt as an organization described in section 501(c)(19) if the requirements of paragraphs (b) and (c) of this section are met and if no part of its net earnings inures to the benefit of any private shareholder or individual. Paragraph (b) of this section contains the membership requirements such a post or organization must meet in order to qualify under section 501(c)(19). Paragraph (c) of this section outlines the purposes, at least one of which such a post or organization must have in order to so qualify.

(2) In addition, an auxiliary unit or society described in paragraph (d) of this section of such a veterans post or organization and a trust or foundation described in paragraph (e) of this section for such post or organization may be exempt as an organization described in section 501(c)(19).

(b) *Membership requirements.* (1) In order to be described in section 501(c)(19) under paragraph (a)(1) of this section, an organization must meet the membership requirements of section

501(c)(19)(B) and this paragraph. There are two requirements that must be met under this paragraph. The first requirement is that at least 75 percent of the members of the organization must be war veterans. For purposes of this section the term *war veterans* means persons, whether or not present members of the United States Armed Forces, who have served in the Armed Forces of the United States during a period of war (including the Korean and Vietnam conflicts).

(2) The second requirement of this paragraph is that at least 97.5 percent of all members of the organization must be described in one or more of the following categories:

- (i) War veterans,
- (ii) Present or former members of the United States Armed Forces,
- (iii) Cadets (including only students in college or university ROTC programs or at Armed Services academies), or
- (iv) Spouses, widows, or widowers of individuals referred to in paragraph (b)(2) (i), (ii) or (iii) of this section.

(c) *Exempt purposes.* In addition to the requirements of paragraphs (a)(1) and (b) of this section, in order to be described in section 501(c)(19) under paragraph (a)(1) of this section an organization must be operated exclusively for one or more of the following purposes:

(1) To promote the social welfare of the community as defined in § 1.501(c)(4)-1(a)(2).

(2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents, and the widows and orphans of deceased veterans,

(3) To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States,

(4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors,

(5) To conduct programs for religious, charitable, scientific, literary, or educational purposes,

(6) To sponsor or participate in activities of a patriotic nature,

(7) To provide insurance benefits for their members or dependents of their members or both, or

(8) To provide social and recreational activities for their members.

(d) *Auxiliary units or societies for war veterans organizations.* A unit or society may be exempt as an organization described in section 501(c)(19) and paragraph (a)(2) of this section if it is an auxiliary unit or society of a post or organization of war veterans described in paragraph (a)(1) of this section. A unit or society is an auxiliary unit or society or such a post or organization if it meets the following requirements:

(1) It is affiliated with, and organized in accordance with, the bylaws and regulations formulated by an organization described in paragraph (a)(1) of this section,

(2) At least 75 percent of its members are either war veterans, or spouses of war veterans, or are related to a war veteran within two degrees of consanguinity (i.e., grandparent, brother, sister, grandchild, represent the most distant allowable relationships),

(3) All of its members are either members of an organization described in paragraph (a)(1) of this section, or spouses of a member of such an organization or are related to a member of such an organization, within two degrees of consanguinity, and

(4) No part of its net earnings inures to the benefit of any private shareholder or individual.

(e) *Trusts or foundations.* A trust or foundation may be exempt as an organization described in section 501(c)(19) and paragraph (a)(2) of this section if it is a trust or foundation for a post or organization of war veterans described in paragraph (a)(1) of this section. A trust or foundation is a trust or foundation for such a post or organization if it meets the following requirements:

(1) The trust or foundation is in existence under local law and, if organized for charitable purposes, has a dissolution provision described in § 1.501(c)(3)-1(b)(4).

(2) The corpus or income cannot be diverted or used other than for the funding of a post or organization of war veterans described in paragraph (a)(1) of this section, for section 170(c)(4) purposes, or as an insurance set aside (as defined in § 1.512(a)-4(b)).

(3) The trust income is not unreasonably accumulated and, if the trust or

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foundation is not an insurance set aside, a substantial portion of the income is in fact distributed to such post or organization or for section 170(c)(4) charitable purposes, and

(4) It is organized exclusively for one or more of those purposes enumerated in paragraph (c) of this section.

[T.D. 7438, 41 FR 44392, Oct. 8, 1976]

**§ 1.501(c)(21)-1 Black lung trusts—certain terms.**

(a) *Created or organized in the United States.* A trust is not *created or organized in the United States* unless it is maintained at all times as a domestic trust in the United States. For this purpose, section 7701(a)(9) limits the term *United States* to the District of Columbia and States of the United States.

(b) *Insurance company.* The term *insurance company* means an insurance, surety, bonding or other company whose liability for the kinds of claims to which section 501(c)(21)(A)(i) applies is as an insurer or guarantor of the liabilities of another.

(c) *Black Lung Acts.* The term *Black Lung Acts* includes any State law providing compensation for disability or death due to pneumoconiosis even though the State law compensates for other kinds of injuries. In such a case, section 501(c)(21) applies only to the extent that the liability is attributable to disability or death due to pneumoconiosis. For this purpose, the term *pneumoconiosis* has the same meaning as it has under federal law. See 30 U.S.C. 902.

(d) *Insurance exclusively covering such liability.* The term *insurance exclusively covering such liability* includes insurance that covers risk for liabilities in addition to the liabilities to which section 501(c)(21)(A)(i) applies. In such a case, payment for premiums may be made from the trust only to the extent of that portion of the premiums that has been separately allocated and stated by the insurer as attributable solely to coverage of the liabilities to which section 501(c)(21)(A)(i) applies.

(e) *Administrative and other incidental expenses.* The term *administrative and other incidental expenses* means expenditures that are appropriate and helpful to the trust making them in carrying

out the purposes for which its assets may be used under section 501(c)(21)(B). The term includes any excise tax imposed on the trust under section 4952 (relating to taxes on taxable expenditures) and reasonable expenses, such as legal expenses, incurred by the trust in connection with an assertion against the trust of liability for a taxable expenditure. The term does not include an excise tax imposed on the trustee or on other disqualified persons under section 4951 (relating to taxes on self-dealing) or under section 4953 (relating to tax on excess contributions to black lung benefit trusts) or any expenses incurred in connection with the assertion of these taxes other than expenses that are treated as part of reasonable compensation under section 4951(d)(2)(C). See §§ 53.4941 (d)-2(f)(3) and (d)-3(c) for interpretations of similar provisions under section 4941(d)(2)(E), relating to reasonable compensation for private foundation disqualified persons.

(f) *Public debt securities of the United States.* The term *public debt securities of the United States* means obligations that are taken into consideration for purposes of the public debt limit. See, for example 31 U.S.C. 757b.

(g) *Obligations of a State or local government.* The term *obligations of a State or local government* means the obligations of a State or local governmental unit the interest on which is exempt from tax under section 103(a). See § 1.103-1(a).

(h) *Time or demand deposits.* The term *time or demand deposits* includes checking accounts, savings accounts, certificates of deposit or other time or demand deposits. The term does not include common or collective trust funds such as a common trust fund as defined in section 584.

[44 FR 52197, Sept. 7, 1979]

**§ 1.501(c)(21)-2 Same—trust instrument.**

As trust does not meet the requirements of section 501(c)(21) if it is not established and maintained pursuant to a written instrument. The trust instrument must definitely and affirmatively prohibit a diversion or use of trust assets that is not permitted under section 501(c)(21)(B) or section

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4953(c), whether by operation or natural termination of the trust, by power of revocation or amendment by the happening of a contingency by collateral arrangement, or by any other means. No particular form for the trust instrument is required. A trust may meet the requirements of section 501(c)921) although the trust instrument fails to contain provisions the effects of which are to prohibit acts that are subject to section 4951 (relating to taxes on self-dealing), section 4952 (relating to taxes on taxable expenditures) or the retention of contributions subject to section 4953 (relating to tax on excess contributions to black lung benefit trusts).

[44 FR 52197, Sept. 7, 1979]

### § 1.501(c)(29)-1 CO-OP Health Insurance Issuers.

(a) *Organizations must notify the Commissioner that they are applying for recognition of section 501(c)(29) status.* An organization will not be treated as described in section 501(c)(29) unless the organization has given notice to the Commissioner that it is applying for recognition as an organization described in section 501(c)(29) in the manner prescribed by the Commissioner in published guidance.

(b) *Effective date of recognition of section 501(c)(29) status.* An organization may be recognized as an organization described in section 501(c)(29) as of a date prior to the date of the notice required by paragraph (a) of this section if the notice is given in the manner and within the time prescribed by the Commissioner and the organization's purposes and activities prior to giving such notice were consistent with the requirements for exempt status under section 501(c)(29). However, an organization may not be recognized as an organization described in section 501(c)(29) before the later of its formation or March 23, 2010.

(c) *Effective/applicability date.* Paragraphs (a) and (b) of this section are applicable beginning February 7, 2012.

[T.D. 9709, 80 FR 4793, Jan. 29, 2015]

### § 1.501(d)-1 Religious and apostolic associations or corporations.

(a) Religious or apostolic associations or corporations are described in section 501(d) and are exempt from taxation under section 501(a) if they have a common treasury or community treasury, even though they engage in business for the common benefit of the members, provided each of the members includes (at the time of filing his return) in his gross income his entire pro rata share, whether distributed or not, of the net income of the association or corporation for the taxable year of the association or corporation ending with or during his taxable year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(b) For annual return requirements of organizations described in section 501(d), see section 6033 and paragraph (a)(5) of § 1.6033-1.

### § 1.501(e)-1 Cooperative hospital service organizations.

(a) *General rule.* Section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization. A cooperative hospital service organization which meets the requirements of section 501(e) and this section shall be treated as an organization described in section 501(c)(3), exempt from taxation under section 501(a), and referred to in section 170(b)(1)(A) (iii) (relating to percentage limitations on charitable contributions). In order to qualify for tax exempt status, a cooperative hospital service organization must—

(1) Be organized and operated on a cooperative basis,

(2) Perform, on a centralized basis, only one or more specifically enumerated services which, if performed directly by a tax exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption, and

(3) Perform such service or services solely for two or more patron-hospitals as described in paragraph (d) of this section.

(b) *Organized and operated on a cooperative basis—(1) In general.* In order to

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meet the requirements of section 501(e), the organization must be organized and operated on a cooperative basis (whether or not under a specific statute on cooperatives) and must allocate or pay all of its net earnings within 8½ months after the close of the taxable year to its patron-hospitals on the basis of the percentage of its services performed for each patron. To *allocate* its net earnings to its patron-hospitals, the organization must make appropriate bookkeeping entries and provide timely written notice to each patron-hospital disclosing to the patron-hospital the amount allocated to it on the books of the organization. For the recordkeeping requirements of a section 501(e) organization, see § 1.521-1(a)(1).

(2) *Percentage of services defined.* The percentage of services performed for each patron-hospital may be determined on the basis of either the value or the quantity of the services provided by the organization to the patron-hospital, provided such basis is realistic in terms of the actual cost of the services to the organization.

(3) *Retention of net earnings.* Exemption will not be denied a cooperative hospital service organization solely because the organization, instead of paying all net earnings to its patron-hospitals, retains an amount for such purposes as retiring indebtedness, expanding the services of the organization, or for any other necessary purpose and allocates such amounts to its patrons. However, such funds may not be accumulated beyond the reasonably anticipated needs of the organization. See, § 1.537-1(b). Whether there is an improper accumulation of funds depends upon the particular circumstances of each case. Moreover, where an organization retains net earnings for necessary purposes, the organization's records must show each patron's rights and interests in the funds retained. For purposes of this paragraph, the term *net earnings* does not include capital contributions to the organization and such contributions need not satisfy the allocation or payment requirements.

(4) *Nonpatronage and other income.* An organization described in section 501(e) may, in addition to net earnings, receive membership dues and related membership assessment fees, gifts,

grants and income from nonpatronage sources such as investment of retained earnings. However, such an organization cannot be exempt if it engages in any business other than that of providing the specified services, described in paragraph (c), for the specified patron-hospitals, described in paragraph (d). Thus, an organization described in section 501(e) generally cannot have unrelated business taxable income as defined in section 512, although it may earn certain interest, annuities, royalties, and rents which are excluded from unrelated business taxable income because of the modifications contained in sections 512(b)(1), (2) or (3). An organization described in section 501(e) may, however, have debt-financed income which is treated as unrelated business taxable income solely because of the applicability of section 514. In addition, exempt status under section 501(e) will not be affected where rent from personal property leased with real property is treated as unrelated business taxable income under section 512(b)(3)(A)(ii) solely because the rent attributable to the personal property is more than incidental or under section 512(b)(3)(B)(i) solely because the rent attributable to the personal property exceeds 50 percent of the total rent received or accrued under the lease. Exemption will not be affected solely because the determination of the amount of rent depends in whole or in part on the income or profits derived from the property leased. See, section 512(b)(3)(B)(ii). An organization described in section 501(e) may also derive nonpatronage income from sources that are incidental to the conduct of its exempt purposes or functions. For example, income derived from the operation of a cafeteria or vending machines primarily for the convenience of its employees or the disposition of by-products in substantially the same state they were in on completion of the exempt function (e.g., the sale of silver waste produced in the processing of x-ray film) will not be considered unrelated business taxable income. See, section 513(a)(2) and § 1.513-1(d)(4)(ii). The nonpatronage and other income permitted under this subparagraph (4) must be allocated or paid as provided

in subparagraph (1) or retained as provided in subparagraph (3).

(5) *Stock ownership*—(i) *Capital stock of organization*. An organization does not meet the requirements of section 501(e) unless all of the organization's outstanding capital stock, if there is such stock, is held solely by its patron-hospitals. However, no amount may be paid as dividends on the capital stock of the organization. For purposes of the preceding sentence, the term *capital stock* includes common stock (whether voting or nonvoting), preferred stock, or any other form evidencing a proprietary interest in the organization.

(ii) *Stock ownership as a condition for obtaining credit*. If by statutory requirement a cooperative hospital service organization must be a shareholder in a United States or state chartered corporation as a condition for obtaining credit from that corporate-lender, the ownership of shares and the payment of dividends thereon will not for such reason be a basis for the denial of exemption to the organization. See, e.g., National Consumer Cooperative Bank, 12 U.S.C. 3001 *et seq.*

(c) *Scope of services*—(1) *Permissible services*. An organization meets the requirements of section 501(e) only if the organization performs, on a centralized basis, one or more of the following services and only such services: data processing, purchasing (including the purchasing and dispensing of drugs and pharmaceuticals to patron-hospitals), warehousing, billing and collection, food, clinical (including radiology), industrial engineering (including the installation, maintenance and repair of biomedical and similar equipment), laboratory, printing, communications, record center, and personnel (including recruitment, selection, testing, training, education and placement of personnel) services. An organization is not described in section 501(e) if, in addition to or instead of one or more of these specified services, the organization performs any other service (other than services referred to under paragraph (b)(4) that are incidental to the conduct of exempt purposes or functions).

(2) *Illustration*. The provisions of this subparagraph may be illustrated by the following example.

*Example*. An organization performs industrial engineering services on a cooperative basis solely for patron-hospitals each of which is an organization described in section 501(c)(3) and exempt from taxation under section 501(a). However, in addition to this service, the organization operates laundry services for its patron-hospitals. This cooperative organization does not meet the requirements of this paragraph because it performs laundry services not specified in this paragraph.

(d) *Patron-hospitals*—(1) *Defined*. Section 501(e) only applies if the organization performs its services solely for two or more patron-hospitals each of which is—

(i) An organization described in section 501(c)(3) which is exempt from taxation under section 501(a),

(ii) A constituent part of an organization described in section 501(c)(3) which is exempt from taxation under section 501(a) and which, if organized and operated as a separate entity, would constitute an organization described in section 501(c)(3), or

(iii) Owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing.

(2) *Business with nonvoting patron-hospitals*. Exemption will not be denied a cooperative hospital service organization solely because the organization (whether organized on a stock or membership basis) transacts business with patron-hospitals which do not have voting rights in the organization and therefore do not participate in the decisions affecting the operation of the organization. Where the organization has both patron-hospitals with voting rights and patron-hospitals without such rights, the organization must provide at least 50 percent of its services to patron-hospitals with voting rights in the organization. Thus, the percentage of services provided to nonvoting patrons may not exceed the percentage of such services provided to voting patrons. A patron-hospital will be deemed to have voting rights in the cooperative hospital service organization if the patron-hospital may vote directly on matters affecting the operation of the organization or if the patron-hospital may vote in the election of cooperative

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board members. Notwithstanding that an organization may have both voting and nonvoting patron-hospitals, patronage refunds must nevertheless be allocated or paid to all patron-hospitals solely on the basis specified in paragraph (b) of this section.

(3) *Services to other organizations.* An organization does not meet the requirements of section 501(e) if, in addition to performing services for patron-hospitals (entities described in subdivisions (i), (ii) or (iii) of subparagraph (1)), the organization performs any service for any other organization. For example, a cooperative hospital service organization is not exempt if it performs services for convalescent homes for children or the aged, vocational training facilities for the handicapped, educational institutions which do not provide hospital care in their facilities, and proprietary hospitals. However, the provision of the specified services between or among cooperative hospital service organizations meeting the requirements of section 501(e) and this section is permissible. Also permissible is the provision of the specified services to entities which are not patron-hospitals, but only if such services are de minimis and are mandated by a governmental unit as, for example, a condition for licensing.

(e) *Effective dates.* An organization, other than an organization performing clinical services, may meet the requirements of section 501(e) and be a tax exempt organization for taxable years ending after June 28, 1968. An organization performing clinical services may meet the requirements of section 501(e) and be a tax exempt organization for taxable years ending after December 31, 1976. However, pursuant to the authority contained in section 7805(b) of the Internal Revenue Code, these regulations shall not become effective with respect to an organization which has received a ruling or determination letter from the Internal Revenue Service recognizing its exemption under section 501(e) until January 2, 1987.

[T.D. 8100, 51 FR 31615, Sept. 4, 1986; 51 FR 33593, Sept. 22, 1986]

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### § 1.501(h)-1 Application of the expenditure test to expenditures to influence legislation; introduction.

(a) *Scope.* (1) There are certain requirements an organization must meet in order to be a *charity* described in section 501(c)(3). Among other things, section 501(c)(3) states that “no substantial part of the activities of [a charity may consist of] carrying on propaganda, or otherwise attempting to influence legislation, (except as otherwise provided in subsection (h)).” This requirement is called the *substantial part test*.

(2) Under section 501(h), many public charities may elect the *expenditure test* as a substitute for the substantial part test. The expenditure test is described in section 501(h) and this § 1.501(h). A public charity is any charity that is not a private foundation under section 509(a). (Unlike a public charity, a private foundation may not make any lobbying expenditures: If a private foundation does make a lobbying expenditure, it is subject to an excise tax under section 4945). Section 1.501(h)-2 lists which public charities are eligible to make the expenditure test election. Section 1.501(h)-2 also provides information about how a public charity makes and revokes the election to be covered by the expenditure test.

(3) A public charity that makes the election may make lobbying expenditures within specified dollar limits. If an electing public charity’s lobbying expenditures are within the dollar limits determined under section 4911(c), the electing public charity will not owe tax under section 4911 nor will it lose its tax exempt status as a charity by virtue of section 501(h). If, however, that electing public charity’s lobbying expenditures exceed its section 4911 lobbying limit, the organization is subject to an excise tax on the excess lobbying expenditures. Further, under section 501(h), if an electing public charity’s lobbying expenditures normally are more than 150 percent of its section 4911 lobbying limit, the organization will cease to be a charity described in section 501(c)(3).

(4) A public charity that elects the expenditure test may nevertheless lose its tax exempt status if it is an action organization under § 1.501(c)(3)-



1(c)(3)(iii) or (iv). A public charity that does not elect the expenditure test remains subject to the substantial part test. The substantial part test is applied without regard to the provisions of section 501(h) and 4911 and the related regulations.

(b) *Effective date.* The provisions of § 1.501(h)-1 through § 1.501(h)-3, are effective for taxable years beginning after August 31, 1990. An election made before August 31, 1990, under the provisions of § 7.0(c)(4) or the instructions to Form 5768, will be effective under these regulations without again filing Form 5768.

[T.D. 8308, 55 FR 35588, Aug. 31, 1990]

**§ 1.501(h)-2 Electing the expenditure test.**

(a) *In general.* The election to be governed by section 501(h) may be made by an eligible organization (as described in paragraph (b) of this section) for any taxable year of the organization beginning after December 31, 1976, other than the first taxable year for which a voluntary revocation of the election is effective (see paragraph (d) of this section). The election is made by filing a completed Form 5768, Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation, with the appropriate Internal Revenue Service Center listed on that form. Under section 501(h)(6), the election is effective with the beginning of the taxable year in which the form is filed. For example, if an eligible organization whose taxable year is the calendar year files Form 5768 on December 31, 1979, the organization is governed by section 501(h) for its taxable year beginning January 1, 1979. Once made, the expenditure test election is effective (without again filing Form 5768) for each succeeding taxable year for which the organization is an eligible organization and which begins before a notice of revocation is filed under paragraph (d) of this section.

(b) *Organizations eligible to elect the expenditure test—(1) In general.* For purposes of section 501(h) and the regulations thereunder, an organization is an eligible organization for a taxable year if, for that taxable year, it is—

(i) Described in section 501(c)(3) (determined, in any year for which an election is in effect, without regard to the substantial part test of section 501(c)(3)),

(ii) Described in section 501(h)(4) and paragraph (b)(2) of this section, and

(iii) Not a disqualified organization described in section 501(h)(5) and paragraph (b)(3) of this section.

(2) *Certain organizations listed.* An organization is described in section 501(h)(4) and this paragraph (b)(2) if it is an organization described in—

(i) Section 170(b)(1)(A)(ii) (relating to educational institutions),

(ii) Section 170(b)(1)(A)(iii) (relating to hospitals and medical research organizations),

(iii) Section 170(b)(1)(A)(iv) (relating to organizations supporting government schools),

(iv) Section 170(b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),

(v) Section 509(a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or

(vi) Section 509(a)(3) (relating to organizations supporting public charities), except that for purposes of this paragraph (b)(2), section 509(a)(3) shall be applied without regard to the last sentence of section 509(a).

(3) *Disqualified organizations.* An organization is a disqualified organization described in section 501(h)(5) and this paragraph (b)(3) if the organization is—

(i) Described in section 170(b)(1)(A)(i) (relating to churches),

(ii) An integrated auxiliary of a church or of a convention or association of churches see (§ 1.6033-2(g)(5)), or

(iii) Described in section 501(c)(3) and affiliated (within the meaning of § 56.4911-7) with one or more organizations described in paragraph (b)(3) (i) or (ii) of this section.

(4) *Other organizations ineligible to elect.* Under section 501(h)(4), certain organizations, although not disqualified organizations, are not eligible to elect the expenditure test. For example, organizations described in section 509(a)(4) are not listed in section 501(h)(4) and therefore are not eligible to elect. Similarly, private foundations (within the meaning of section 509(a))

are not eligible to elect. For the treatment of expenditures by a private foundation for the purpose of carrying on propaganda, or otherwise attempting, to influence legislation, see § 53.4945-2.

(c) *New organizations.* A newly created organization may submit Form 5768 to elect the expenditure test under section 501(h) before it is determined to be an eligible organization and may submit Form 5768 at the time it submits its application for recognition of exemption (Form 1023). If the newly created organization is determined to be an eligible organization, the election will be effective under the provisions of paragraph (a) of this section, that is, with the beginning of the taxable year in which the Form 5768 is filed by the eligible organization. However, if a newly created organization is determined by the Service not to be an eligible organization, the organization's election will not be effective and the substantial part test will apply from the effective date of its section 501(c)(3) classification.

(d) *Voluntary revocation of expenditure test election—(1) Revocation effective.* An organization may voluntarily revoke an expenditure test election by filing a notice of voluntary revocation with the appropriate Internal Revenue Service Center listed on Form 5768. Under section 501(h)(6)(B), a voluntary revocation is effective with the beginning of the first taxable year after the taxable year in which the notice is filed. If an organization voluntarily revokes its election, the substantial part test of section 501(c)(3) will apply with respect to the organization's activities in attempting to influence legislation beginning with the taxable year for which the voluntary revocation is effective.

(2) *Re-election of expenditure test.* If an organization's expenditure test election is voluntarily revoked, the organization may again make the expenditure test election, effective no earlier than for the taxable year following the first taxable year for which the revocation is effective.

(3) *Example.* X, an organization whose taxable year is the calendar year, plans to voluntarily revoke its expenditure test election effective beginning with its taxable year 1985. X must file its no-

tice of voluntary revocation on Form 5768 after December 31, 1983, and before January 1, 1985. If X files a notice of voluntary revocation on December 31, 1984, the revocation is effective beginning with its taxable year 1985. The organization may again elect the expenditure test by filing Form 5768. Under paragraph (d)(2) of this section, the election may not be made for taxable year 1985. Under paragraph (a) of this section, a new expenditure test election will be effective for taxable years beginning with taxable year 1986, if the Form 5768 is filed after December 31, 1985, and before January 1, 1987.

(e) *Involuntary revocation of expenditure test election.* If, while an election by an eligible organization is in effect, the organization ceases to be an eligible organization, its election is automatically revoked. The revocation is effective with the beginning of the first full taxable year for which it is determined that the organization is not an eligible organization. If an organization's expenditure test election is involuntarily revoked under this paragraph (e) but the organization continues to be described in section 501(c)(3), the substantial part test of section 501(c)(3) will apply with respect to the organization's activities in attempting to influence legislation beginning with the first taxable year for which the involuntary revocation is effective.

(f) *Supersession.* This section supersedes § 7.0(c)(4) of the Temporary Income Tax Regulations under the Tax Reform Act of 1976, effective August 31, 1990.

[T.D. 8308, 55 FR 35588, Aug. 31, 1990]

**§ 1.501(h)-3 Lobbying or grass roots expenditures normally in excess of ceiling amount.**

(a) *Scope.* This section provides rules under section 501(h) for determining whether an organization that has elected the expenditure test and that is not a member of an affiliated group of organizations (as defined in § 56.4911-7(e)) either normally makes lobbying expenditures in excess of its lobbying ceiling amount or normally makes grass roots expenditures in excess of its

grass roots ceiling amount. Under section 501(h) and this section, an organization that has elected the expenditure test and that normally makes expenditures in excess of the corresponding ceiling amount will cease to be exempt from tax under section 501(a) as an organization described in section 501(c)(3). For similar rules relating to members of an affiliated group of organizations, see § 56.4911-9.

(b) *Loss of exemption*—(1) *In general.* Under section 501(h)(1), an organization that has elected the expenditure test shall be denied exemption from taxation under section 501(a) as an organization described in section 501(c)(3) for the taxable year following a determination year if—

(i) The sum of the organization's lobbying expenditures for the base years exceeds 150 percent of the sum of its lobbying nontaxable amounts for the base years, or (ii) The sum of the organization's grass roots expenditures for its base years exceeds 150 percent of the sum of its grass roots nontaxable amounts for the base years.

The organization thereafter shall not be exempt from tax under section 501(a) as an organization described in section 501(c)(3) unless, pursuant to paragraph (d) of this section, the organization re-applies for recognition of exemption and is recognized as exempt.

(2) *Special exception for organization's first election.* For the first, second, or third consecutive determination year for which an organization's first expenditure test election is in effect, no determination is required under paragraph (b)(1) of this section, and the organization will not be denied exemption from tax by reason of section 501(h) and this section if, taking into account as base years only those years for which the expenditure test election is in effect—

(i) The sum of the organization's lobbying expenditures for such base years does not exceed 150 percent of the sum of its lobbying nontaxable amounts for the same base years, and

(ii) The sum of the organization's grass roots expenditure for those base years does not exceed 150 percent of the sum of its grass roots nontaxable amounts for such base years. If an organization does not satisfy the require-

ments of this paragraph (b)(2), paragraph (b)(1) of this section will apply.

(c) *Definitions.* For purposes of this section—

(1) The term *lobbying expenditures* means lobbying expenditures as defined in section 4911(c)(1) or section 4911(f)(4)(A) and § 56.4911-2(a).

(2) The term *lobbying nontaxable amount* is defined in § 56.4911-1(c)(1).

(3) An organization's *lobbying ceiling amount* is 150 percent of the organization's lobbying nontaxable amount for a taxable year.

(4) The term *grass roots expenditures* means expenditures for grass roots lobbying communications as defined in section 4911(c)(3) or section 4911(f)(4)(A) and §§ 56.4911-2 and 56.4911-3.

(5) The term *grass roots nontaxable amount* is defined in § 56.4911-1(c)(2).

(6) An organization's *grass roots ceiling amount* is 150 percent of the organization's grass roots nontaxable amount for a taxable year.

(7) In general, the term *base years* means the determination year and the three taxable years immediately preceding the determination year. The base years, however, do not include any taxable year preceding the taxable year for which the organization is first treated as described in section 501(c)(3).

(8) A taxable year is a *determination year* if it is a year for which the expenditure test election is in effect, other than the taxable year for which the organization is first treated as described in section 501(c)(3).

(d) *Reapplication for recognition of exemption*—(1) *Time of application.* An organization that is denied exemption from taxation under section 501(a) by reason of section 501(h) and this section may apply on Form 1023 for recognition of exemption as an organization described in section 501(c)(3) for any taxable year following the first taxable year for which exemption is so denied. See paragraphs (d)(2) and (d)(3) of this section for material to be included with an application described in the preceding sentence.

(2) *Section 501(h) calculation.* An application described in paragraph (d)(1) of this section must demonstrate that the organization would not be denied exemption from taxation under section 501(a) by reason of section 501(h) if the

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expenditure test election has been in effect for all of its last taxable year ending before the application is made by providing the calculations, described either in paragraphs (b)(1) (i) and (ii) of this section or in § 56.4911-9(b), that would have applied to the organization for that year.

(3) *Operations not disqualifying.* An application described in paragraph (d)(1) of this section must include information that demonstrates to the satisfaction of the Commissioner that the organization will not knowingly operate in a manner that would disqualify the organization for tax exemption under section 501(c)(3) by reason of attempting to influence legislation.

(4) *Reelection of expenditure test.* If an organization is denied exemption from tax for a taxable year by reason of section 501(h) and this section, and thereafter is again recognized as an organization described in section 501(c)(3) pursuant to this paragraph (d), it may again elect the expenditure test under section 501(h) in accordance with § 1.501(h)-2(a).

(e) *Examples.* The provisions of this section are illustrated by the following examples, which also illustrate the operation of the tax imposed by section 4911.

*Example 1.* (1) The following table contains information used in this example concerning organization X.

Year	Exempt purpose expenditures (EPE)	Calculation	Lobbying	
			Nontaxable amount (LNTA)	Lobbying expenditures (LE)
1979 .....	\$400,000	(20% of \$400,000=) .....	\$80,000	\$100,000
1980 .....	300,000	(20% of \$300,000=) .....	60,000	100,000
1981 .....	600,000	(20% of \$500,000 + 15% of \$100,000=) .....	115,000	120,000
1982 .....	500,000	(20% of \$500,000=) .....	100,000	100,000
Totals .....	1,800,000	.....	355,000	420,000

(2) Organization X, whose taxable year is the calendar year, was organized in 1971. X first made the expenditure test election under section 501(h) effective for taxable years beginning with 1979 and has not revoked the election. None of X's lobbying expenditures for its taxable years 1979 through 1982 are grass roots expenditures. Under section 4911(a) and § 56.4911-1(a), X must determine for each year for which the expenditure test election is effective whether it is liable for the 25 percent excise tax imposed by section 4911(a) on excess lobbying expenditures. X is liable for this tax for each of its taxable years 1979, 1980, and 1981, because in each year its lobbying expenditures exceeded its lobbying nontaxable amount for the year. For 1979, the tax imposed by section 4911(a) is \$5,000 {25% × (\$100,000 - \$80,000) = \$5,000}. For 1980, the tax is \$10,000. For 1981, the tax is \$1,250.

(3) The taxable years 1979 through 1981 are all determination years under paragraph (c)(8) of this section. On its annual return for determination year 1979, the first year of its first election, X can demonstrate, under paragraph (b)(2) of this section, that its lobbying expenditures during 1979 (\$100,000) do not exceed 150 percent of its lobbying nontaxable amount for 1979 (\$120,000). For determination year 1980, under paragraph (b)(2), X can demonstrate that the sum of its lobbying

expenditures for 1979 and 1980 (\$200,000) does not exceed 150 percent of the sum of its lobbying nontaxable amounts for 1979 and 1980 (\$210,000). For 1981, under paragraph (b)(2), X can demonstrate that the sum of its lobbying expenditures for 1979, 1980, and 1981 (\$320,000) does not exceed 150 percent of the sum of its lobbying nontaxable amounts for 1979, 1980, and 1981 (\$382,500). For each of the determination years 1979, 1980, and 1981, the first three years of its first election, X satisfies the requirements of paragraph (b)(2). Accordingly, no determination under paragraph (b)(1) of this section is required for those years, and X is not denied tax exemption by reason of section 501(h).

(4) Under paragraph (b)(1) of this section, X must determine for its determination year 1982 whether it has normally made lobbying expenditures in excess of the lobbying ceiling amount. This determination takes into account expenditures in base years 1979 through 1982. The sum of X's lobbying expenditures for the base years (\$420,000) does not exceed 150 percent of the sum of the lobbying nontaxable amounts for the base years (150% × \$355,000 = \$532,500). Accordingly, X is not denied tax exemption by reason of section 501(h).

*Example 2.* (1) The following table contains information used in this example concerning W.

Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE) (dollars)	Grass roots nontaxable amount (25 percent of LNTA) (dollars)	Grass roots expenditures (dollars)
1979	700,000	(20% of \$500,000 + 15% of \$200,000=).	130,000	120,000	32,500	30,000
1980	800,000	(20% of \$500,000 + 15% of \$300,000=).	145,000	100,000	36,250	60,000
1981	800,000	(20% of \$500,000 + 15% of \$300,000=).	145,000	100,000	36,250	65,000
1982	900,000	(20% of \$500,000 + 15% of \$400,000=).	160,000	150,000	40,000	65,000
Total	3,200,000		580,000	470,000	145,000	220,000

(2) Organization W, whose taxable year is the calendar year, made the expenditure test election under section 501(h) effective for taxable years beginning with 1979 and has not revoked the election. W has been treated as an organization described in section 501(c)(3) for each of its taxable years beginning within its taxable year 1974.

(3) Under section 4911(a) and §56.4911-1(a), W must determine for each year for which the expenditure test election is effective whether it is liable for the 25 percent excise tax imposed by section 4911(a) on excess lobbying expenditures. In 1980, 1981, and 1982, W has excess lobbying expenditures because its grass roots expenditures in each of those years exceeded its grass roots nontaxable amount for the year. Therefore, W is liable for the excise tax under section 4911(a) for those years. The tax imposed by section 4911(a) for 1980 is \$5,937.50 {25% × (\$60,000 - \$36,250) = \$5,937.50}. For 1981, the tax is \$7,187.50. For 1982, the tax is \$6,250.

(4) On its annual return for its determination years 1979, 1980, and 1981, the first three years of its first election, W demonstrates that it satisfies the requirements of paragraph (b)(2) of this section. Accordingly, no determination under paragraph (b)(1) of this section is required for those years, and W is

not denied tax exemption by reason of section 501(h).

(5) On its annual return for its determination year 1982, W must determine under paragraph (b)(1) whether it has normally made lobbying expenditures or grass roots expenditures in excess of the corresponding ceiling amount. This determination takes into account expenditures in base years 1979 through 1982. The sum of W's lobbying expenditures for the base years (\$470,000) does not exceed 150% of the sum of W's lobbying nontaxable amounts for those years (150% × \$580,000 = \$870,000). However, the sum of W's grass roots expenditures for the base years (\$220,000) does exceed 150% of the sum of W's grass roots nontaxable amounts for those years (150% × \$145,000 = \$217,500). Under section 501(h), W is denied tax exemption under section 501(a) as an organization described in section 501(c)(3) for its taxable year 1983. For its taxable year 1984 and any taxable year thereafter, W is exempt from tax as an organization described in section 501(c)(3) only if W applies for recognition of its exempt status under paragraph (d) of this section and is recognized as exempt from tax.

*Example 3.* (1) The following table contains information used in this example concerning organization Y.

Taxable Year	Exempt purpose expenditures (EPE) (dollars)	Calculation	Lobbying nontaxable amount (LNTA) (dollars)	Lobbying expenditures (LE)(dollars)	Grass roots nontaxable amount (25 percent of LNTA)(dollars)	Grass roots expenditures (dollars)
1977	700,000	(20% of \$500,000 + 15% of \$200,000=).	130,000	182,000	32,500	30,000
1978	800,000	(20% of \$500,000 + 15% of \$300,000=).	145,000	224,750	36,250	35,000
Subtotal	1,500,000		275,000	406,750	68,750	65,000
1979	900,000	(20% of \$500,000 + 15% of \$400,000=).	160,000	264,000	40,000	50,000
Totals	2,400,000		435,000	670,750	108,750	115,000

(2) Organization Y, whose taxable year is the calendar year, was first treated as an or-

ganization described in section 501(c)(3) on February 1, 1977. Y made the expenditure

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test election under section 501(h) effective for taxable years beginning with 1977 and has not revoked the election.

(3) For 1977, Y has excess lobbying expenditures of \$52,000 because its lobbying expenditures (\$182,000) exceed its lobbying nontaxable amount (\$130,000) for the taxable year. Accordingly, Y is liable for the 25 percent excise tax imposed by section 4911(a). The amount of the tax is \$13,000 [ $25\% \times (\$182,000 - \$130,000) = \$13,000$ ].

(4) For 1978, Y again has excess lobbying expenditures and is again liable for the 25 percent excise tax imposed by section 4911(a). The amount of the tax is \$19,937.50 [ $25\% \times (\$224,750 - \$145,000) = \$19,937.50$ ].

(5) For 1979, Y's lobbying expenditures (\$264,000) exceed its lobbying nontaxable amount (\$160,000) by \$104,000, and its grass roots expenditures (\$50,000) exceed its grass roots nontaxable amount (\$40,000) by \$10,000. Under § 56.4911-1(b), Y's excess lobbying expenditures are the greater of \$104,000 or \$10,000. The amount of the tax, therefore, is \$26,000 [ $25\% \times \$104,000 = \$26,000$ ].

(6) Under paragraph (c)(8) of this section, 1977 is not a determination year because it is the first year for which the organization is treated as described in section 501(c)(3). For 1977, Y need not determine whether it has normally made lobbying expenditures or grass roots expenditures in excess of the corresponding ceiling amount for purposes of determining whether it is denied exemption under section 501(h) for its taxable year 1978.

(7) For determination year 1978, Y must determine whether it has normally made lobbying or grass roots expenditures in excess of the corresponding ceiling amount, taking into account expenditures for the base years 1977 and 1978. For Y, the determination under paragraph (b)(2) of this section considers the same base years as the determination under paragraph (b)(1) of this section and is, therefore, redundant. Accordingly, Y proceeds to determine, under (b)(1), whether it is denied exemption. Y's grass roots expenditures for 1977 and 1978 (\$65,000) did not exceed 150 percent of the sum of its grass roots nontaxable amounts for those years (\$103,125). Y's lobbying expenditures for 1977 and 1978 (\$406,750) did not exceed 150% of its lobbying nontaxable amount for those years ( $150\% \times \$275,000 = \$412,500$ ). Therefore, Y is not denied tax exemption under section 501(h) for its taxable year 1979.

(8) For determination year 1979, the sum of Y's grass roots expenditures in base years 1977, 1978, and 1979 does not exceed 150 percent of its grass roots nontaxable amount (calculation omitted). However, the sum of Y's lobbying expenditures for the base years (\$670,750) does exceed 150% of the sum of the lobbying nontaxable amounts for those years ( $150\% \times \$435,000 = \$652,500$ ). Since Y was not described in section 501(c)(3) prior to 1977, only the years 1977, 1978, and 1979 may be

considered in determining whether Y has normally made lobbying expenditures in excess of its lobbying ceiling. Therefore, Y determines that it has normally made lobbying expenditures in excess of its lobbying ceiling. Under section 501(h), Y is denied tax exemption under section 501(a) as an organization described in section 501(c)(3) for its taxable year 1980. For its taxable year 1981, and any taxable year thereafter, Y is exempt from tax as an organization described in section 501(c)(3) only if Y applies for recognition of its exempt status under paragraph (d) of this section and is recognized as exempt from tax.

*Example 4.* Organization M made the expenditure test election under section 501(h) effective for taxable years beginning with 1977 and has not revoked the election. M has \$500,000 of exempt purpose expenditures during each of the years 1981 through 1984. In addition, during each of those years, M spends \$75,000 for direct lobbying and \$25,000 for grass roots lobbying. Since the amount expended for M's lobbying (both total lobbying and grass roots lobbying) is within the respective nontaxable expenditure limitations, M is not liable for the 25 percent excise tax imposed under section 4911(a) upon excess lobbying expenditures, nor is M denied tax-exempt status by reason of section 501 (h).

*Example 5.* Assume the same facts as in Example 4, except that, on behalf of M, numerous unpaid volunteers conduct substantial lobbying activities with no reimbursement. Since the substantial lobbying activities of the unpaid volunteers are not counted towards the expenditure limitations and the amount expended for M's lobbying is within the respective nontaxable expenditure limitations, M is not liable for the 25 percent excise tax under section 4911, nor is M denied tax-exempt status by reason of section 501(h).

[T.D. 8308, 55 FR 35589, Aug. 31, 1990]

### § 1.501(r)-0 Outline of regulations.

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- (b) Definitions.
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- (14) FAP application form.
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(a) Effective/applicability date.

(b) Reasonable interpretation for taxable years beginning on or before December 29, 2015.

[T.D. 9708, 79 FR 78997, Dec. 31, 2014; 80 FR 12762, Mar. 11, 2015]

### § 1.501(r)-1 Definitions.

(a) *Application*. The definitions set forth in this section apply to §§ 1.501(r)-2 through 1.501(r)-7.

(b) *Definitions*—(1) *Amounts generally billed (AGB)* means the amounts generally billed for emergency or other medically necessary care to individuals who have insurance covering such care, determined in accordance with § 1.501(r)-5(b).

(2) *AGB percentage* means a percentage of gross charges that a hospital facility uses under § 1.501(r)-5(b)(3) to determine the AGB for any emergency or other medically necessary care it provides to an individual who is eligible for assistance under its financial assistance policy (FAP).

(3) *Application period* means the period during which a hospital facility must accept and process an application for financial assistance under its FAP submitted by an individual in order to have made reasonable efforts to determine whether the individual is FAP-eligible under § 1.501(r)-6(c). A hospital facility may accept and process an individual's FAP application submitted outside of the application period. With respect to any care provided by a hospital facility to an individual, the application period begins on the date the care is provided and ends on the later of the 240th day after the date that the first post-discharge billing statement for the care is provided or either—

(i) In the case of an individual who the hospital facility is notifying as described in § 1.501(r)-6(c)(4), the deadline specified by a written notice described in § 1.501(r)-6(c)(4); or

(ii) In the case of an individual who the hospital facility has presumptively

determined to be eligible for less than the most generous assistance available under the FAP as described in § 1.501(r)-6(c)(2), the end of the reasonable period of time described in § 1.501(r)-6(c)(2)(i)(B).

(4) *Authorized body of a hospital facility* means—

(i) The governing body (that is, the board of directors, board of trustees, or equivalent controlling body) of the hospital organization that operates the hospital facility or a committee of, or other party authorized by, that governing body to the extent such committee or other party is permitted under state law to act on behalf of the governing body; or

(ii) The governing body of an entity that is disregarded or treated as a partnership for federal tax purposes that operates the hospital facility or a committee of, or other party authorized by, that governing body to the extent such committee or other party is permitted under state law to act on behalf of the governing body.

(5) *Billing and collections policy* means a written policy that includes all of the elements described in § 1.501(r)-4(b)(4)(i).

(6) *Date provided* means, in the case of any billing statement, written notice, or other written communication that is mailed, the date of mailing. The date that a billing statement, written notice, or other written communication is provided can also be the date such communication is sent electronically or delivered by hand.

(7) *Discharge* means to release from a hospital facility after the care at issue has been provided, regardless of whether that care has been provided on an inpatient or outpatient basis. Thus, a billing statement for care is considered “post-discharge” if it is provided to an individual after the care has been provided and the individual has left the hospital facility.

(8) *Disregarded entity* means an entity that is generally disregarded as separate from its owner for federal tax purposes under § 301.7701-3 of this chapter. One example of a disregarded entity is a domestic single member limited liability company that does not elect to be classified as an association taxable



as a corporation for federal tax purposes.

(9) *Emergency medical care* means care provided by a hospital facility for emergency medical conditions.

(10) *Emergency medical conditions* means emergency medical conditions as defined in section 1867 of the Social Security Act (42 U.S.C. 1395dd).

(11) *Extraordinary collection action (ECA)* means an action described in § 1.501(r)-6(b)(1).

(12) *Financial assistance policy (FAP)* means a written policy that meets the requirements described in § 1.501(r)-4(b).

(13) *FAP application* means the information and accompanying documentation that an individual submits to apply for financial assistance under a hospital facility's FAP. An individual is considered to have submitted a complete FAP application if he or she provides information and documentation sufficient for the hospital facility to determine whether the individual is FAP-eligible and an incomplete FAP application if he or she provides some, but not sufficient, information and documentation to determine FAP-eligibility. The term "FAP application" does not refer only to written submissions, and a hospital facility may obtain information from an individual in writing or orally (or a combination of both).

(14) *FAP application form* means the application form (and any accompanying instructions) that a hospital facility makes available for individuals to submit as part of a FAP application.

(15) *FAP-eligible* means eligible for financial assistance under a hospital facility's FAP for care covered by the FAP, without regard to whether an individual has applied for assistance under the FAP.

(16) *Gross charges*, or the *chargemaster rate*, means a hospital facility's full, established price for medical care that the hospital facility consistently and uniformly charges patients before applying any contractual allowances, discounts, or deductions.

(17) *Hospital facility* means a facility that is required by a state to be licensed, registered, or similarly recognized as a hospital. Multiple buildings operated under a single state license

are considered to be a single hospital facility. For purposes of this paragraph (b)(17), the term "state" includes only the 50 states and the District of Columbia and not any U.S. territory or foreign country. References to a hospital facility taking actions include instances in which the hospital organization operating the hospital facility takes actions through or on behalf of the hospital facility.

(18) *Hospital organization* means an organization recognized (or seeking to be recognized) as described in section 501(c)(3) that operates one or more hospital facilities. If the section 501(c)(3) status of such an organization is revoked, the organization will, for purposes of section 4959, continue to be treated as a hospital organization during the taxable year in which such revocation becomes effective.

(19) *Medicaid* means any medical assistance program administered by the state in which a hospital facility is licensed in accordance with Title XIX of the Social Security Act (42 U.S.C. 1396 through 1396w-5), including programs in which such medical assistance is provided through a contract between the state and a Medicaid managed care organization or a prepaid inpatient health plan.

(20) *Medicare fee-for-service* means health insurance available under Medicare Part A and Part B of Title XVIII of the Social Security Act (42 U.S.C. 1395c through 1395w-5).

(21) *Noncompliant facility income* means income that a hospital organization operating more than one hospital facility derives from a hospital facility that fails to meet one or more of the requirements of section 501(r) during a taxable year as determined in accordance with § 1.501(r)-2(d).

(22) *Operating a hospital facility*—(i) *In general.* Operating a hospital facility includes operating the facility through the organization's own employees or contracting out to another organization to operate the facility. For example, if an organization hires a management company to operate the facility, the hiring organization is considered to operate the facility. An organization also operates a hospital facility if it is

the sole member or owner of a disregarded entity that operates the hospital facility. In addition, an organization operates a hospital facility if it owns a capital or profits interest in an entity treated as a partnership for federal tax purposes that operates the hospital facility, unless paragraph (b)(22)(ii) of this section applies. For purposes of this paragraph (b)(22), an organization is considered to own a capital or profits interest in an entity treated as a partnership for federal tax purposes if it owns such an interest directly or indirectly through one or more lower-tier entities treated as partnerships for federal tax purposes.

(ii) *Exception for certain partnerships.* An organization does not operate a hospital facility despite owning a capital or profits interest in an entity treated as a partnership for federal tax purposes that operates the hospital facility if—

(A) The organization does not have control over the operation of the hospital facility operated by the partnership sufficient to ensure that the operation of the hospital facility furthers an exempt purpose described in section 501(c)(3) and thus treats the operation of the hospital facility, including the facility's provision of medical care, as an unrelated trade or business described in section 513 with respect to the hospital organization; or

(B) At all times since March 23, 2010, the organization has been organized and operated primarily for educational or scientific purposes and has not engaged primarily in the operation of one or more hospital facilities and, pursuant to a partnership agreement entered into before March 23, 2010—

(1) Does not own more than 35 percent of the capital or profits interest in the partnership (determined in accordance with section 707(b)(3));

(2) Does not own a general partner interest, managing-member interest, or similar interest in the partnership; and

(3) Does not have control over the operation of the hospital facility sufficient to ensure that the hospital facility complies with the requirements of section 501(r).

(23) *Partnership agreement* means, for purposes of paragraph (b)(22)(ii)(B) of this section, all written agreements

among the partners, or between one or more partners and the partnership, and concerning affairs of the partnership and responsibilities of the partners, whether or not embodied in a document referred to by the partners as the partnership agreement. A partnership agreement also includes any modifications to the agreement agreed to by all partners, or adopted in any other manner provided by the partnership agreement, except for modifications adopted on or after March 23, 2010, that affect whether or not the agreement is described in paragraph (b)(22)(ii)(B) of this section. In addition, a partnership agreement includes provisions of federal, state, or local law that were in effect before March 23, 2010, and continue to be in effect that govern the affairs of the partnership or are considered under such law to be part of the partnership agreement.

(24) *Plain language summary of the FAP* means a written statement that notifies an individual that the hospital facility offers financial assistance under a FAP and provides the following additional information in language that is clear, concise, and easy to understand:

(i) A brief description of the eligibility requirements and assistance offered under the FAP.

(ii) A brief summary of how to apply for assistance under the FAP.

(iii) The direct Web site address (or URL) and physical locations where the individual can obtain copies of the FAP and FAP application form.

(iv) Instructions on how the individual can obtain a free copy of the FAP and FAP application form by mail.

(v) The contact information, including telephone number and physical location, of the hospital facility office or department that can provide information about the FAP and of either—

(A) The hospital facility office or department that can provide assistance with the FAP application process; or

(B) If the hospital facility does not provide assistance with the FAP application process, at least one nonprofit organization or government agency that the hospital facility has identified as an available source of assistance with FAP applications.

(vi) A statement of the availability of translations of the FAP, FAP application form, and plain language summary of the FAP in other languages, if applicable.

(vii) A statement that a FAP-eligible individual may not be charged more than AGB for emergency or other medically necessary care.

(25) *Presumptive FAP-eligibility determination* means a determination that an individual is FAP-eligible based on information other than that provided by the individual or based on a prior FAP-eligibility determination, as described in §1.501(r)-6(c)(2).

(26) *Private health insurer* means any organization that is not a governmental unit that offers health insurance, including nongovernmental organizations administering a health insurance plan under Medicare Advantage (Part C of Title XVIII of the Social Security Act, 42 U.S.C. 1395w-21 through 1395w-29). For purposes of §1.501(r)-5(b), medical assistance provided through a contract between the state and a Medicaid managed care organization or a prepaid inpatient health plan is not considered to be a reimbursement from or a claim allowed by a private health insurer.

(27) *Referring* an individual's debt to a debt collection agency or other party means contracting with, delegating to, or otherwise using the debt collection agency or other party to collect amounts owed by the individual to the hospital facility while still maintaining ownership of the debt.

(28) *Substantially-related entity* means, with respect to a hospital facility operated by a hospital organization, an entity treated as a partnership for federal tax purposes in which the hospital organization owns a capital or profits interest, or a disregarded entity of which the hospital organization is the sole member or owner, that provides emergency or other medically necessary care in the hospital facility, unless the provision of such care is an unrelated trade or business described in section 513 with respect to the hospital organization. Notwithstanding the preceding sentence, a partnership that qualifies for the exception described in paragraph (b)(22)(ii)(B) of this section is not considered a substantially-related enti-

ty within the meaning of this paragraph (b)(28).

(29) *Widely available on a Web site* means—

(i) The hospital facility conspicuously posts a complete and current version of the document on—

(A) The hospital facility's Web site;

(B) If the hospital facility does not have its own Web site separate from the hospital organization that operates it, the hospital organization's Web site; or

(C) A Web site established and maintained by another entity, but only if the Web site of the hospital facility or hospital organization (if the facility or organization has a Web site) provides a conspicuously-displayed link to the Web page where the document is posted, along with clear instructions for accessing the document on that Web site;

(ii) Individuals with access to the Internet can access, download, view, and print a hard copy of the document from the Web site—

(A) Without requiring special computer hardware or software (other than software that is readily available to members of the public without payment of any fee);

(B) Without paying a fee to the hospital facility, hospital organization, or other entity maintaining the Web site; and

(C) Without creating an account or being otherwise required to provide personally identifiable information; and

(iii) The hospital facility provides individuals who ask how to access a copy of the document online with the direct Web site address, or URL, of the Web page where the document is posted.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014; 80 FR 12762, Mar. 11, 2015]

#### § 1.501(r)-2 Failures to satisfy section 501(r).

(a) *Revocation of section 501(c)(3) status.* Except as otherwise provided in paragraphs (b) and (c) of this section, a hospital organization failing to meet one or more of the requirements of section 501(r) separately with respect to one or more hospital facilities it operates may have its section 501(c)(3) status revoked as of the first day of the

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taxable year in which the failure occurs. In determining whether to continue to recognize the section 501(c)(3) status of a hospital organization that fails to meet one or more of the requirements of section 501(r) with respect to one or more hospital facilities, the Commissioner will consider all relevant facts and circumstances including, but not limited to, the following:

(1) Whether the organization has previously failed to meet the requirements of section 501(r), and, if so, whether the same type of failure previously occurred.

(2) The size, scope, nature, and significance of the organization's failure(s).

(3) In the case of an organization that operates more than one hospital facility, the number, size, and significance of the facilities that have failed to meet the section 501(r) requirements relative to those that have complied with these requirements.

(4) The reason for the failure(s).

(5) Whether the organization had, prior to the failure(s), established practices or procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the section 501(r) requirements.

(6) Whether the practices or procedures had been routinely followed and the failure(s) occurred through an oversight or mistake in applying them.

(7) Whether the organization has implemented safeguards that are reasonably calculated to prevent similar failures from occurring in the future.

(8) Whether the organization corrected the failure(s) as promptly after discovery as is reasonable given the nature of the failure(s).

(9) Whether the organization took the measures described in paragraphs (a)(7) and (a)(8) of this section before the Commissioner discovered the failure(s).

(b) *Minor omissions and errors*—(1) *In general.* A hospital facility's omission of required information from a policy or report described in § 1.501(r)-3 or § 1.501(r)-4, or error with respect to the implementation or operational requirements described in §§ 1.501(r)-3 through 1.501(r)-6, will not be considered a failure to meet a requirement of section

501(r) if the following conditions are satisfied:

(i) Such omission or error was minor and either inadvertent or due to reasonable cause.

(ii) The hospital facility corrects such omission or error as promptly after discovery as is reasonable given the nature of the omission or error. Such correction must include establishment (or review and, if necessary, revision) of practices or procedures (formal or informal) that are reasonably designed to promote and facilitate overall compliance with the requirements of section 501(r).

(2) *Minor.* In the case of multiple omissions or errors, the omissions or errors are considered minor for purposes of this paragraph (b) only if they are minor in the aggregate.

(3) *Inadvertent.* For purposes of this paragraph (b), the fact that the same omission or error has been made and corrected previously is a factor tending to show that an omission or error is not inadvertent.

(4) *Reasonable cause.* For purposes of this paragraph (b), the fact that a hospital facility has established practices or procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the section 501(r) requirements prior to the occurrence of an omission or error is a factor tending to show that the omission or error is due to reasonable cause.

(c) *Excusing certain failures if hospital facility corrects and discloses.* A hospital facility's failure to meet one or more of the requirements described in §§ 1.501(r)-3 through 1.501(r)-6 that is neither willful nor egregious shall be excused for purposes of this section if the hospital facility corrects and makes disclosure in accordance with rules set forth by revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin. For purposes of this paragraph (c), a "willful" failure includes a failure due to gross negligence, reckless disregard, or willful neglect, and an "egregious" failure includes only a very serious failure, taking into account the severity of the impact and the number of affected persons. Whether a failure is willful or egregious will be determined based on

all of the facts and circumstances. A hospital facility's correction and disclosure of a failure in accordance with the relevant guidance is a factor tending to show that the failure was not willful.

(d) *Taxation of noncompliant hospital facilities*—(1) *In general.* Except as otherwise provided in paragraphs (b) and (c) of this section, if a hospital organization that operates more than one hospital facility fails to meet one or more of the requirements of section 501(r) separately with respect to a hospital facility during a taxable year, the income derived from the noncompliant hospital facility (“noncompliant facility income”) during that taxable year will be subject to tax computed as provided in section 11 (or as provided in section 1(e) if the hospital organization is a trust described in section 511(b)(2)), but substituting the term “noncompliant facility income” for “taxable income,” if—

(i) The hospital organization continues to be recognized as described in section 501(c)(3) during the taxable year; but

(ii) The hospital organization would not continue to be recognized as described in section 501(c)(3) during the taxable year based on the facts and circumstances described in paragraph (a) of this section (but disregarding paragraph (a)(3) of this section) if the noncompliant hospital facility were the only hospital facility operated by the organization.

(2) *Noncompliant facility income*—(i) *In general.* For purposes of this paragraph (d), the noncompliant facility income derived from a hospital facility during a taxable year will be the gross income derived from that hospital facility during the taxable year, less the deductions allowed by chapter 1 that are directly connected to the operation of that hospital facility during the taxable year, excluding any gross income and deductions taken into account in computing any unrelated business taxable income described in section 512 that is derived from the facility during the taxable year.

(ii) *Directly connected deductions.* For purposes of this paragraph (d), to be directly connected with the operation of a hospital facility that has failed to

meet the requirements of section 501(r), an item of deduction must have proximate and primary relationship to the operation of the hospital facility. Expenses, depreciation, and similar items attributable solely to the operation of a hospital facility are proximately and primarily related to such operation, and therefore qualify for deduction to the extent that they meet the requirements of section 162, section 167, or other relevant provisions of the Internal Revenue Code (Code). Where expenses, depreciation, and similar items are attributable to a noncompliant hospital facility and other hospital facilities operated by the hospital organization (and/or to other activities of the hospital organization unrelated to the operation of hospital facilities), such items shall be allocated among the hospital facilities (and/or other activities) on a reasonable basis. The portion of any such item so allocated to a noncompliant hospital facility is proximately and primarily related to the operation of that facility and shall be allowable as a deduction in computing the facility's noncompliant facility income in the manner and to the extent it would meet the requirements of section 162, section 167, or other relevant provisions of the Code.

(3) *No aggregation.* In computing the noncompliant facility income of a hospital facility, the gross income from (and the deductions allowed with respect to) the hospital facility may not be aggregated with the gross income from (and the deductions allowed with respect to) the hospital organization's other noncompliant hospital facilities subject to tax under this paragraph (d) or its unrelated trade or business activities described in section 513.

(4) *Interaction with other Code provisions*—(i) *Hospital organization operating a noncompliant hospital facility continues to be treated as tax-exempt.* A hospital organization operating a noncompliant hospital facility subject to tax under this paragraph (d) shall continue to be treated as an organization that is exempt from tax under section 501(a) because it is described in section 501(c)(3) for all purposes of the Code. In addition, the application of this paragraph (d) shall not, by itself, result in the operation of the noncompliant hospital

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facility being considered an unrelated trade or business described in section 513 with respect to the hospital organization. Thus, for example, the application of this paragraph (d) shall not, by itself, affect the tax-exempt status of bonds issued to finance the noncompliant hospital facility.

(ii) *Noncompliant hospital facility operated by a tax-exempt hospital organization is subject to tax.* A noncompliant hospital facility described in paragraph (d)(1) of this section is subject to tax under this paragraph (d), notwithstanding the fact that the hospital organization operating the hospital facility is otherwise exempt from tax under section 501(a) and subject to tax under section 511(a) and that §1.11-1(a) of this chapter states such organizations are not liable for the tax imposed under section 11.

(iii) *Noncompliant hospital facility not a business entity.* A noncompliant hospital facility subject to tax under this paragraph (d) is not considered a business entity for purposes of §301.7701-2(b)(7) of this chapter.

(e) *Instances in which a hospital organization is not required to meet section 501(r).* A hospital organization is not required to meet the requirements of section 501(r) (and, therefore, is not subject to any consequence described in this section for failing to meet the requirements of section 501(r)) with respect to—

(1) Any hospital facility it is not “operating” within the meaning of §1.501(r)-1(b)(22);

(2) The operation of a facility that is not required by a state to be licensed, registered, or similarly recognized as a hospital; or

(3) Any activities that constitute an unrelated trade or business described in section 513 with respect to the hospital organization.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014; 80 FR 12762, Mar. 11, 2015]

#### **§ 1.501(r)-3 Community health needs assessments.**

(a) *In general.* With respect to any taxable year, a hospital organization meets the requirements of section 501(r)(3) with respect to a hospital facility it operates only if—

(1) The hospital facility has conducted a community health needs assessment (CHNA) that meets the requirements of paragraph (b) of this section in such taxable year or in either of the two taxable years immediately preceding such taxable year (except as provided in paragraph (d) of this section); and

(2) An authorized body of the hospital facility (as defined in §1.501(r)-1(b)(4)) has adopted an implementation strategy to meet the community health needs identified through the CHNA, as described in paragraph (c) of this section, on or before the 15th day of the fifth month after the end of such taxable year.

(b) *Conducting a CHNA—(1) In general.* To conduct a CHNA for purposes of paragraph (a) of this section, a hospital facility must complete all of the following steps:

(i) Define the community it serves.

(ii) Assess the health needs of that community.

(iii) In assessing the health needs of the community, solicit and take into account input received from persons who represent the broad interests of that community, including those with special knowledge of or expertise in public health.

(iv) Document the CHNA in a written report (CHNA report) that is adopted for the hospital facility by an authorized body of the hospital facility.

(v) Make the CHNA report widely available to the public.

(2) *Date a CHNA is conducted.* For purposes of this section, a hospital facility will be considered to have conducted a CHNA on the date it has completed all of the steps described in paragraph (b)(1) of this section. Solely for purposes of determining the taxable year in which a CHNA has been conducted under this paragraph (b)(2), a hospital facility will be considered to have completed the step of making a CHNA report widely available to the public on the date it first makes the CHNA report widely available to the public as described in paragraph (b)(7)(i) of this section.

(3) *Community served by a hospital facility.* In defining the community it serves for purposes of paragraph

(b)(1)(i) of this section, a hospital facility may take into account all of the relevant facts and circumstances, including the geographic area served by the hospital facility, target population(s) served (for example, children, women, or the aged), and principal functions (for example, focus on a particular specialty area or targeted disease). However, a hospital facility may not define its community to exclude medically underserved, low-income, or minority populations who live in the geographic areas from which the hospital facility draws its patients (unless such populations are not part of the hospital facility's target patient population(s) or affected by its principal functions) or otherwise should be included based on the method the hospital facility uses to define its community. In addition, in determining its patient populations for purposes of defining its community, a hospital facility must take into account all patients without regard to whether (or how much) they or their insurers pay for the care received or whether they are eligible for assistance under the hospital facility's financial assistance policy. In the case of a hospital facility consisting of multiple buildings that operate under a single state license and serve different geographic areas or populations, the community served by the hospital facility is the aggregate of such areas or populations.

(4) *Assessing community health needs.* To assess the health needs of the community it serves for purposes of paragraph (b)(1)(ii) of this section, a hospital facility must identify significant health needs of the community, prioritize those health needs, and identify resources (such as organizations, facilities, and programs in the community, including those of the hospital facility) potentially available to address those health needs. For these purposes, the health needs of a community include requisites for the improvement or maintenance of health status both in the community at large and in particular parts of the community (such as particular neighborhoods or populations experiencing health disparities). These needs may include, for example, the need to address financial and other barriers to accessing care, to

prevent illness, to ensure adequate nutrition, or to address social, behavioral, and environmental factors that influence health in the community. A hospital facility may determine whether a health need is significant based on all of the facts and circumstances present in the community it serves. In addition, a hospital facility may use any criteria to prioritize the significant health needs it identifies, including, but not limited to, the burden, scope, severity, or urgency of the health need; the estimated feasibility and effectiveness of possible interventions; the health disparities associated with the need; or the importance the community places on addressing the need.

(5) *Persons representing the broad interests of the community—(i) In general.* For purposes of paragraph (b)(1)(iii) of this section, a hospital facility must solicit and take into account input received from all of the following sources in identifying and prioritizing significant health needs and in identifying resources potentially available to address those health needs:

(A) At least one state, local, tribal, or regional governmental public health department (or equivalent department or agency), or a State Office of Rural Health described in section 338J of the Public Health Service Act (42 U.S.C. 254r), with knowledge, information, or expertise relevant to the health needs of that community.

(B) Members of medically underserved, low-income, and minority populations in the community served by the hospital facility, or individuals or organizations serving or representing the interests of such populations. For purposes of this paragraph (b), medically underserved populations include populations experiencing health disparities or at risk of not receiving adequate medical care as a result of being uninsured or underinsured or due to geographic, language, financial, or other barriers.

(C) Written comments received on the hospital facility's most recently conducted CHNA and most recently adopted implementation strategy.

(ii) *Additional sources of input.* In addition to the sources described in paragraph (b)(5)(i) of this section, a hospital

facility may solicit and take into account input received from a broad range of persons located in or serving its community, including, but not limited to, health care consumers and consumer advocates, nonprofit and community-based organizations, academic experts, local government officials, local school districts, health care providers and community health centers, health insurance and managed care organizations, private businesses, and labor and workforce representatives.

(6) *Documentation of a CHNA*—(i) *In general.* For purposes of paragraph (b)(1)(iv) of this section, the CHNA report adopted for the hospital facility by an authorized body of the hospital facility must include—

(A) A definition of the community served by the hospital facility and a description of how the community was determined;

(B) A description of the process and methods used to conduct the CHNA;

(C) A description of how the hospital facility solicited and took into account input received from persons who represent the broad interests of the community it serves;

(D) A prioritized description of the significant health needs of the community identified through the CHNA, along with a description of the process and criteria used in identifying certain health needs as significant and prioritizing those significant health needs;

(E) A description of the resources potentially available to address the significant health needs identified through the CHNA; and

(F) An evaluation of the impact of any actions that were taken, since the hospital facility finished conducting its immediately preceding CHNA, to address the significant health needs identified in the hospital facility's prior CHNA(s).

(ii) *Process and methods used to conduct the CHNA.* A hospital facility's CHNA report will be considered to describe the process and methods used to conduct the CHNA for purposes of paragraph (b)(6)(i)(B) of this section if the CHNA report describes the data and other information used in the assessment, as well as the methods of collecting and analyzing this data and in-

formation, and identifies any parties with whom the hospital facility collaborated, or with whom it contracted for assistance, in conducting the CHNA. In the case of data obtained from external source material, the CHNA report may cite the source material rather than describe the method of collecting the data.

(iii) *Input from persons who represent the broad interests of the community served by the hospital facility.* A hospital facility's CHNA report will be considered to describe how the hospital facility took into account input received from persons who represent the broad interests of the community it serves for purposes of paragraph (b)(6)(i)(C) of this section if the CHNA report summarizes, in general terms, any input provided by such persons and how and over what time period such input was provided (for example, whether through meetings, focus groups, interviews, surveys, or written comments and between what approximate dates); provides the names of any organizations providing input and summarizes the nature and extent of the organization's input; and describes the medically underserved, low-income, or minority populations being represented by organizations or individuals that provided input. A CHNA report does not need to name or otherwise identify any specific individual providing input on the CHNA. In the event a hospital facility solicits, but cannot obtain, input from a source described in paragraph (b)(5)(i) of this section, the hospital facility's CHNA report also must describe the hospital facility's efforts to solicit input from such source.

(iv) *Separate CHNA reports.* While a hospital facility may conduct its CHNA in collaboration with other organizations and facilities (including, but not limited to, related and unrelated hospital organizations and facilities, nonprofit and government hospitals, governmental departments, and nonprofit organizations), every hospital facility must document the information described in this paragraph (b)(6) in a separate CHNA report to satisfy paragraph (b)(1)(iv) of this section unless it adopts a joint CHNA report as described in paragraph (b)(6)(v) of this section. However, if a hospital facility



is collaborating with other facilities and organizations in conducting its CHNA or if another organization (such as a state or local public health department) has conducted a CHNA for all or part of the hospital facility's community, portions of the hospital facility's CHNA report may be substantively identical to portions of a CHNA report of a collaborating hospital facility or other organization conducting a CHNA, if appropriate under the facts and circumstances. For example, if two hospital facilities with overlapping, but not identical, communities are collaborating in conducting a CHNA, the portions of each hospital facility's CHNA report relevant to the shared areas of their communities might be identical. Similarly, if the state or local public health department with jurisdiction over the community served by a hospital facility conducts a CHNA for an area that includes the hospital facility's community, the hospital facility's CHNA report might include portions of the state or local public health department's CHNA report that are relevant to its community.

(v) *Joint CHNA reports*—(A) *In general.* A hospital facility that collaborates with other hospital facilities or other organizations (such as state or local public health departments) in conducting its CHNA will satisfy paragraph (b)(1)(iv) of this section if an authorized body of the hospital facility adopts for the hospital facility a joint CHNA report produced for the hospital facility and one or more of the collaborating facilities and organizations, provided that the following conditions are met:

(1) The joint CHNA report meets the requirements of paragraph (b)(6)(i) of this section.

(2) The joint CHNA report is clearly identified as applying to the hospital facility.

(3) All of the collaborating hospital facilities and organizations included in the joint CHNA report define their community to be the same.

(B) *Example.* The following example illustrates this paragraph (b)(6)(v):

*Example.* P is one of 10 hospital facilities located in and serving the populations of a particular Metropolitan Statistical Area (MSA). P and seven other facilities in the

MSA, some of which are unrelated to P, decide to collaborate in conducting a CHNA for the MSA and to each define their community as constituting the entire MSA. The eight hospital facilities work together with the state and local health departments of jurisdictions in the MSA to assess the health needs of the MSA and collaborate in conducting surveys and holding public forums to solicit and receive input from the MSA's residents, including its medically underserved, low-income, and minority populations. The hospital facilities also consider the written comments received on their most recently conducted CHNAs and most recently adopted implementation strategies. The hospital facilities then work together to prepare a joint CHNA report documenting this joint CHNA process that contains all of the elements described in paragraph (b)(6)(i) of this section. The joint CHNA report identifies all of the collaborating hospital facilities included in the report, including P, by name, both within the report itself and on the cover page. The board of directors of the hospital organization operating P adopts the joint CHNA report for P. P has complied with the requirements of this paragraph (b)(6)(v) and, accordingly, has satisfied paragraph (b)(1)(iv) of this section.

(7) *Making the CHNA report widely available to the public*—(i) *In general.* For purposes of paragraph (b)(1)(v) of this section, a hospital facility's CHNA report is made widely available to the public only if the hospital facility—

(A) Makes the CHNA report widely available on a Web site, as defined in § 1.501(r)-1(b)(29), at least until the date the hospital facility has made widely available on a Web site its two subsequent CHNA reports; and

(B) Makes a paper copy of the CHNA report available for public inspection upon request and without charge at the hospital facility at least until the date the hospital facility has made available for public inspection a paper copy of its two subsequent CHNA reports.

(ii) *Making draft CHNA reports widely available.* Notwithstanding paragraph (b)(7)(i) of this section, if a hospital facility makes widely available on a Web site (and/or for public inspection) a version of the CHNA report that is expressly marked as a draft on which the public may comment, the hospital facility will not be considered to have made the CHNA report widely available to the public for purposes of determining the date on which the hospital

facility has conducted a CHNA under paragraph (b)(2) of this section.

(c) *Implementation strategy*—(1) *In general.* For purposes of paragraph (a)(2) of this section, a hospital facility's implementation strategy to meet the community health needs identified through the hospital facility's CHNA is a written plan that, with respect to each significant health need identified through the CHNA, either—

(i) Describes how the hospital facility plans to address the health need; or

(ii) Identifies the health need as one the hospital facility does not intend to address and explains why the hospital facility does not intend to address the health need.

(2) *Description of how the hospital facility plans to address a significant health need.* A hospital facility's implementation strategy will have described a plan to address a significant health need identified through a CHNA for purposes of paragraph (c)(1)(i) of this section if the implementation strategy—

(i) Describes the actions the hospital facility intends to take to address the health need and the anticipated impact of these actions;

(ii) Identifies the resources the hospital facility plans to commit to address the health need; and

(iii) Describes any planned collaboration between the hospital facility and other facilities or organizations in addressing the health need.

(3) *Description of why a hospital facility is not addressing a significant health need.* In explaining why it does not intend to address a significant health need for purposes of paragraph (c)(1)(ii) of this section, a brief explanation of the hospital facility's reason for not addressing the health need is sufficient. Such reasons may include, for example, resource constraints, other facilities or organizations in the community addressing the need, a relative lack of expertise or competency to effectively address the need, the need being a relatively low priority, and/or a lack of identified effective interventions to address the need.

(4) *Joint implementation strategies.* A hospital facility may develop an implementation strategy in collaboration with other hospital facilities or other organizations, including, but not lim-

ited to, related and unrelated hospital organizations and facilities, for-profit and government hospitals, governmental departments, and nonprofit organizations. In general, a hospital facility that collaborates with other facilities or organizations in developing its implementation strategy must still document its implementation strategy in a separate written plan that is tailored to the particular hospital facility, taking into account its specific resources. However, a hospital facility that adopts a joint CHNA report described in paragraph (b)(6)(v) of this section may also adopt a joint implementation strategy that, with respect to each significant health need identified through the joint CHNA, either describes how one or more of the collaborating facilities or organizations plan to address the health need or identifies the health need as one the collaborating facilities or organizations do not intend to address and explains why they do not intend to address the health need. For a collaborating hospital facility to meet the requirements of paragraph (a)(2) of this section, such a joint implementation strategy adopted for the hospital facility must—

(i) Be clearly identified as applying to the hospital facility;

(ii) Clearly identify the hospital facility's particular role and responsibilities in taking the actions described in the implementation strategy and the resources the hospital facility plans to commit to such actions; and

(iii) Include a summary or other tool that helps the reader easily locate those portions of the joint implementation strategy that relate to the hospital facility.

(5) *When the implementation strategy must be adopted*—(i) *In general.* For purposes of paragraph (a)(2) of this section, an authorized body of the hospital facility must adopt the implementation strategy on or before the 15th day of the fifth month after the end of the taxable year in which the hospital facility completes the final step for the CHNA described in paragraph (b)(1) of this section, regardless of whether the hospital facility began working on the CHNA in a prior taxable year.

(ii) *Example.* The following example illustrates this paragraph (c)(5):

*Example.* M is a hospital facility that last conducted a CHNA and adopted an implementation strategy in Year 1. In Year 3, M defines the community it serves, assesses the significant health needs of that community, and solicits and takes into account input received from persons who represent the broad interests of that community. In Year 4, M documents its CHNA in a CHNA report that is adopted by an authorized body of M, makes the CHNA report widely available on a Web site, and makes paper copies of the CHNA report available for public inspection. To meet the requirements of paragraph (a)(2) of this section, an authorized body of M must adopt an implementation strategy to meet the health needs identified through the CHNA completed in Year 4 by the 15th day of the fifth month of Year 5.

(d) *Exception for acquired, new, and terminated hospital facilities—(1) Acquired hospital facilities.* A hospital organization that acquires a hospital facility (whether through merger or acquisition) must meet the requirements of section 501(r)(3) with respect to the acquired hospital facility by the last day of the organization's second taxable year beginning after the date on which the hospital facility was acquired. In the case of a merger between two organizations that results in the liquidation of one organization and the survival of the other organization, the hospital facility or facilities formerly operated by the liquidated organization will be considered "acquired" for purposes of this paragraph (d)(1).

(2) *New hospital organizations.* An organization that becomes newly subject to the requirements of section 501(r) because it is recognized as described in section 501(c)(3) and is operating a hospital facility must meet the requirements of section 501(r)(3) with respect to any hospital facility by the last day of the second taxable year beginning after the later of the effective date of the determination letter or ruling recognizing the organization as described in section 501(c)(3) or the first date that a facility operated by the organization was licensed, registered, or similarly recognized by a state as a hospital.

(3) *New hospital facilities.* A hospital organization must meet the requirements of section 501(r)(3) with respect to a new hospital facility it operates by the last day of the second taxable year beginning after the date the facility

was licensed, registered, or similarly recognized by its state as a hospital.

(4) *Transferred or terminated hospital facilities.* A hospital organization is not required to meet the requirements of section 501(r)(3) with respect to a hospital facility in a taxable year if, before the end of that taxable year, the hospital organization transfers all ownership of the hospital facility to another organization or otherwise ceases its operation of the hospital facility or the facility ceases to be licensed, registered, or similarly recognized as a hospital by a state.

(e) *Transition rule for CHNAs conducted in taxable years beginning before March 23, 2012.* A hospital facility that conducted a CHNA described in section 501(r)(3) in either its first taxable year beginning after March 23, 2010, or its first taxable year beginning after March 23, 2011, does not need to meet the requirements of section 501(r)(3) again until the third taxable year following the taxable year in which the hospital facility conducted that CHNA, provided that the hospital facility adopted an implementation strategy to meet the community health needs identified through that CHNA on or before the 15th day of the fifth calendar month following the close of its first taxable year beginning after March 23, 2012.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014; 80 FR 12762, Mar. 11, 2015]

#### § 1.501(r)-4 Financial assistance policy and emergency medical care policy.

(a) *In general.* A hospital organization meets the requirements of section 501(r)(4) with respect to a hospital facility it operates only if the hospital organization establishes for that hospital facility—

(1) A written financial assistance policy (FAP) that meets the requirements of paragraph (b) of this section; and

(2) A written emergency medical care policy that meets the requirements of paragraph (c) of this section.

(b) *Financial assistance policy—(1) In general.* To satisfy paragraph (a)(1) of this section, a hospital facility's FAP must—

(i) Apply to all emergency and other medically necessary care provided by the hospital facility, including all such

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care provided in the hospital facility by a substantially-related entity (as defined in §1.501(r)-1(b)(28));

(ii) Be widely publicized as described in paragraph (b)(5) of this section; and

(iii) Include—

(A) The eligibility criteria for financial assistance and whether such assistance includes free or discounted care;

(B) The basis for calculating amounts charged to patients;

(C) The method for applying for financial assistance;

(D) In the case of a hospital facility that does not have a separate billing and collections policy, the actions that may be taken in the event of non-payment;

(E) If applicable, any information obtained from sources other than an individual seeking financial assistance that the hospital facility uses, and whether and under what circumstances it uses prior FAP-eligibility determinations, to presumptively determine that the individual is FAP-eligible, as described in §1.501(r)-6(c)(2); and

(F) A list of any providers, other than the hospital facility itself, delivering emergency or other medically necessary care in the hospital facility that specifies which providers are covered by the hospital facility’s FAP and which are not.

(2) *Eligibility criteria and basis for calculating amounts charged to patients*—(i) *In general.* To satisfy paragraphs (b)(1)(iii)(A) and (b)(1)(iii)(B) of this section, the FAP must specify the following:

(A) All financial assistance available under the FAP, including all discounts and free care available under the FAP and, if applicable, the amount(s) (for example, gross charges) to which any discount percentages available under the FAP will be applied.

(B) The eligibility criteria that an individual must satisfy to receive each discount, free care, or other level of assistance available under the FAP.

(C) The method under §1.501(r)-5(b) the hospital facility uses to determine the amounts generally billed to individuals who have insurance covering emergency or other medically necessary care (AGB). If the hospital facility uses the look-back method de-

scribed in §1.501(r)-5(b)(3), the FAP also must state the AGB percentage(s) that the hospital facility uses to determine AGB and describe how the hospital facility calculated such percentage(s) or, alternatively, explain how members of the public may readily obtain such percentage(s) and accompanying description of the calculation in writing and free of charge. In addition, the FAP must indicate that, following a determination of FAP-eligibility, a FAP-eligible individual may not be charged more than AGB for emergency or other medically necessary care.

(ii) *Examples.* The following examples illustrate this paragraph (b)(2):

*Example 1.* (i) Q is a hospital facility that establishes a FAP that provides assistance to all uninsured and underinsured individuals whose family income is less than or equal to x% of the Federal Poverty Level (FPL), with the level of discount for which an individual is eligible under Q’s FAP determined based upon the individual’s family income as a percentage of FPL. Q’s FAP defines the meaning of “uninsured,” “underinsured,” “family income,” and “Federal Poverty Level.” Q’s FAP also states that Q determines AGB by multiplying the gross charges for any emergency or other medically necessary care it provides to a FAP-eligible individual by an AGB percentage of 56%. The FAP states, further, that Q calculated the AGB percentage of 56% based on all claims allowed by Medicare and private health insurers over a specified 12-month period, divided by the associated gross charges for those claims. Q’s FAP contains the following chart, specifying each discount available under the FAP, the amounts (gross charges) to which these discounts will be applied, and the specific eligibility criteria for each such discount:

Family income as % of FPL	Discount off of gross charges
>y% – x% .....	50%.
>z% – y% .....	75%.
≤z% .....	Free.

(ii) Q’s FAP also contains a statement that no FAP-eligible individual will be charged more for emergency or other medically necessary care than AGB because Q’s AGB percentage is 56% of gross charges and the most a FAP-eligible individual will be charged is 50% of gross charges. Q’s FAP satisfies the requirements of this paragraph (b)(2).

*Example 2.* (i) R is a hospital facility that establishes a FAP that provides assistance based on household income. R’s FAP defines the meaning of “household income.” R’s FAP contains the following chart specifying the assistance available under the FAP and

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the specific eligibility criteria for each level of assistance offered, which R updates occasionally to account for inflation:

Household income	Maximum amount individual will be responsible for paying
>\$b – \$a .....	40% of gross charges, up to the lesser of AGB or x% of household income.
>\$c – \$b .....	20% of gross charges, up to the lesser of AGB or y% of household income.
≤\$c .....	\$0 (free).

(ii) R's FAP contains a statement that no FAP-eligible individual will be charged more for emergency or other medically necessary care than AGB. R's FAP also states that R determines AGB by multiplying the gross charges for any emergency or other medically necessary care it provides by AGB percentages, which are based on claims allowed under Medicare. In addition, the FAP provides a Web site address individuals can visit, and a telephone number they can call, if they would like to obtain an information sheet stating R's AGB percentages and explaining how these AGB percentages were calculated. This information sheet, which R makes available on its Web site and provides to any individual who requests it, states that R's AGB percentages are 35% of gross charges for inpatient care and 61% of gross charges for outpatient care. It also states that these percentages were based on all claims allowed for R's emergency or other medically necessary inpatient and outpatient care by Medicare over a specified 12-month period, divided by the associated gross charges for those claims. R's FAP satisfies the requirements of this paragraph (b)(2).

(3) *Method for applying for financial assistance*—(i) *In general.* To satisfy paragraph (b)(1)(iii)(C) of this section, a hospital facility's FAP must describe how an individual applies for financial assistance under the FAP. In addition, either the hospital facility's FAP or FAP application form (including accompanying instructions) must describe the information and documentation the hospital facility may require an individual to provide as part of his or her FAP application and provide the contact information described in §1.501(r)-1(b)(24)(v). A hospital facility may not deny financial assistance under its FAP based on an applicant's failure to provide information or documentation unless that information or documentation is described in the FAP or FAP application form. However, a hospital facility may grant financial assistance under its FAP notwith-

standing an applicant's failure to provide information or documentation described in the FAP or FAP application form and may, for example, rely on other evidence of eligibility or an attestation by the applicant to determine that the applicant is FAP-eligible.

(ii) *Example.* The following example illustrates this paragraph (b)(3):

*Example.* S is a hospital facility with a FAP that bases eligibility solely on an individual's household income. S's FAP provides that an individual may apply for financial assistance by completing and submitting S's FAP application form. S's FAP also describes how individuals can obtain copies of the FAP application form. S's FAP application form contains lines on which the applicant lists all items of household income received by the applicant's household over the last month and the names of the applicant's household members. The instructions to S's FAP application form tell applicants where to submit the application and provide that an applicant must attach to his or her FAP application form proof of household income in the form of payroll check stubs from the last month or, if last month's wages are not representative of the applicant's annual income, a copy of the applicant's most recent federal tax return. Alternatively, the instructions state that an applicant may provide documentation of his or her qualification for certain specified state means-tested programs. The instructions also state that if an applicant does not have any of the listed documents proving household income, he or she may call S's financial assistance office and discuss other evidence that may be provided to demonstrate eligibility. S does not deny financial assistance to FAP applicants based on a failure to submit any information or documentation not mentioned in the FAP application form or instructions. S's FAP application form instructions also provide the contact information of the hospital facility office that can provide an applicant with information about the FAP and assistance with the FAP application process. S's FAP satisfies the requirements of this paragraph (b)(3).

(4) *Actions that may be taken in the event of nonpayment*—(i) *In general.* To satisfy paragraph (b)(1)(iii)(D) of this section, either a hospital facility's FAP or a separate written billing and collections policy established for the hospital facility must describe—

(A) Any actions that the hospital facility (or other authorized party) may take related to obtaining payment of a bill for medical care, including, but not

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limited to, any extraordinary collection actions (ECAs) described in § 1.501(r)-6(b);

(B) The process and time frames the hospital facility (or other authorized party) uses in taking the actions described in paragraph (b)(4)(i)(A) of this section, including, but not limited to, the reasonable efforts it will make to determine whether an individual is FAP-eligible before engaging in any ECAs, as described in § 1.501(r)-6(c); and

(C) The office, department, committee, or other body with the final authority or responsibility for determining that the hospital facility has made reasonable efforts to determine whether an individual is FAP-eligible and may therefore engage in ECAs against the individual.

(ii) *Separate billing and collections policy.* In the case of a hospital facility that satisfies paragraph (b)(1)(iii)(D) of this section by establishing a separate written billing and collections policy, the hospital facility's FAP must state that the actions the hospital facility may take in the event of nonpayment are described in a separate billing and collections policy and explain how members of the public may readily obtain a free copy of this separate policy.

(5) *Widely publicizing the FAP*—(i) *In general.* To satisfy the requirement in paragraph (b)(1)(ii) of this section to widely publicize its FAP, a hospital facility must—

(A) Make the FAP, FAP application form, and plain language summary of the FAP (as defined in § 1.501(r)-1(b)(24)) widely available on a Web site (as defined in § 1.501(r)-1(b)(29));

(B) Make paper copies of the FAP, FAP application form, and plain language summary of the FAP available upon request and without charge, both by mail and in public locations in the hospital facility, including, at a minimum, in the emergency room (if any) and admissions areas;

(C) Notify and inform members of the community served by the hospital facility about the FAP in a manner reasonably calculated to reach those members who are most likely to require financial assistance from the hospital facility; and

(D) Notify and inform individuals who receive care from the hospital facility about the FAP by—

(1) Offering a paper copy of the plain language summary of the FAP to patients as part of the intake or discharge process;

(2) Including a conspicuous written notice on billing statements that notifies and informs recipients about the availability of financial assistance under the hospital facility's FAP and includes the telephone number of the hospital facility office or department that can provide information about the FAP and FAP application process and the direct Web site address (or URL) where copies of the FAP, FAP application form, and plain language summary of the FAP may be obtained; and

(3) Setting up conspicuous public displays (or other measures reasonably calculated to attract patients' attention) that notify and inform patients about the FAP in public locations in the hospital facility, including, at a minimum, the emergency room (if any) and admissions areas.

(ii) *Accessibility to limited English proficient individuals.* To widely publicize its FAP, a hospital facility must accommodate all significant populations that have limited English proficiency (LEP) by translating its FAP, FAP application form, and plain language summary of the FAP into the primary language(s) spoken by such populations. A hospital facility will satisfy this translation requirement in a taxable year if it makes available translations of its FAP, FAP application form, and plain language summary of the FAP in the language spoken by each LEP language group that constitutes the lesser of 1,000 individuals or 5 percent of the community served by the hospital facility or the population likely to be affected or encountered by the hospital facility. For purposes of this paragraph (b)(5)(ii), a hospital facility may determine the percentage or number of LEP individuals in the hospital facility's community or likely to be affected or encountered by the hospital facility using any reasonable method.

(iii) *Meaning of notify and inform.* For purposes of paragraphs (b)(5)(i)(C) and (b)(5)(i)(D)(3) of this section, a measure

will notify and inform members of a community or patients about the hospital facility's FAP if the measure, at a minimum, notifies the reader or listener that the hospital facility offers financial assistance under a FAP and informs him or her about how or where to obtain more information about the FAP and FAP application process and to obtain copies of the FAP, FAP application form, and plain language summary of the FAP.

(iv) *Meaning of reasonably calculated.* Whether one or more measures to widely publicize a hospital facility's FAP are reasonably calculated to notify and inform members of a community or patients about the hospital facility's FAP in the manner described in paragraphs (b)(5)(i)(C) and (b)(5)(i)(D)(3) of this section will depend on all of the facts and circumstances, including the primary language(s) spoken by the members of the community served by the hospital facility and other attributes of the community and the hospital facility.

(v) *Examples.* The following examples illustrate this paragraph (b)(5):

*Example 1.* (i) Z is a hospital facility. The home page and main billing page of Z's Web site conspicuously display the following message: "Need help paying your bill? You may be eligible for financial assistance. Click *here* for more information." When readers click on the link, they are taken to a Web page that explains the various discounts available under Z's FAP and the specific eligibility criteria for each such discount. This Web page also provides all of the other information required to be included in a plain language summary of the FAP (as defined in § 1.501(r)-1(b)(24)), including a telephone number of Z that individuals can call and a room number of Z that individuals can visit for more information about the FAP and assistance with FAP applications. In addition, the Web page contains prominently-displayed links that allow readers to download PDF files of the FAP and the FAP application form, free of charge and without being required to create an account or provide personally identifiable information. Z provides any individual who asks how to access a copy of the FAP, FAP application form, or plain language summary of the FAP online with the URL of this Web page. By implementing these measures, Z has made its FAP widely available on a Web site within the meaning of paragraph (b)(5)(i)(A) of this section.

(ii) Z distributes copies of the plain language summary of its FAP and its FAP application form to all of its referring staff

physicians and to the community health centers serving its community. Z also distributes copies of these documents to the local health department and to numerous public agencies and nonprofit organizations in its community that address the health issues and other needs of low-income populations, in quantities sufficient to meet demand. In addition, every issue of the quarterly newsletter that Z mails to the individuals in its customer database contains a prominently-displayed advertisement informing readers that Z offers financial assistance and that people having trouble paying their hospital bills may be eligible for financial assistance. The advertisement provides readers with the URL of the Web page where Z's FAP and FAP application form can be accessed and a telephone number of Z that individuals can call and a room number of Z that individuals can visit with questions about the FAP or assistance with the FAP application process. By implementing these measures, Z notifies and informs members of its community about the FAP within the meaning of paragraph (b)(5)(i)(C) of this section.

(iii) Z makes paper copies of the FAP, FAP application form, and plain language summary of the FAP available upon request and without charge, both by mail and in its admissions areas and emergency room. Z also conspicuously displays a sign in large font regarding the FAP in its admissions areas and emergency room. The sign says: "Uninsured? Having trouble paying your hospital bill? You may be eligible for financial assistance." The sign also provides the URL of the Web page where Z's FAP and FAP application form can be accessed. In addition, the sign provides a telephone number of Z that individuals can call and a room number of Z that individuals can visit with questions about the FAP or assistance with the FAP application process. Underneath each sign, Z conspicuously displays copies of a brochure that contains all of the information required to be included in a plain language summary of the FAP (as defined in § 1.501(r)-1(b)(24)). Z makes these brochures available in quantities sufficient to meet visitor demand. Z also offers a plain language summary of the FAP as part of its intake process. Z's billing statements include a conspicuously-placed statement in large font containing the same information that Z includes on its signs. By implementing these measures, Z makes a paper copy of the FAP, FAP application form, and plain language summary of the FAP available upon request within the meaning of paragraph (b)(5)(i)(B) of this section and informs individuals who receive care from the hospital facility about the FAP within the meaning of paragraph (b)(5)(i)(D) of this section.

(iv) Because Z takes measures to widely publicize the FAP described in paragraphs (b)(5)(i)(A), (b)(5)(i)(B), (b)(5)(i)(C), and

(b)(5)(i)(D) of this section, Z meets the requirement to widely publicize its FAP under paragraph (b)(1)(ii) of this section.

*Example 2.* Assume the same facts as *Example 1*, except that Z serves a community in which 6% of the members speak Spanish and have limited proficiency in English. Z translates its FAP, FAP application form, and FAP brochure (which constitutes a plain language summary of the FAP) into Spanish, and displays and distributes both Spanish and English versions of these documents in its hospital facility using all of the measures described in *Example 1*. Z also distributes Spanish versions of its FAP application form and FAP brochure to organizations serving Spanish-speaking members of its community. Moreover, the home page and main billing page of Z's Web site conspicuously display an "¿Habla Español?" link that takes readers to a Web page that summarizes the FAP in Spanish and contains links that allow readers to download PDF files of the Spanish versions of the FAP and FAP application form, free of charge and without being required to create an account or provide personally identifiable information. Z meets the requirement to widely publicize its FAP under paragraph (b)(1)(ii) of this section.

(6) *Readily obtainable information.* For purposes of paragraphs (b)(2)(i)(C) and (b)(4)(ii) of this section, information is readily obtainable by members of the public if a hospital facility—

(i) Makes the information available free of charge on a Web site and via a paper copy upon request in a manner similar to that described in paragraphs (b)(5)(i)(A) and (b)(5)(i)(B) of this section; and

(ii) Provides translations of the information as described in paragraph (b)(5)(ii) of this section.

(7) *Providing documents electronically.* A hospital facility may provide electronically (for example, on an electronic screen, by email, or by providing the direct Web site address, or URL, of the Web page where the document or information is posted) any document or information that is required by this paragraph (b) to be provided in the form of a paper copy to any individual who indicates he or she prefers to receive or access the document or information electronically.

(8) *Medically necessary care.* For purposes of meeting the requirements of this section, a hospital facility may (but is not required to) use a definition of medically necessary care applicable under the laws of the state in which it

is licensed, including the Medicaid definition, or a definition that refers to the generally accepted standards of medicine in the community or to an examining physician's determination.

(c) *Emergency medical care policy*—(1) *In general.* To satisfy paragraph (a)(2) of this section, a hospital organization must establish a written policy for a hospital facility that requires the hospital facility to provide, without discrimination, care for emergency medical conditions to individuals regardless of whether they are FAP-eligible.

(2) *Interference with provision of emergency medical care.* A hospital facility's emergency medical care policy will not be described in paragraph (c)(1) of this section unless it prohibits the hospital facility from engaging in actions that discourage individuals from seeking emergency medical care, such as by demanding that emergency department patients pay before receiving treatment for emergency medical conditions or by permitting debt collection activities that interfere with the provision, without discrimination, of emergency medical care.

(3) *Relation to federal law governing emergency medical care.* Subject to paragraph (c)(2) of this section, a hospital facility's emergency medical care policy will be described in paragraph (c)(1) of this section if it requires the hospital facility to provide the care for emergency medical conditions that the hospital facility is required to provide under Subchapter G of Chapter IV of Title 42 of the Code of Federal Regulations (or any successor regulations).

(4) *Examples.* The following examples illustrate this paragraph (c):

*Example 1.* F is a hospital facility with a dedicated emergency department that is subject to the Emergency Medical Treatment and Labor Act (EMTALA) and is not a critical access hospital. F establishes a written emergency medical care policy requiring F to comply with EMTALA by providing medical screening examinations and stabilizing treatment and referring or transferring an individual to another facility, when appropriate, and providing emergency services in accordance with 42 CFR 482.55 (or any successor regulation). F's emergency medical care policy also states that F prohibits any actions that would discourage individuals from seeking emergency medical care, such as by demanding that emergency department patients pay before receiving treatment for



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emergency medical conditions or permitting debt collection activities that interfere with the provision, without discrimination, of emergency medical care. F's emergency medical care policy is described in paragraph (c)(1) of this section.

*Example 2.* G is a rehabilitation hospital facility. G does not have a dedicated emergency department, nor does it have specialized capabilities that would make it appropriate to accept transfers of individuals who need stabilizing treatment for an emergency medical condition. G establishes a written emergency medical care policy that addresses how it appraises emergencies, provides initial treatment, and refers or transfers an individual to another facility, when appropriate, in a manner that complies with 42 CFR 482.12(f)(2) (or any successor regulation). G's emergency medical care policy also prohibits G from engaging in actions that discourage individuals from seeking emergency medical care, such as by demanding that patients pay before receiving initial treatment for emergency medical conditions or permitting debt collection activities that interfere with the facility's appraisal and provision, without discrimination, of such initial treatment. G's emergency medical care policy is described in paragraph (c)(1) of this section.

(d) *Establishing the FAP and other policies*—(1) *In general.* A hospital organization has established a FAP, a billing and collections policy, or an emergency medical care policy for a hospital facility only if an authorized body of the hospital facility (as defined in § 1.501(r)-1(b)(4)) has adopted the policy for the hospital facility and the hospital facility has implemented the policy.

(2) *Implementing a policy.* For purposes of this paragraph (d), a hospital facility will be considered to have implemented a policy if the hospital facility has consistently carried out the policy.

(3) *Establishing a policy for more than one hospital facility.* A hospital organization may establish a FAP, billing and collections policy, and/or emergency medical care policy for a hospital facility that is identical to that of other hospital facilities or a joint policy that is shared with multiple hospital facilities provided that any joint policy clearly identifies each facility to which it applies. However, hospital facilities that have different AGB percentages or use different methods to determine AGB must include in their FAPs (or, in the case of information re-

lated to AGB percentages, otherwise make readily obtainable) different information regarding AGB to meet the requirements of paragraph (b)(2)(i)(C) of this section.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014]

### § 1.501(r)-5 Limitation on charges.

(a) *In general.* A hospital organization meets the requirements of section 501(r)(5) with respect to a hospital facility it operates only if the hospital facility (and any substantially-related entity, as defined in § 1.501(r)-1(b)(28)) limits the amount charged for care it provides to any individual who is eligible for assistance under its financial assistance policy (FAP) to—

(1) In the case of emergency or other medically necessary care, not more than the amounts generally billed to individuals who have insurance covering such care (AGB), as determined under paragraph (b) of this section; and

(2) In the case of all other medical care covered under the FAP, less than the gross charges for such care, as described in paragraph (c) of this section.

(b) *Amounts generally billed*—(1) *In general.* For purposes of meeting the requirements of paragraph (a)(1) of this section, a hospital facility must determine AGB for emergency or other medically necessary care using a method described in paragraph (b)(3) or (b)(4) of this section or any other method specified in regulations or other guidance published in the Internal Revenue Bulletin. A hospital facility may use only one of these methods to determine AGB at any one time, but different hospital facilities operated by the same hospital organization may use different methods. A hospital facility may change the method it uses to determine AGB at any time.

(2) *Meaning of charged.* For purposes of paragraph (a)(1) of this section, a FAP-eligible individual is considered to be “charged” only the amount he or she is personally responsible for paying, after all deductions, discounts (including discounts available under the FAP), and insurance reimbursements have been applied. Thus, in the case of a FAP-eligible individual who has health insurance coverage, a hospital facility will meet the requirements of paragraph (a)(1) of this section if the

FAP-eligible individual is not personally responsible for paying (for example, in the form of co-payments, co-insurance, and deductibles) more than AGB for the care after all reimbursements by the health insurer have been applied, even if the total amount paid by the FAP-eligible individual and his or her health insurer together exceeds AGB.

(3) *Look-back method*—(i) *In general.* A hospital facility may determine AGB for any emergency or other medically necessary care it provides to a FAP-eligible individual by multiplying the hospital facility's gross charges for the care by one or more percentages of gross charges (AGB percentage(s)). A hospital facility using this method must calculate its AGB percentage(s) at least annually by dividing the sum of the amounts of all of its claims for emergency and other medically necessary care that have been allowed by health insurers described in paragraph (b)(3)(ii) of this section during a prior 12-month period by the sum of the associated gross charges for those claims. Whether a claim is used in calculating a hospital facility's AGB percentage(s) depends on whether the claim was allowed by a health insurer during the 12-month period used in the calculation, not on whether the care resulting in the claim was provided during that 12-month period. If the amount a health insurer will allow for a claim has not been finally determined as of the last day of the 12-month period used to calculate the AGB percentage(s), a hospital facility should exclude the amount of the claim from that calculation and include it in the subsequent 12-month period during which the amount allowed is finally determined. When including allowed claims in calculating its AGB percentage(s), the hospital facility should include the full amount that has been allowed by the health insurer, including both the amount the insurer will pay or reimburse and the amount (if any) the individual is personally responsible for paying in the form of co-payments, co-insurance, and deductibles, regardless of whether or when the full amount allowed is actually paid and disregarding any discounts applied to the individual's portion.

(ii) *Health insurers used in calculating AGB percentage(s).* In calculating its AGB percentage(s), a hospital facility must include the claims allowed during a prior 12-month period by—

- (A) Medicare fee-for-service;
- (B) Medicare fee-for-service and all private health insurers that pay claims to the hospital facility; or
- (C) Medicaid, either alone or in combination with the insurer(s) described in paragraph (b)(3)(ii)(A) or (b)(3)(ii)(B) of this section.

(iii) *One or multiple AGB percentages.* A hospital facility's AGB percentage that is calculated using the method described in this paragraph (b)(3) may be one average percentage of gross charges for all emergency and other medically necessary care provided by the hospital facility. Alternatively, a hospital facility may calculate multiple AGB percentages for separate categories of care (such as inpatient and outpatient care or care provided by different departments) or for separate items or services, as long as the hospital facility calculates AGB percentages for all emergency and other medically necessary care provided by the hospital facility.

(iv) *Start date for applying AGB percentages.* For purposes of determining AGB under this paragraph (b)(3), with respect to any AGB percentage that a hospital facility has calculated, the hospital facility must begin applying the AGB percentage by the 120th day after the end of the 12-month period the hospital facility used in calculating the AGB percentage.

(v) *Use of all claims for medical care.* A hospital facility determining AGB under this paragraph (b)(3) may use claims allowed for all medical care during a prior 12-month period rather than just those allowed for emergency and other medically necessary care.

(vi) *Determining AGB percentages for more than one hospital facility.* Although generally a hospital organization must calculate AGB percentage(s) separately for each hospital facility it operates, hospital facilities that are covered under the same Medicare provider agreement (as defined in 42 CFR 489.3

or any successor regulations) may calculate one AGB percentage (or multiple AGB percentages for separate categories of care or for separate items or services) using the method described in this paragraph (b)(3) based on the claims and gross charges for all such hospital facilities and implement the AGB percentage(s) across all such hospital facilities.

(4) *Prospective Medicare or Medicaid method.* A hospital facility may determine AGB for any emergency or other medically necessary care provided to a FAP-eligible individual by using the billing and coding process the hospital facility would use if the FAP-eligible individual were a Medicare fee-for-service or Medicaid beneficiary and setting AGB for the care at the amount the hospital facility determines would be the total amount Medicare or Medicaid would allow for the care (including both the amount that would be reimbursed by Medicare or Medicaid and the amount the beneficiary would be personally responsible for paying in the form of co-payments, co-insurance, and deductibles). A hospital facility using the method described in this paragraph (b)(4) may base AGB on Medicare fee-for-service or Medicaid or both, provided that, if it uses both, its FAP describes the circumstance under which it will use Medicare fee-for-service or Medicaid in determining AGB.

(5) *Examples.* The following examples illustrate this paragraph (b):

*Example 1.* On March 15 of Year 1, Y, a hospital facility, generates data on the amount of all of Y's claims for emergency and other medically necessary care that were allowed by all private health insurers and Medicare fee-for-service over the immediately preceding calendar year. Y determines that the private health insurers allowed a total amount of \$250 million and Medicare fee-for-service allowed a total amount of \$150 million, with the total allowed amounts including both the portion the insurers agreed to reimburse and the portion that the insured patients were personally responsible for paying. Y's gross charges for these claims totaled \$800 million. Y calculates that its AGB percentage is 50% of gross charges (\$400 million/\$800 million). Y updates its FAP to reflect the new AGB percentage of 50% and makes the updated FAP widely available (both on its Web site and via paper copies upon request) on April 1 of Year 1. Between April 1 of Year 1 (less than 120 days after the

end of the preceding calendar year) and March 31 of Year 2, Y determines AGB for any emergency or other medically necessary care it provides to a FAP-eligible individual by multiplying the gross charges for the care provided to the individual by 50%. Y has determined AGB between April 1 of Year 1 and March 31 of Year 2 in accordance with this paragraph (b) by using the look-back method described in paragraph (b)(3) of this section.

*Example 2.* On August 20 of Year 1, X, a hospital facility, generates data on the amount of all of X's claims for emergency and other medically necessary care that were allowed by Medicare fee-for-service over the 12 months ending on July 31 of Year 1. X determines that, of these claims for inpatient services, Medicare allowed a total amount of \$100 million (including both the portion Medicare agreed to reimburse and the portion Medicare beneficiaries were personally responsible for paying). X's gross charges for these inpatient claims totaled \$250 million. Of the claims for outpatient services, Medicare allowed a total amount of \$125 million. X's gross charges for these outpatient claims totaled \$200 million. X calculates that its AGB percentage for inpatient services is 40% of gross charges (\$100 million/\$250 million) and its AGB percentage for outpatient services is 62.5% of gross charges (\$125 million/\$200 million). Y discloses its AGB percentages and describes how they were calculated on the Web page where its FAP can be accessed, and it updates this Web page to reflect the new AGB percentages on November 1. Y also starts making an updated information sheet with the new AGB percentages available upon request on and after November 1. Between November 1 of Year 1 (less than 120 days after the end of the 12-month claim period) and October 31 of Year 2, X determines AGB for any emergency or other medically necessary inpatient care it provides to a FAP-eligible individual by multiplying the gross charges for the inpatient care it provides to the individual by 40% and AGB for any emergency or other medically necessary outpatient care it provides to a FAP-eligible individual by multiplying the gross charges for the outpatient care it provides to the individual by 62.5%. X has determined AGB between November 1 of Year 1 and October 31 of Year 2 in accordance with this paragraph (b) by using the look-back method described in paragraph (b)(3) of this section.

*Example 3.* Whenever Z, a hospital facility, provides emergency or other medically necessary care to a FAP-eligible individual, Z determines the AGB for the care by using the billing and coding process it would use if the individual were a Medicare fee-for-service beneficiary and setting AGB for the care at the amount it determines Medicare and the Medicare beneficiary together would be

expected to pay for the care. Z has determined AGB in accordance with this paragraph (b) by using the prospective Medicare method described in paragraph (b)(4) of this section.

*Example 4.* Using the look-back method described in paragraph (b)(3) of this section, W, a hospital facility, calculates that its AGB percentage for Year 1 is 60% of gross charges. Under W's FAP, which applies to all emergency and other medically necessary care provided by W and which has been updated to reflect the AGB percentage for Year 1, the most that W charges a FAP-eligible individual is 50% of gross charges. W properly implements its FAP and charges no FAP-eligible individual more for emergency or other medically necessary care than 50% of gross charges in Year 1. W has met the requirements of paragraphs (a)(1) and (b) of this section in Year 1.

*Example 5.* A, an individual, receives medically necessary care from hospital facility V for which the AGB is \$3y. A is insured by U, a health insurer. Under U's contracts with V and A, the amount allowed for the care V provided to A is \$5y. Of that amount allowed, A is personally responsible for paying \$1y (in co-payments and deductibles) while U is responsible for paying \$4y. Based on the eligibility criteria specified in its FAP, V determines that A is FAP-eligible. Pursuant to paragraph (b)(2) of this section, V may charge U and A collectively \$5y while still meeting the requirements of paragraph (a)(1) of this section because the amount A is personally responsible for paying in co-payments and deductibles (\$1y) is less than the AGB for the care (\$3y).

*Example 6.* Assume the same facts as *Example 5*, except that under U's contracts with V and A, A is personally responsible for paying \$4y (in co-payments and deductibles) for the care while U is responsible for paying V \$1y. Because A is FAP-eligible under V's FAP, paragraph (a)(1) of this section requires that A not be personally responsible for paying V more than \$3y (the AGB for the care provided).

(c) *Gross charges.* A hospital facility must charge a FAP-eligible individual less than the gross charges for any medical care covered under the hospital facility's FAP. A billing statement issued by a hospital facility to a FAP-eligible individual for medical care covered under the FAP may state the gross charges for such care and apply contractual allowances, discounts, or deductions to the gross charges, provided that the actual amount the individual is personally responsible for paying is less than the gross charges for such care.

(d) *Safe harbor for certain charges in excess of AGB.* A hospital facility will be deemed to meet the requirements of paragraph (a) of this section, even if it charges more than AGB for emergency or other medically necessary care (or gross charges for any medical care covered under the FAP) provided to a FAP-eligible individual, if—

(1) The charge in excess of AGB was not made or requested as a pre-condition of providing medically necessary care to the FAP-eligible individual (for example, an upfront payment that a hospital facility requires before providing medically necessary care);

(2) As of the time of the charge, the FAP-eligible individual has not submitted a complete FAP application to the hospital facility to obtain financial assistance for the care or has not otherwise been determined by the hospital facility to be FAP-eligible for the care; and

(3) If the individual subsequently submits a complete FAP application and is determined to be FAP-eligible for the care, the hospital facility refunds any amount the individual has paid for the care (whether to the hospital facility or any other party to whom the hospital facility has referred or sold the individual's debt for the care) that exceeds the amount he or she is determined to be personally responsible for paying as a FAP-eligible individual, unless such excess amount is less than \$5 (or such other amount set by notice or other guidance published in the Internal Revenue Bulletin).

(e) *Medically necessary care.* For purposes of meeting the requirements of this section, a hospital facility may (but is not required to) use a definition of medically necessary care applicable under the laws of the state in which it is licensed, including the Medicaid definition, or a definition that refers to the generally accepted standards of medicine in the community or to an examining physician's determination.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014]

#### § 1.501(r)-6 Billing and collection.

(a) *In general.* A hospital organization meets the requirements of section 501(r)(6) with respect to a hospital facility it operates only if the hospital

facility does not engage in extraordinary collection actions (ECAs), as defined in paragraph (b) of this section, against an individual to obtain payment for care before the hospital facility has made reasonable efforts to determine whether the individual is eligible for assistance for the care under its financial assistance policy (FAP), as described in paragraph (c) of this section. For purposes of this section, with respect to any debt owed by an individual for care provided by a hospital facility—

(1) ECAs against the individual include ECAs to obtain payment for the care against any other individual who has accepted or is required to accept responsibility for the individual's hospital bill for the care; and

(2) The hospital facility will be deemed to have engaged in an ECA against the individual to obtain payment for the care, or to have taken one or more of the steps necessary to have made reasonable efforts to determine whether the individual is FAP-eligible for the care, if any purchaser of the individual's debt, any debt collection agency or other party to which the hospital facility has referred the individual's debt, or any substantially-related entity (as defined in §1.501(r)-1(b)(28)) has engaged in such an ECA or taken such steps (whichever is applicable).

(b) *Extraordinary collection actions*—(1) *In general.* Except as otherwise provided in this paragraph (b), the following actions taken by a hospital facility against an individual related to obtaining payment of a bill for care covered under the hospital facility's FAP are ECAs:

(i) Selling an individual's debt to another party (other than debt sales described in paragraph (b)(2) of this section).

(ii) Reporting adverse information about the individual to consumer credit reporting agencies or credit bureaus.

(iii) Deferring or denying, or requiring a payment before providing, medically necessary care because of an individual's nonpayment of one or more bills for previously provided care covered under the hospital facility's FAP (which is considered an ECA to obtain payment for the previously provided

care, not the care being potentially deferred or denied). If a hospital facility requires a payment before providing medically necessary care to an individual with one or more outstanding bills for previously provided care, such a requirement for payment will be presumed to be because of the individual's nonpayment of such bill(s) unless the hospital facility can demonstrate that it required the payment from the individual based on factors other than, and without regard to, the individual's nonpayment of past bills.

(iv) Actions that require a legal or judicial process, including but not limited to—

(A) Placing a lien on an individual's property (other than a lien described in paragraph (b)(3) of this section);

(B) Foreclosing on an individual's real property;

(C) Attaching or seizing an individual's bank account or any other personal property;

(D) Commencing a civil action against an individual;

(E) Causing an individual's arrest;

(F) Causing an individual to be subject to a writ of body attachment; and

(G) Garnishing an individual's wages.

(2) *Certain debt sales that are not ECAs.* A hospital facility's sale of an individual's debt for care provided by the hospital facility will not be considered an ECA if, prior to the sale, the hospital facility has entered into a legally binding written agreement with the purchaser of the debt pursuant to which—

(i) The purchaser is prohibited from engaging in any ECAs to obtain payment for the care;

(ii) The purchaser is prohibited from charging interest on the debt in excess of the rate in effect under section 6621(a)(2) at the time the debt is sold (or such other interest rate set by notice or other guidance published in the Internal Revenue Bulletin);

(iii) The debt is returnable to or recallable by the hospital facility upon a determination by the hospital facility or the purchaser that the individual is FAP-eligible; and

(iv) If the individual is determined to be FAP-eligible and the debt is not returned to or recalled by the hospital facility, the purchaser is required to adhere to procedures specified in the

agreement that ensure that the individual does not pay, and has no obligation to pay, the purchaser and the hospital facility together more than he or she is personally responsible for paying as a FAP-eligible individual.

(3) *Liens on certain judgments, settlements, or compromises.* Any lien that a hospital facility is entitled to assert under state law on the proceeds of a judgment, settlement, or compromise owed to an individual (or his or her representative) as a result of personal injuries for which the hospital facility provided care is not an ECA.

(4) *Bankruptcy claims.* The filing of a claim in any bankruptcy proceeding is not an ECA.

(c) *Reasonable efforts*—(1) *In general.* A hospital facility will have made reasonable efforts to determine whether an individual is FAP-eligible for care only if the hospital facility meets the requirements described in paragraph (c)(2) or (c)(3) of this section.

(2) *Presumptive FAP-eligibility determinations based on third-party information or prior FAP-eligibility determinations*—(i) *In general.* With respect to any care provided by a hospital facility to an individual, the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for the care if it determines that the individual is FAP-eligible for the care based on information other than that provided by the individual or based on a prior FAP-eligibility determination and, if the individual is presumptively determined to be eligible for less than the most generous assistance available under the FAP, the hospital facility—

(A) Notifies the individual regarding the basis for the presumptive FAP-eligibility determination and the way to apply for more generous assistance available under the FAP;

(B) Gives the individual a reasonable period of time to apply for more generous assistance before initiating ECAs to obtain the discounted amount owed for the care; and

(C) If the individual submits a complete FAP application seeking more generous assistance during the application period (as defined in § 1.501(r)-1(b)(3)), determines whether the individual is eligible for a more generous

discount and otherwise meets the requirements described in paragraph (c)(6) of this section with respect to that complete FAP application.

(ii) *Examples.* The following examples illustrate this paragraph (c)(2):

*Example 1.* V is a hospital facility with a FAP under which the specific assistance for which an individual is eligible depends exclusively upon that individual's household income. The most generous assistance offered for care under V's FAP is free care. V's FAP states that V uses enrollment in certain specified means-tested public programs to presumptively determine that individuals are FAP-eligible. D, an individual, receives care from V. Although D does not submit a FAP application to V, V learns that D is eligible for certain benefits under a state program that bases eligibility on household income. Based on this knowledge, V presumptively determines that D is eligible to receive free care under its FAP. V notifies D that it has determined he is eligible for free care based on his eligibility for the benefits under the state program and therefore does not owe V anything for the care he received. V has made reasonable efforts to determine whether D is FAP-eligible under this paragraph (c)(2).

*Example 2.* X is a hospital facility with a FAP that describes the data, including both hospital and publicly-available data, X uses to make presumptive FAP-eligibility determinations. On January 16, F, an individual, receives care from X. Using the hospital and publicly-available data described in its FAP, X presumptively determines that F is eligible for a 50% discount under its FAP, a discount that is not the most generous discount available under the FAP. The first billing statement that X sends to F indicates that F has been given a 50% discount under X's FAP, explains the basis for this presumptive FAP-eligibility determination, and informs F that she may apply for financial assistance if she believes she is eligible for a more generous discount. The billing statement indicates that F may call 1-800-888-xxxx or visit X's Web site at [www.hospitalX.org/FAP](http://www.hospitalX.org/FAP) to learn more about the FAP or the FAP application process. X sends F three more billing statements, each of which contains the standard written notice about the FAP that X includes on all of its billing statements in accordance with § 1.501(r)-4(b)(5), but F neither pays the amount she is personally responsible for paying nor applies for more generous financial assistance. The time between the first and fourth billing statement constitutes a reasonable period of time for F to apply for more generous assistance. V has made reasonable efforts to determine whether D is FAP-eligible under this paragraph (c)(2).

(3) *Reasonable efforts based on notification and processing of applications.* With respect to any care provided by a hospital facility to an individual, the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for the care if it—

(i) Notifies the individual about the FAP as described in paragraph (c)(4) of this section before initiating any ECAs to obtain payment for the care and refrains from initiating such ECAs (with the exception of an ECA described in paragraph (b)(1)(iii) of this section) for at least 120 days from the date the hospital facility provides the first post-discharge billing statement for the care;

(ii) In the case of an individual who submits an incomplete FAP application during the application period, notifies the individual about how to complete the FAP application and gives the individual a reasonable opportunity to do so as described in paragraph (c)(5) of this section; and

(iii) In the case of an individual who submits a complete FAP application during the application period, determines whether the individual is FAP-eligible for the care and otherwise meets the requirements described in paragraph (c)(6) of this section.

(4) *Notification*—(i) *In general.* With respect to any care provided by a hospital facility to an individual and except as provided in paragraph (c)(4)(iii) of this section, a hospital facility will have notified an individual about its FAP for purposes of paragraph (c)(3)(i) of this section only if the hospital facility does the following at least 30 days before first initiating one or more ECA(s) to obtain payment for the care:

(A) Provides the individual with a written notice that indicates financial assistance is available for eligible individuals, that identifies the ECA(s) that the hospital facility (or other authorized party) intends to initiate to obtain payment for the care, and that states a deadline after which such ECA(s) may be initiated that is no earlier than 30 days after the date that the written notice is provided.

(B) Provides the individual with a plain language summary of the FAP (as defined in § 1.501(r)-1(b)(24)) with the

written notice described in paragraph (c)(4)(i)(A) of this section (or, if applicable, paragraph (c)(4)(iii) of this section).

(C) Makes a reasonable effort to orally notify the individual about the hospital facility's FAP and about how the individual may obtain assistance with the FAP application process.

(ii) *Notification in the event of multiple episodes of care.* A hospital facility may satisfy the notification requirements described in paragraph (c)(4)(i) of this section simultaneously for multiple episodes of care and notify the individual about the ECA(s) the hospital facility intends to initiate to obtain payment for multiple outstanding bills for care. However, if a hospital facility aggregates an individual's outstanding bills for multiple episodes of care before initiating one or more ECAs to obtain payment for those bills, it will have not have made reasonable efforts to determine whether the individual is FAP-eligible under paragraph (c)(3) of this section unless it refrains from initiating the ECA(s) until 120 days after it provided the first post-discharge billing statement for the most recent episode of care included in the aggregation.

(iii) *Notification before deferring or denying care due to nonpayment for prior care.* In the case of an ECA described in paragraph (b)(1)(iii) of this section, a hospital facility may notify the individual about its FAP less than 30 days before initiating the ECA, provided that the hospital facility does the following:

(A) Otherwise meets the requirements of paragraph (c)(4)(i) of this section but, instead of the notice described in paragraph (c)(4)(i)(A) of this section, provides the individual with a FAP application form and a written notice indicating that financial assistance is available for eligible individuals and stating the deadline, if any, after which the hospital facility will no longer accept and process a FAP application submitted (or, if applicable, completed) by the individual for the previously provided care at issue. This deadline must be no earlier than the later of 30 days after the date that the written notice is provided or 240 days

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after the date that the first post-discharge billing statement for the previously provided care was provided.

(B) If the individual submits a FAP application for the previously provided care on or before the deadline described in paragraph (c)(4)(iii)(A) of this section (or at any time, if the hospital facility didn't provide any such deadline to the individual), processes the FAP application on an expedited basis.

(iv) *Examples.* The following example illustrates this paragraph (c)(4):

*Example 1.* A, an individual, receives care from T, a hospital facility, in February. T provides A with the first post-discharge billing statement for that care on March 3. This and subsequent billing statements that T sends to A contain the standard written notice about the FAP that X includes on all of its billing statements in accordance with § 1.501(r)-4(b)(5). A has not paid her bill or submitted a FAP application when T provides her with the third billing statement for the care, postmarked June 1. With this third billing statement, T includes a plain language summary of the FAP and a letter informing A that if she does not pay the amount owed or submit a FAP application by July 1, T intends to report A's delinquency to credit reporting agencies. T also calls A and informs her about the financial assistance available to eligible patients under T's FAP and about how to obtain assistance with the FAP application process. A does not pay her bill or submit a FAP application by July 1. T has made reasonable efforts to determine whether A is FAP-eligible, and thus may report A's delinquency to credit reporting agencies, as of July 2.

*Example 2.* G, an individual, receives care from Y, a hospital facility, on May 25 of Year 1. Y also makes numerous attempts to encourage G to apply for financial assistance, including by calling G to inform her about the financial assistance available to eligible patients under Y's FAP and to offer assistance with the FAP application process. By June 24 of Year 2, Y, which had not previously initiated any ECAs against G to obtain payment for the care, notifies G in writing that if G does not pay or complete a FAP application by July 24 of Year 2, Y intends to file a lawsuit seeking a judgment for the amount G owes for the care and to seek court permission to enforce the judgment by either seizing G's bank account or garnishing G's wages. The written notice also includes a plain language summary of the FAP. G fails to pay or submit a FAP application by July 24 of Year 2. Y has made reasonable efforts to determine whether G is FAP-eligible, and may seek a judgment for the amount G owes and court permission to en-

force the judgment by seizing G's bank account or garnishing G's wages, as of July 25 of Year 2.

(5) *Incomplete FAP applications*—(i) *In general.* With respect to any care provided by a hospital facility to an individual, if an individual submits an incomplete FAP application during the application period, the hospital facility will have notified the individual about how to complete the FAP application and given the individual a reasonable opportunity to do so for purposes of paragraph (c)(3)(ii) of this section only if the hospital facility—

(A) Suspends any ECAs to obtain payment for the care as described in paragraph (c)(8) of this section; and

(B) Provides the individual with a written notice that describes the additional information and/or documentation required under the FAP or FAP application form that must be submitted to complete the FAP application and that includes the contact information described in § 1.501(r)-1(b)(24)(v).

(ii) *FAP application completed.* If an individual who has submitted an incomplete FAP application during the application period subsequently completes the FAP application during the application period (or, if later, within a reasonable timeframe given to respond to requests for additional information and/or documentation), the individual will be considered to have submitted a complete FAP application during the application period, and the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible only if it meets the requirements for complete FAP applications described in paragraph (c)(6) of this section.

(iii) *Examples.* The following examples illustrate this paragraph (c)(5):

*Example 1.* (i) Assume the same facts as *Example 1* in paragraph (c)(4)(iv) of this section and the following additional facts: A submits an incomplete FAP application to T on July 15, which is before the last day of the application period on October 29 but after T has already initiated ECAs. Eligibility for assistance under T's FAP is based solely on an individual's family income and the instructions to T's FAP application form require applicants to attach to their application forms certain documentation verifying family income. The FAP application form that A



submits to T on July 15 includes all of the required income information, but A fails to attach the required documentation verifying her family income. On July 22, a member of T's staff calls A to inform her that she failed to attach any of the required documentation of her family income and explains what kind of documentation A needs to submit and how she can submit it. T indicates that the documentation should be provided by September 22. T also sends A a letter that describes the missing documentation that A must submit by September 22 (and how to submit it) and provides a telephone number A can call and room number she can visit to get assistance with the FAP application process. T does not initiate any new ECAs against A and does not take any further action on the ECAs T previously initiated against A between July 15 and September 22. A does not respond to T's letter and does not submit any missing documentation by September 22. T has made reasonable efforts to determine whether A is FAP-eligible, and may initiate or resume ECAs against A, as of September 23.

(ii) On October 10, before the last day of the application period on October 29, A provides T with the missing documentation. Because A has submitted a complete FAP application during the application period, to meet the requirements of paragraph (a) of this section, T must process the FAP application documentation to determine whether A is FAP-eligible and otherwise meet the requirements for complete FAP applications described in paragraph (c)(6) of this section.

*Example 2.* (i) B, an individual, receives care from U, a hospital facility, on January 10. U has established a FAP that provides assistance to all individuals whose household income is less than \$y, and the instructions to U's FAP application form specify the documentation that applicants must provide to verify their household income. Shortly after receiving care, B submits a FAP application form to U indicating that he has household income of less than \$y. B's FAP application form includes all of the required income information, but B fails to attach the required documentation verifying household income.

(ii) On February 9, U sends B the first post-discharge billing statement for the care that contains the standard written notice about the FAP that U includes on all of its billing statements in accordance with § 1.501(r)-4(b)(5). With this first post-discharge billing statement, U includes a letter informing B that the income information he provided on his FAP application form indicates that he may be eligible to pay only x% of the amount stated on the billing statement if he can provide documentation that verifies his household income. In addition, this letter describes the type of documentation (which is also described in the instructions to U's FAP application form) that B needs to provide to complete his FAP application and provides a

telephone number that B may call and room number he may visit if he has questions or needs assistance with the FAP application process. By the time U is getting ready to send B a third billing statement for the care, B has not provided any response to U's request for the missing documentation. Accordingly, with the third billing statement postmarked May 10, U includes a plain language summary of the FAP plus a written notice informing B that U intends to report B's delinquency to credit reporting agencies if B does not submit the missing documentation or pay the amount due by June 9. U also calls B to inform B about the impending ECA and to see if he has questions about the missing documentation that U has requested. B does not provide any response to U's request for the missing documentation by June 9. U has made reasonable efforts to determine whether B is FAP-eligible, and thus may report B's delinquency to credit reporting agencies, as of June 10.

(6) *Complete FAP applications*—(i) *In general.* With respect to any care provided by a hospital facility to an individual, if an individual submits a complete FAP application during the application period, the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for the care only if the hospital facility does the following in a timely manner:

(A) Suspends any ECAs to obtain payment for the care as described in paragraph (c)(8) of this section.

(B) Makes a determination as to whether the individual is FAP-eligible for the care and notifies the individual in writing of this eligibility determination (including, if applicable, the assistance for which the individual is eligible) and the basis for this determination.

(C) If the hospital facility determines the individual is FAP-eligible for the care, does the following:

(1) If the individual is determined to be eligible for assistance other than free care, provides the individual with a billing statement that indicates the amount the individual owes for the care as a FAP-eligible individual and how that amount was determined and that states, or describes how the individual can get information regarding, the AGB for the care.

(2) Refunds to the individual any amount he or she has paid for the care (whether to the hospital facility or any

other party to whom the hospital facility has referred or sold the individual's debt for the care) that exceeds the amount he or she is determined to be personally responsible for paying as a FAP-eligible individual, unless such excess amount is less than \$5 (or such other amount set by notice or other guidance published in the Internal Revenue Bulletin).

(3) Takes all reasonably available measures to reverse any ECA (with the exception of a sale of debt and an ECA described in paragraph (b)(1)(iii) of this section) taken against the individual to obtain payment for the care. Such reasonably available measures generally include, but are not limited to, measures to vacate any judgment against the individual, lift any levy or lien (other than a lien described in paragraph (b)(3) of this section) on the individual's property, and remove from the individual's credit report any adverse information that was reported to a consumer reporting agency or credit bureau.

(ii) *Anti-abuse rule for complete FAP applications.* A hospital facility will not have made reasonable efforts to determine whether an individual is FAP-eligible if the hospital facility bases its determination that the individual is not FAP-eligible on information that the hospital facility has reason to believe is unreliable or incorrect or on information obtained from the individual under duress or through the use of coercive practices. For purposes of this paragraph (c)(6)(ii), a coercive practice includes delaying or denying emergency medical care to an individual until the individual has provided information requested to determine whether the individual is FAP-eligible for the care being delayed or denied.

(iii) *Determination based on complete FAP applications sufficient for reasonable efforts.* A hospital facility will have made reasonable efforts to determine whether an individual is FAP-eligible with respect to any ECAs it initiates to obtain payment for care if, before initiating any such ECAs, it determines whether the individual is FAP-eligible for the care based on a complete FAP application and otherwise meets the requirements described in this paragraph (c)(6). If these conditions are satisfied,

the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for the care regardless of whether it has notified the individual as described in paragraph (c)(4) of this section or, if applicable, in paragraph (c)(5)(i)(B) of this section.

(iv) *Determining Medicaid eligibility.* A hospital facility will not fail to have made reasonable efforts to determine whether an individual is FAP-eligible for care if, upon receiving a complete FAP application from an individual who the hospital facility believes may qualify for Medicaid, the hospital facility postpones determining whether the individual is FAP-eligible for the care until after the individual's Medicaid application has been completed and submitted and a determination as to the individual's Medicaid eligibility has been made.

(v) *Examples.* The following examples illustrate this paragraph (c)(6):

*Example 1.* C, an individual, receives care from W, a hospital facility, on September 1. W has established a FAP that provides assistance only to individuals whose family income is less than or equal to x% of the Federal Poverty Level (FPL), which, in the case of C's family size, is \$y. Upon discharge, W's staff gives C a plain language summary of the FAP and informs C that if she needs assistance filling out a FAP application form, W has a social worker on staff who can assist her. C expresses interest in getting assistance with a FAP application while she is still on site and is directed to K, one of W's social workers. K explains the eligibility criteria in W's FAP to C, and C realizes that to determine her family income as a percentage of FPL she needs to look at her prior year's tax returns. On September 20, after returning home and obtaining the necessary information, C submits a FAP application to W that contains all of the information and documentation required in the FAP application form instructions. W's staff promptly examines C's FAP application and, based on the information and documentation therein, determines that C's family income is well in excess of \$y. On October 1, W sends C her first post-discharge billing statement for the care she received on September 1. With the billing statement, W includes a letter informing C that she is not eligible for financial assistance because her FAP application indicates that she has family income in excess of x% of FPL (\$y for a family the size of C's family) and W only provides financial assistance to individuals with family income

that is less than x% of FPL. W has made reasonable efforts to determine whether C is FAP-eligible as of October 1.

*Example 2.* E, an individual, receives care from P, a hospital facility, from February 24 to 28. E pays a co-payment of \$30 at discharge and is determined by her insurer to be personally responsible for paying another \$550 in deductibles. P sends E several billing statements starting on March 20 indicating that E owes \$550. By July 30, E has not paid the \$550 or submitted a FAP application. On July 30, P notifies E in writing that if E does not pay or complete a FAP application by August 30, P intends to report B's delinquency to credit reporting agencies. The written notice also includes a plain language summary of the FAP. In addition, P calls E and informs her about the financial assistance available to eligible patients under P's FAP and about how to obtain assistance with the FAP application process. E fails to pay or submit a FAP application by August 30. P subsequently reports E's delinquency to credit reporting agencies. E then provides a complete FAP application to P on November 10, before the last day of the application period on November 15. P promptly examines the application and determines that E is eligible for free care under P's FAP. P contacts the credit reporting agencies to which it had reported E's delinquency and asks them to remove the adverse information from E's credit report. P also sends E a letter that informs her that she is eligible for free care under P's FAP and explains the basis for this eligibility determination and includes with this letter a check for \$30 (the co-payment E had paid). P has made reasonable efforts to determine whether E is FAP-eligible.

*Example 3.* R, a hospital facility, has established a FAP that provides financial assistance only to individuals whose family income is less than or equal to x% of the Federal Poverty Level (FPL), based on their prior year's federal tax return. L, an individual, receives care from R. While L is being discharged from R, she is approached by M, an employee of a debt collection company that has a contract with R to handle all of R's patient billing. M asks L for her family income information, telling L that this information is needed to determine whether L is eligible for financial assistance. L tells M that she does not know what her family income is and would need to consult her tax returns to determine it. M tells L that she can just provide a "rough estimate" of her family income. L states that her family income may be around \$y, an amount slightly above the amount that would allow her to qualify for financial assistance. M enters \$y on the income line of a FAP application form with L's name on it and marks L as not FAP-eligible. Based on M's information collection, R determines that L is not FAP-eligible and notifies L of this determination

with her first billing statement. Because M had reason to believe that the income estimate provided by L was unreliable, R has violated the anti-abuse rule described in paragraph (c)(6)(ii) of this section. Thus, R has not made reasonable efforts to determine whether L is FAP-eligible.

(7) *When no FAP application is submitted.* Unless and until an individual submits a FAP application during the application period, any paragraphs of this section that are conditioned on an individual's submitting a FAP application (namely, paragraphs (c)(2)(i)(C), (c)(3)(ii), and (c)(3)(iii) of this section) do not apply, and the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for care, and may initiate one or more ECAs to obtain payment for the care, once it has met the requirements of this section that are not contingent on an individual's submission of a FAP application. For example, unless and until a hospital facility receives a FAP application from an individual during the application period, the hospital facility has made reasonable efforts to determine whether the individual is FAP-eligible for care (and thus may initiate ECAs to obtain payment for the care) once it has notified the individual about the FAP as described in paragraph (c)(3)(i) of this section.

(8) *Suspending ECAs while a FAP application is pending.* With respect to any care provided by a hospital facility to an individual, if an individual submits a FAP application during the application period, the hospital facility (or other authorized party) will have suspended ECAs for purposes of this paragraph (c) only if, after receiving the application, the hospital facility (or other authorized party) does not initiate, or take further action on any previously-initiated, ECAs (with the exception of an ECA described in paragraph (b)(1)(iii) of this section) to obtain payment for the care until either—

(i) The hospital facility has determined whether the individual is FAP-eligible based on a complete FAP application and otherwise met the requirements of paragraph (c)(6) of this section; or

(ii) In the case of an incomplete FAP application, the individual has failed to

respond to requests for additional information and/or documentation within a reasonable period of time given to respond to such requests.

(9) *Waiver does not constitute reasonable efforts.* For purposes of this paragraph (c), obtaining a signed waiver from an individual, such as a signed statement that the individual does not wish to apply for assistance under the FAP or receive the information described in paragraphs (c)(4) or (c)(5) of this section, will not itself constitute a determination that the individual is not FAP-eligible and will not satisfy the requirement to make reasonable efforts to determine whether the individual is FAP-eligible before engaging in ECAs against the individual.

(10) *Agreements with other parties.* With the exception of sales described in paragraph (b)(2) of this section, if a hospital facility sells or refers an individual's debt related to care to another party, the hospital facility will have made reasonable efforts to determine whether the individual is FAP-eligible for the care only if it first enters into (and, to the extent applicable, enforces) a legally binding written agreement with the party that is reasonably designed to ensure that no ECAs are taken to obtain payment for the care until reasonable efforts have been made to determine whether the individual is FAP-eligible for the care. At a minimum, such an agreement must provide the following:

(i) If the individual submits a FAP application after the referral or sale of the debt but before the end of the application period, the party will suspend ECAs to obtain payment for the care as described in paragraph (c)(8) of this section.

(ii) If the individual submits a FAP application after the referral or sale of the debt but before the end of the application period and is determined to be FAP-eligible for the care, the party will do the following in a timely manner:

(A) Adhere to procedures specified in the agreement that ensure that the individual does not pay, and has no obligation to pay, the party and the hospital facility together more than he or she is required to pay for the care as a FAP-eligible individual.

(B) If applicable and if the party (rather than the hospital facility) has the authority to do so, take all reasonably available measures to reverse any ECA (other than the sale of a debt or an ECA described in paragraph (b)(1)(iii) of this section) taken against the individual as described in paragraph (c)(6)(i)(C)(3) of this section.

(iii) If the party refers or sells the debt to yet another party during the application period, the party will obtain a written agreement from that other party including all of the elements described in this paragraph (c)(10).

(11) *Clear and conspicuous placement.* A hospital facility may print any written notice or communication described in this paragraph (c), including any plain language summary of the FAP, on a billing statement or along with other descriptive or explanatory matter, provided that the required information is conspicuously placed and of sufficient size to be clearly readable.

(12) *Providing documents electronically.* A hospital facility may provide any written notice or communication described in this paragraph (c) electronically (for example, by email) to any individual who indicates he or she prefers to receive the written notice or communication electronically.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014; 80 FR 12762, Mar. 11, 2015]

**§ 1.501(r)-7 Effective/applicability dates.**

(a) *Effective/applicability date.* The rules of §§1.501(r)-1 through 1.501(r)-6 apply to taxable years beginning after December 29, 2015.

(b) *Reasonable interpretation for taxable years beginning on or before December 29, 2015.* For taxable years beginning on or before December 29, 2015, a hospital facility may rely on a reasonable, good faith interpretation of section 501(r). A hospital facility will be deemed to have operated in accordance with a reasonable, good faith interpretation of section 501(r) if it has complied with the provisions of the proposed or final regulations under section 501(r) (REG-130266-11 and/or REG-106499-12). Accordingly, a hospital facility may rely on §1.501(r)-3 of the proposed or final regulations, or another

reasonable interpretation of section 501(r)(3), for any CHNA conducted or implementation strategy adopted before the first day of the hospital organization's first taxable year beginning after December 29, 2015.

[T.D. 9708, 79 FR 78998, Dec. 31, 2014]

**§ 1.502-1 Feeder organizations.**

(a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the ground that all the profits of such organization are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501.

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organiza-

tions, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations. For purposes of this paragraph, organizations are related only if they consist of:

- (1) A parent organization and one or more of its subsidiary organizations; or
- (2) Subsidiary organizations having a common parent organization

An exempt organization is not related to another exempt organization merely because they both engage in the same type of exempt activities.

(c) In certain cases an organization which carries on a trade or business for profit but is not operated for the primary purpose of carrying on such trade or business is subject to the tax imposed under section 511 on its unrelated business taxable income.

(d) *Exception*—(1) *Taxable years beginning before January 1, 1970.* For purposes of section 502 and this section, for taxable years beginning before January 1, 1970, the term *trade or business* does not include the rental by an organization of its real property (including personal property leased with the real property).

(2) *Taxable years beginning after December 31, 1969.* For purposes of section 502 and this section, for taxable years beginning after December 31, 1969, the term *trade or business* does not include:

- (i) The deriving of rents described in section 512(b)(3)(A),
- (ii) Any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation, or
- (iii) Any trade or business (such as a *thrift shop*) which consists of the selling of merchandise, substantially all of which has been received by the organization as gifts or contributions

For purposes of the exception described in subdivision (i) of this subparagraph, if the rents derived by an organization would not be excluded from unrelated business income pursuant to section 512(b)(3) and the regulations thereunder, the deriving of such rents shall be considered a *trade or business*.

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(3) *Cross references and special rules.* (i) For determination of when rents are excluded from the tax on unrelated business income see section 512(b)(3) and the regulations thereunder.

(ii) The rules contained in § 1.513-1(e)(1) shall apply in determining whether a trade or business is described in section 502(b)(2) and subparagraph (2)(ii) of this paragraph.

(iii) The rules contained in § 1.513-1(e)(3) shall apply in determining whether a trade or business is described in section 502(b)(3) and subparagraph (2)(iii) of this paragraph.

[T.D. 6500, 25 FR 11737, No. 26, 1960, as amended by T.D. 6662, 28 FR 6973, July 29, 1963; T.D. 7033, 35 FR 19997, Dec. 31, 1970]

**§ 1.503(a)-1 Denial of exemption to certain organizations engaged in prohibited transactions.**

(a)(1) Prior to January 1, 1970, section 503 applies to those organizations described in sections 501(c)(3), 501(c)(17), and section 401(a) except:

(i) A religious organization (other than a trust);

(ii) An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

(iii) An organization which normally receives a substantial part of its support (exclusive or income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501(a)) from the United States or any State or political subdivision thereof or from direct or indirect contributions from the general public,

(iv) An organization which is operated, supervised, controlled or principally supported by a religious organization (other than a trust) which is itself not subject to the provisions of this section; and

(v) An organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research or agricultural research.

(2) Effective January 1, 1907, and prior to January 1, 1975, section 503 shall apply only to organizations described in section 501(c) (17) or (18) or section 401(a).

(3) Effective January 1, 1975, section 503 shall apply only to organization described in section 501(c) (17) or (18) or described in section 401(a) and referred to in section 4975(g) (2) or (3).

(b) The prohibited transactions enumerated in section 503(b) are in addition to and not in limitation of the restrictions contained in section 501(c) (3), (17), or (18) or section 401(a). Even though an organization has not engaged in any of the prohibited transactions referred to in section 503(b), it still may not qualify for tax exemptions in view of the general provisions of section 501(c) (3), (17), or (18) or section 401(a). Thus, if a trustee or other fiduciary of the organization (whether or not he is also a creator or such organization) enters into a transaction with the organization, such transaction will be closely scrutinized in the light of the fiduciary principle requiring undivided loyalty to ascertain whether the organization is in fact being operated for the stated exempt purpose.

(c) An organization—

(1) Described in section 501(c)(3) which after July 1, 1950, but before January 1, 1970, has engaged in any prohibited transaction as defined in section 503(b), unless it is excepted by the provisions of paragraph (a)(1) of this section;

(2) Described in section 401(a) and referred to in section 4975(g) (2) or (3) which after March 1, 1954, has engaged in any prohibited transaction as defined in section 503(b);

(3) Described in section 401(a) and not referred to in section 4975(g) (2) or (3) which after March 1, 1954, but before January 1, 1975, has engaged in any prohibited transaction as defined in section 503(b) or which after December 31, 1962, but before January 1, 1975, has engaged in any prohibited transaction as defined in section 503(g) prior to its repeal by section 2003(b)(5) of the Employee Retirement Income Security Act of 1974 (88 Stat. 978);

(4) Described in section 501(c)(17) which after December 31, 1959, has engaged in any prohibited transaction as defined in section 503(b); or

(5) Described in section 501(c)(18) which after December 31, 1969, has engaged in any prohibited transaction described in section 503(b)

Shall not be exempt from taxation under section 501(a) for any taxable year subsequent to the taxable year in which there is mailed to it a notice in writing by the Commissioner that it has engaged in such prohibited transactions. Such notification by the Commissioner shall be by registered or certified mail to the last known name and address of the organization. However, notwithstanding the requirement of notification by the Commissioner, the exemption shall be denied with respect to any taxable year if such organization during or prior to such taxable year commenced the prohibited transaction with the purpose of diverting income or corpus from its exempt purposes and such transaction involved a substantial part of the income or corpus of such organization. For the purpose of this section, the term *taxable year* means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the *taxable year* of the organizations means a calendar year. See 26 CFR §1.503(j)-1 (rev. as of Apr. 1, 1974) for provisions relating to the definition of prohibited transactions in the case of trusts benefiting certain owner-employees after December 31, 1962, but prior to January 1, 1975. See also section 2003 (c)(1)(B) of the Employee Retirement Income Security Act of 1974 (88 Stat. 978) in the case of an organization described in section 401(a) with respect to which a disqualified person elects to pay a tax in the amount and manner provided with respect to the tax imposed by section 4975 of the Code so that the organization may avoid denial of exemption under section 503. For further guidance regarding the definition of last known address, see §301.6212-2 of this chapter.

(d) The application of section 503(b) may be illustrated by the following examples:

*Example 1.* A creates a foundation in 1954 ostensibly for educational purposes. B, a trustee, accumulates the foundation's income from 1957 until 1959 and then uses a substantial part of this accumulated income to send A's children to college. The foundation would lose its exemption for the taxable years 1957 through 1959 and for subsequent taxable years until it regains its exempt status.

*Example 2.* If under the facts in Example 1 such private benefit was the purpose of the foundation from its inception, such foundation is not exempt by reason of the general provisions of section 501(c)(3), without regard to the provisions of section 503, for all years since its inception, that is, for the taxable years 1954 through 1959 and subsequent taxable years, since under section 501(c)(3) the organization must be organized and operated exclusively for exempt purposes. See §1.501(c)(3)-1.

[T.D. 7428, 41 FR 34621, Aug. 16, 1976, as amended by T.D. 8939, 66 FR 2819, Jan. 12, 2001]

#### § 1.503(b)-1 Prohibited transactions.

(a) *In general.* The term *prohibited transaction* means any transaction set forth in section 503(b) engaged in by any organization described in paragraph (a) of §1.503(a)-1. Whether a transaction is a prohibited transaction depends on the facts and circumstances of the particular case. This section is intended to deny tax-exempt status to such organizations which engage in certain transactions which inure to the private advantage of (1) the creator of such organization (if it is a trust); (2) any substantial contributor to such organization; (3) a member of the family (as defined in section 267(c)(4) of an individual who is such creator of or such substantial contributor to such organization; or (4) a corporation controlled, as set forth in section 503(b), by such creator or substantial contributor.

(b) *Loans as prohibited transactions under section 503(b)(1)-(1) Adequate security.* For the purposes of section 503(b)(1), which treats as prohibited transactions certain loans by an organization without receipt of adequate security and a reasonable rate of interest, the term *adequate security* means something in addition to and supporting a promise to pay, which is so pledged to the organization that it may be sold, foreclosed upon, or otherwise disposed of in default of repayment of

the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan. Mortgages or liens on property, accommodation endorsements of those financially capable of meeting the indebtedness, and stock or securities issued by corporations other than the borrower may constitute security for a loan to the persons or organizations described in section 503(b). Stock of a borrowing corporation does not constitute adequate security. A borrower's evidence of indebtedness, irrespective of its name, is not security for a loan, whether or not it was issued directly to the exempt organization. However, if any such evidence of indebtedness provides for security that may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, there may be adequate security for such loan. If an organization subject to section 503(b) purchases debentures issued by a person specified in section 503(b), the purchase is considered, for purposes of section 503(b)(1), as a loan made by the purchaser to the issuer on the date of such purchase. For example, if an exempt organization subject to section 503(b) makes a purchase through a registered security exchange of debentures issued by a person described in section 503(b), and owned by an unknown third party, the purchase will be considered as a loan to the issuer by the purchaser. For rules relating to loan of funds to, or investment of funds in stock or securities of, persons described in section 503(b) by an organization described in section 401(a), see paragraph (b)(5) of § 1.401-1.

(2) *Effective dates.* The effective dates for the application of the definition of adequate security in paragraph (b)(1) of this paragraph are:

- (i) March 15, 1956, for loans (other than debentures) made after March 15, 1956;
- (ii) January 31, 1957, for loans (other than debentures) made before March 16, 1956, and continued after January 31, 1957;
- (iii) November 8, 1956, for debentures which were purchased after November 8, 1956;

(iv) December 1, 1958, for debentures which were purchased before November 9, 1956, and held after December 1, 1958;

(v) If an employees' pension, stock bonus, or profit-sharing trust described in section 401(a) made a loan before March 1, 1954, repayable by its terms after December 31, 1955, and which would constitute a prohibited transaction if made on or after March 1, 1954, the loan shall not constitute a prohibited transaction if held until maturity (determined without regard to any extension or renewal thereof);

(vi) January 1, 1960, for loans (including the purchase of debentures) made by supplemental unemployment benefit trusts, described in section 501(c)(17);

(vii) January 1, 1970, for loans (including the purchase of debentures) made by employees' contribution pension plan trusts described in section 501(c)(18).

(3) *Certain exceptions to section 503(b)(1).* See section 503(e) and § 1.503(e)-1, 1.503(e)-2, and 1.503(e)-3 for special rules providing that certain obligations acquired by trusts described in section 401(a) or section 501(c)(17) or (18) shall not be treated as loans made without the receipt of adequate security for purposes of section 503(b)(1). See section 503(f) and § 1.503(f)-1 for an exception to the application of sections 503(b)(1) for certain loans made by employees' trusts described in section 401(a).

(c) *Examples.* The principles of this section are illustrated by the following examples: (Assume that section 503 (e) and (f) are not applicable.)

*Example 1.* A, creator of an exempt trust subject to section 503, borrows \$100,000 from such trust in 1960, giving his unsecured promissory note. The net worth of A is \$1,000,000. The net worth of A is not security for such loan and the transaction is a prohibited transaction. If, however, the note is secured by a mortgage on property of sufficient value, or is accompanied by acceptable collateral of sufficient value, or carries with it the secondary promise of repayment by an accommodation endorser financially capable of meeting the indebtedness, it may be adequately secured. However, subordinated debentures bonds of a partnership which are guaranteed by the general partners are not adequately secured since the general partners are liable for the firm's debt and their guaranty adds no additional security.



*Example 2.* Assume the same facts as in example 1 except that A's promissory note in the amount of \$100,000 to the trust is secured by property which has a fair market value of \$75,000. A's promissory note secured to the extent of \$75,000 is not adequately secured within the meaning of section 503(b)(1) since the security at the time of the transaction must be sufficient to repay the indebtedness, interest, and charges which may pertain thereto.

*Example 3.* Corporation M, a substantial contributor to an exempt organization subject to section 503, borrows \$150,000 from such organization in 1960, giving its promissory note accompanied by stock of the borrowing corporation with a fair market value of \$200,000. Since promissory notes and debentures have priority over stock in the event of liquidation of the corporation, stock of a borrowing corporation is not adequate security. Likewise, debenture bonds which are convertible on default into voting stock of the issuing corporation do not constitute adequate security under section 503(b)(1).

*Example 4.* B, creator of an exempt trust subject to section 503, borrows \$100,000 from such trust in 1960, giving his secured promissory note at the rate of 3 percent interest. The prevailing rate of interest charged by financial institutions in the community where the transaction takes place is 5 percent for a loan of the same duration and similarly secured. The loan by the trust to the grantor is a prohibited transaction since section 503(b)(1) requires both adequate security and a reasonable rate of interest. Further, a promise to repay the loan plus a percentage of future profits which may be greater than the prevailing rate of interest does not meet the reasonable rate of interest requirement.

*Example 5.* N Corporation, a substantial contributor to an exempt organization subject to section 503 borrows \$50,000 on or after March 16, 1956, from the organization. If the loan is not adequately secured, the organization has committed a prohibited transaction at the time the loan was made. If the loan had been made on or before March 15, 1956, and is continued after January 31, 1957, it must be adequately secured on February 1, 1957, or it will be considered a prohibited transaction on that date. However, if the exempt organization were an employees' trust, described in section 401(a), and the loan were made before March 1, 1954, repayable by its terms after December 31, 1955, it would not have to be adequately secured on February 1, 1957. Moreover, if the exempt organization were a supplemental unemployment benefit trust, described in section 501(c)(17), and the loan were made before January 1, 1960, repayable by its terms after December 31, 1959, it would not have to be adequately secured on January 1, 1960.

*Example 6.* An exempt organization subject to section 503 purchases a debenture issued

by O Corporation, which is a substantial contributor to the organization. The organization purchases the debenture in an arm's length transaction from a third person on or after November 9, 1956. The purchase is considered as a loan by the organization to O Corporation. The loan must be adequately secured when it is made, or it is considered as a prohibited transaction at that time. If the organization purchased the debenture before November 9, 1956, and holds it after December 1, 1958, the debenture must be adequately secured on December 2, 1958, or it will then be considered as a prohibited transaction. However, if the organization were an employees' trust described in section 401(a), and if the debenture were purchased before March 1, 1954, and its maturity date is after December 31, 1955, the debenture does not have to be adequately secured. Moreover, if the organization were an employees' contribution pension plan trust described in section 501(c)(18), and if the debenture were purchased before January 1, 1970, and its maturity date is after December 31, 1969, the debenture does not have to be adequately secured.

[T.D. 7428, 41 FR 34621, Aug. 16, 1976]

#### **§ 1.503(c)-1 Future status of organizations denied exemption.**

(a) Any organization described in section 501(c) (3), (17), or (18), or an employees' trust described in section 401(a), which is denied exemption under section 501(a) by reason of the provisions of section 503(a), may file, in any taxable year following the taxable year in which notice of denial was issued, a claim for exemption. In the case of organizations described in section 501(c) (3), (17), or (18), the appropriate exemption application shall be used for this purpose, and shall be filed with the district director. In the case of an employees' trust described in section 401(a), the information described in § 1.404(a)-2 shall be submitted with a letter claiming exemption. All employees' trust described in section 401(a) shall submit this information to the district director with whom a request for a determination as to its qualification under section 401 and exemption under section 501 may be submitted under paragraph (s) of § 601.201 of this chapter (Statement of Procedural Rules). A claim for exemption must

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contain or have attached to it, in addition to the information generally required of such an organization claiming exemption as an organization described in section 501(c) (17), or (18), or section 401(a) (or section 501(c)(3) prior to January 1, 1970), a written declaration made under the penalties of perjury by principal officer of such organization authorized to make such declaration that the organization will not knowingly again engage in a prohibited transaction, (as defined in section 503(b) (or 4975(c) if such section applies to such organization)). In the case of section 501(c)(3) organizations which have lost their exemption after December 31, 1969, pursuant to section 503, a claim for exemption must contain or have attached to it a written agreement made under penalties of perjury by a principal officer of such organization authorized to make such agreement that the organization will not violate the provisions of chapter 42. In addition, such organization must comply with the rules for governing instruments as prescribed in §1.508-3. See §1.501(a)-1 for proof of exemption requirements in general.

(b) If the Commissioner is satisfied that such organization will not knowingly again engage in a prohibited transaction (as defined under section 503(b) or 4975(c), as applicable to such organization) or in the case of a section 501(c)(3) organization, will not violate the provisions of chapter 42, and the organization also satisfied all the other requirements under section 501(c) (3), (17), or (18), or section 401(a), the organization will be so notified in writing. In such case the organization will be exempt (subject to the provisions of section 501(c)(3), or sections 501(c) (17), (18) or 401(a), and 503, and 504 when applicable) with respect to the taxable years subsequent to the taxable year in which the claim described in section 503(c) is filed. Section 503 contemplates that an organization denied exemption because of the terms of such section will be subject to taxation for at least one full taxable year. For the purpose of this section, the term *taxable year* means the established annual accounting period of the organization; or, if the organization has no such established annual accounting period, the

*taxable year* of the organization means the calendar year.

(c) For taxable years beginning after December 31, 1969, the denial of an exemption pursuant to this section, for a taxable year prior to January 1, 1970, of an organization described in section 501(c)(3) shall not cause such organization to cease to be described in section 501(c)(3) for purposes of part II of subchapter F, chapter 1 and for purposes of the application of chapter 42 taxes.

(d) In the case of an organization described in section 501(c)(3), which has lost its exemption pursuant to section 503, and which has not notified the Commissioner that it is applying for recognition of its exempt status under section 508(a) and this section, no gift or contribution made after December 31, 1969, which would otherwise be deductible under section 170, 642(c), or 545(b)(2) shall be allowed as a deduction.

[T.D. 7428, 41 FR 34622, Aug. 16, 1976, as amended by T.D. 7896, 48 FR 23817, May 27, 1983; T.D. 9849, 84 FR 9235, Mar. 14, 2019]

#### § 1.503(d)-1 Cross references.

For provisions relating to loans described in section 503(b)(1) by a trust described in section 401(a), see §1.503(b)-1 and section 503 (e) and (f) and the regulations thereunder.

[T.D. 7428, 41 FR 34623, Aug. 16, 1976]

#### § 1.503(e)-1 Special rules.

(a) *In general.* (1) Section 503(e) provides that for purposes of section 503(b)(1) (relating to loans made without the receipt of adequate security and a reasonable rate of interest) the acquisition of a bond, debenture, note, or certificate or other evidence of indebtedness shall not be treated as a loan made without the receipt of adequate security if certain requirements are met. Those requirements are described in §1.503(e)-2.

(2) Section 503(e) does not affect the requirement in section 503(b)(1) of a reasonable rate of interest. Thus, although the acquisition of a certificate of indebtedness which meets all of the requirements of section 503(e) and of §1.503(e)-2 will not be considered as a loan made without the receipt of adequate security, the acquisition of such

an indebtedness does constitute a prohibited transaction if the indebtedness does not bear a reasonable rate of interest.

(3) The provisions of section 503(e) do not limit the effect of section 401(a) and §1.401-2, section 501(c)(17)(A)(i), or section 501(c)(18)(A), all relating to the use of diversion of corpus or income of the respective employee trusts. Furthermore, the provisions of section 503(e) do not limit the effect of any of the provisions of section 503 other than section 503(b)(1). Thus, for example, although a loan made by employees' trust described in section 503(a)(1)(B) meets all the requirements of section 503(e) and therefore is not treated as a loan made without the receipt of adequate security, such an employees' trust making such a loan will lose its exempt status if the loan is not considered as made for the exclusive benefit of the employees or their beneficiaries. Similarly, a loan which meets the requirements of section 503(e) will constitute a prohibited transaction within the meaning of section 503(b)(6) if it results in a substantial diversion of the trust's income or corpus to a person described in section 503(b).

(b) *Definitions.* For purposes of section 503(e):

(1) The term *obligation* means bond, debenture, note, or certificate or other evidence of indebtedness.

(2) The term *issuer* includes any person described in section 503(b) who issues an obligation.

(3)(i) The term *person independent of the issuer* means a person who is not related to the issuer by blood, by marriage, or by reason of any substantial business interests. Persons who will be considered not to be independent of the issuer include but are not limited to:

(a) The spouse, ancestor, lineal descendant, or brother or sister (whether by whole or half blood) of an individual who is the issuer of an obligation;

(b) A corporation controlled directly or indirectly by an individual who is the issuer, or directly or indirectly by the spouse, ancestor, lineal descendant, or brother or sister (whether by whole or half blood) of an individual who is the issuer;

(c) A corporation which directly or indirectly controls, or is controlled by, a corporate issuer;

(d) A controlling shareholder of a corporation which is the issuer, or which controls the issuer;

(e) An officer, director, or other employee of the issuer, of a corporation controlled by the issuer, or of a corporation which controls the issuer;

(f) A fiduciary of any trust created by the issuer, by a corporation which controls the issuer, or by a corporation which is controlled by the issuer; or

(g) A corporation controlled by a person who controls a corporate issuer.

(ii) For purposes of paragraph (b)(3)(i) of this section, the term *control* means, with respect to a corporation, direct or indirect ownership of 50 percent or more of the total combined voting power of all voting stock or 50 percent or more of the total value of shares of all classes of stock. If the aggregate amount of stock in a corporation owned by an individual and by the spouse, ancestors, lineal descendants, brothers and sisters (whether by whole or half blood) of the individual is 50 percent or more of the total combined voting power of all voting stock or is 50 percent or more of the total value of all classes of stock, then each of these persons shall be considered as the controlling shareholder of the corporation.

(iii) In determining family relationships for purposes of paragraph (b)(3)(i) of this section, a legally adopted child of an individual shall be treated as a child of such individual by blood.

(4) The term *issue* means all the obligations of an issuer which are offered for sale on substantially the same terms. Obligations shall be considered offered for sale on substantially the same terms if such obligation would, at the same time and under the same circumstances, be traded on the market at the same price. On the other hand, if the terms on which obligations are offered for sale differ in such manner as would cause such obligations to be traded on the market at different prices, then such obligations are not part of the same issue. The following are examples of terms which, if different, would cause obligations to be traded on the market at different prices: (i) Interest rate; (ii) Maturity

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date; (iii) Collateral; and (iv) Conversion provisions

The fact that obligations are offered for sale on different dates will not preclude such obligations from being part of the same issue if they all mature on the same date and if the terms on which they are offered for sale are otherwise the same, since such obligations would, at the same time and under the same conditions, be traded on the market at the same price. Obligations shall not be considered part of the same issue merely because they are part of the same authorization or because they are registered as part of the same issue with the Securities and Exchange Commission.

[T.D. 7428, 41 FR 34623, Aug. 16, 1976]

**§ 1.503(e)-2 Requirements.**

(a) *In general.* The requirements which must be met under section 503(e) for an obligation not to be treated as a loan made without the receipt of adequate security for purposes of section 503(b)(1) are described in paragraphs (b), (c), and (d) of this section. For purposes of this section, the term *employee trust* shall mean any of the three kinds of organizations described in section 503(a)(1).

(b) *Methods of acquisition*—(1) *In general.* The employee trust must acquire the obligation of the market, by purchase from an underwriter, or by purchase from the issuer, in the manner described in subparagraph (2), (3), or (4) of this paragraph.

(2) *On the market.* (i) An obligation is acquired on the market when it is purchased through a national securities exchange which is registered with the Securities and Exchange Commission, or when it is purchased in an over-the-counter transaction. For purposes of the preceding sentence, securities purchased through an exchange which is not a national securities exchange registered with the Securities and Exchange Commission shall be treated as securities purchased in an over-the-counter transaction.

(ii)(a) If the obligation is listed on a national securities exchange registered with the Securities and Exchange Commission, it must be purchased through such an exchange or in an over-the-

counter transaction at a price not greater than the price of the obligation prevailing on such an exchange at the time of the purchase by the employee trust.

(b) For purposes of section 503(e), the price of the obligation prevailing at the time of the purchase means the price which accurately reflects the market value of the obligation. In the case of an obligation purchased through a national securities exchange which is registered with the Securities and Exchange Commission, the price paid for the obligation will be considered the prevailing price of the obligation. In the case of an obligation purchased in an over-the-counter transaction, the prevailing price may be the price at which the last sale of the obligation was affected on such national securities exchange immediately before the employee trust's purchase of such obligation on the same day or may be the mean between the highest and lowest prices at which sales were effected on such exchange on the same day or on the immediately preceding day or on the last day during which there were sales of such obligation or may be a price determined by any other method which accurately reflects the market value of the obligation.

(iii)(a) If the obligation is not listed on a national securities exchange which is registered with the Securities and Exchange Commission, it must be purchased in an over-the-counter transaction at a price not greater than the offering price for the obligation as established by current bid and asked prices quoted by persons independent of the issuer.

(b) For purposes of section 503(e) the offering price for the obligation at the time of the purchase means the price which accurately reflects the market value of the obligation. The offering price may be the price at which the last sale of the obligation to a person independent of the issuer was effected immediately before the employee trust's purchase of such obligation on the same day or may be the mean between the highest and lowest prices at which sales to persons independent of the issuer were effected on the same day or on the last day during which they were sales of such obligation or

may be a price determined by any other method which accurately reflects the market value of the obligation. The offering price for an obligation must be a valid price for the amount of the obligations which the trust is purchasing. For example, if an employees' trust described in section 503(a)(1)(B) purchases 1,000 bonds of the employer corporation at the offering price established by current prices for a lot of 10 such bonds, such offering price may not be a valid price for 1,000 bonds and the purchase may therefore not meet the requirements of this subdivision. For a purchase of an obligation to qualify under this subdivision, there must be sufficient current prices quoted by persons independent of the issuer to establish accurately the current value of the obligation. Thus, if there are no current prices quoted by persons independent of the issuer, an over-the-counter transaction will not qualify under this subparagraph even though the obligation was purchased in an arms's length transaction from a person independent of the issuer.

(iv) For purposes of this section, an over-the-counter transaction is one not executed on a national securities exchange which is registered with the Securities and Exchange Commission. An over-the-counter transaction may be made through a dealer or an exchange which is not such a national securities exchange or may be made directly from the seller to the purchaser.

(3) *From an underwriter.* An obligation may be purchased from an underwriter if it is purchased at a price not greater than:

(i) The public offering price for the obligation as set forth in a prospectus or offering circular filed with the Securities and Exchange Commission, or

(ii) The price at which a substantial portion of the issue including such obligation is acquired by persons independent of the issuer

whichever is the lesser price. For purposes of this subparagraph, a portion of the issue will be considered substantial if the purchasers of such portion by persons independent of the issuer are sufficient to establish that fair market value of the obligations included in such issue. In determining whether the purchases are sufficient to establish

the fair market value, all the surrounding facts and circumstances will be considered, including the number of independent purchasers, the aggregate amount purchased by each such independent purchaser, and the number of transactions. In the case of a large issue, purchases of a small percentage of the outstanding obligations may be considered purchases of a substantial portion of the issue; whereas, in the case of a small issue, purchases of a larger percentage of the outstanding obligations will ordinarily be required. The requirement in paragraph (b)(3)(ii) of this section contemplates purchase of the obligations by persons independent of the issuer contemporaneously with the purchase by the employee trust. If a substantial portion has been purchased at different prices, the price of the portion may be based on the average of such prices, and if several substantial portions have been sold to persons independent of the issuer, the price of any of the substantial portions may be used for purposes of this subparagraph.

(4) *From the issuer.* An obligation may be purchased directly from the issuer at a price not greater than the price paid currently for a substantial portion of the same issue by persons independent of the issuer. This requirement contemplates purchase of a substantial portion of the same issue by persons independent of the issuer contemporaneously with the purchase by the employee trust. For purposes of this subparagraph, a portion of the issue will be considered substantial if the purchases of such portion by persons independent of the issuer are sufficient to establish the fair market value of the obligations included in such issue. In determining whether the purchases are sufficient to establish the fair market value, all the surrounding facts and circumstances will be considered, including the number of independent purchasers, the aggregate amount purchased by each such independent purchaser, and the number of transactions. In the case of a large issue, purchases of a small percentage of the outstanding obligations may be considered purchases of a substantial portion of the issue; whereas, in the case of a

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small issue, purchases of a larger percentage of the outstanding obligations will ordinarily be required. The price paid for a substantial portion of the issue may be determined in the manner provided in paragraph (b)(3) of this section.

(c) *Limitations on holdings of obligations.* (1) Immediately following acquisition of the obligation by the employee trust:

(i) Not more than 25 percent of the aggregate amount of the obligations issued in such issue and outstanding immediately after acquisition by the trust may be held by the trust, and

(ii) At least 50 percent of such aggregate amount must be held by persons independent of the issuer.

(2)(i) For purposes of paragraph (c)(1) of this section, an obligation is not considered as outstanding if it is held by the issuer. For example, if an obligation which has been issued and outstanding is repurchased and held by the issuer, without cancellation or retirement, such an obligation is not considered outstanding.

(ii) For purposes of paragraph (c)(1) of this section, the amounts of the obligations held by the trust and by persons independent of the issuer shall be computed on the basis of the face amount of the obligations.

(d) *Limitation on amount invested in obligations.* (1)(i) Immediately following acquisition of the obligation, not more than 25 percent of the assets of the employee trust may be invested in all obligations of all persons described in section 503(b). For purposes of determining the amount of the trust's assets which are invested in obligations of persons described in section 503(b) immediately following acquisition of the obligation, those obligations shall be valued as follows:

(a) Those obligations included in the acquisition in respect of which the percentage test in the first sentence of this subdivision is being applied shall be valued at their adjusted basis, as provided in section 1011, relating to adjusted basis for determining gain or loss; and

(b) All other obligations of persons described in section 503(b) which were part of the trust's assets immediately before the acquisition of the obliga-

tions described in (d)(1)(i)(a) of this section shall be valued at their fair market value on the day that the obligations described in (d)(1)(i)(a) of this section were acquired. For purposes of determining the total amount of the assets of the trust (including obligations of persons described in section 503(b)), there shall be used the fair market value of those assets on the day the obligation is acquired.

(ii) The application of the rules in paragraph (d)(1)(i) of this section may be illustrated by the following example:

*Example.* On February 1, 1960, an exempt employees' trust described in section 401(a) purchases unsecured debentures issued by the employer corporation for \$1,000. At the time of this purchase, such debentures have a fair market value of \$1,200. Immediately after the purchase of such unsecured debentures, the assets of the trust consist of the following:

	Cost	Fair market value on Feb. 1, 1960
(a) Assets other than obligations of persons described in sec. 503(b) .....	\$5,000	\$7,800
(b) Obligations of persons described in sec. 503(b) acquired before Feb. 1, 1960 .....	500	1,000
(c) Unsecured debentures of employer purchased on Feb. 1, 1960 .....	1,000	1,200

Immediately following acquisition of the unsecured debentures by the trust, the percent of the assets of the trust that are invested in all obligations of all persons described in section 503(b) is computed as follows:

(1) Obligations of persons described in section 503(b) acquired before Feb. 1, 1960 (valued at fair market value) .....	\$1,000
(2) Unsecured debentures of employer purchased on Feb. 1, 1960 (valued at cost) .....	1,000
(3) Total amount of trust's assets invested in obligations of persons described in section 503(b) ((1) plus (2)) .....	2,000
(4) Assets of the trust other than obligations of persons described in section 503(b) (valued at fair market value on Feb. 1, 1960) .....	7,800
(5) Obligations of persons described in section 503(b) acquired before Feb. 1, 1960 (valued at fair market value on Feb. 1, 1960) .....	1,000
(6) Unsecured debentures of employer purchased on Feb. 1, 1960 (valued at fair market value on Feb. 1, 1960) .....	\$1,200
(7) Total assets of the trust valued at fair market value on Feb. 1, 1960 (sum of (4), (5), and (6)) .....	10,000

(8) Percent of assets of the trust invested in all obligations of all persons described in section 503(b) immediately following purchase of unsecured debentures on Feb. 1, 1960 ((3) + (7), that is, \$2,000 + \$10,000) ..... 20%

(2) In determining for purposes of subparagraph (1) of this paragraph the amount invested in obligations of persons described in section 503(b), there shall be included amounts invested in any obligations issued by any such person, irrespective of whether the obligation is secured, and irrespective of whether the obligation meets the conditions of section 503(e) or section 503(f). Obligations of persons described in section 503(b) other than the issuer of the obligation to which section 503(e) applies are also included within the 25 percent limitation. For example, if on February 19, 1959, an exempt employees' trust described in section 401(a) purchases unsecured debentures issued by the employer corporation in a transaction effected on the New York Stock Exchange, and if immediately after the purchase 10 percent of the trust's assets is invested in such debentures and 20 percent of its assets is invested in a loan made with adequate security on January 12, 1959, to the wholly-owned subsidiary of the employer corporation, then the purchase of the employer's debentures will not qualify under section 503(e), since 30 percent of the trust's assets are then invested in obligations of persons described in section 503(b).

(e) *Change of terms of an obligation.* A change in terms of an obligation is considered as the acquisition of a new obligation. If such new obligation is not adequately secured, the requirements of section 503(e) must be met at the time the terms of the obligation are changed for such section to be applicable to such new loan.

[T.D. 7428, 41 FR 34624, Aug. 16, 1976]

#### § 1.503(e)-3 Effective dates.

(a) Section 503(e) and §§ 1.503(e)-1 and 1.503(e)-3 are effective in the case of an employees' trust described in section 401(a) for taxable years ending after March 15, 1956. Thus, if during a taxable year ending before March 16, 1956, an employees' trust made a loan which meets the requirements of section 503(e), such loan will not be treated as

made without the receipt of adequate security and will not cause the loss of exemption for taxable years ending after March 15, 1956, although such loan was not considered adequately secured when made. (However, section 503 does not apply to organizations described in section 401(a) not referred to in section 4975(g) (2) or (3) for transactions occurring after December 31, 1974.)

(b)(1) In the case of obligations acquired by an employees' trust described in section 401(a) before September 2, 1958, which were held on that date, the requirements described in paragraphs (c) and (d) of § 1.503(e)-2 which were not satisfied immediately following the acquisition shall be treated as satisfied at that time if those requirements would have been satisfied had the obligations been acquired on September 2, 1958. For example, on January 3, 1955, an employees' trust described in section 401(a) purchased through the New York Stock Exchange unsecured debentures issued by the employer corporation. Under section 503(e) the acquisition of such debentures by the trust will not be treated for taxable years ending after March 15, 1956, as a loan made without the receipt of adequate security if the debentures were held by the employees' trust on September 2, 1958, and if the requirements of paragraphs (c) and (d) of § 1.503(e)-2 which were not met on January 3, 1955, were met on September 2, 1958, as if that date were the date of acquisition.

(2) In the case of obligations acquired before September 2, 1958, which were not held by the employees' trust described in section 401(a) on that date, only the requirements described in paragraph (b) of § 1.503(e)-2 must be satisfied for section 503(e) to be applicable to such acquisition. For example, if on December 5, 1956, an employees' trust lent money to the employer corporation by purchasing a debenture issued by the employer and if the trust sold the debenture on August 1, 1958, such loan would not be treated as made without the receipt of adequate security if the requirement described in paragraph (b) of § 1.503(e)-2 was met on December 5, 1956.

(c) Section 503(e) and §§ 1.503(e)-1 and 1.503(e)-2 are effective in the case of trusts described in section 501(c)(17)

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with respect to loans made, renewed, or, in the case of demand loans, continued after December 31, 1959, and in the case of trusts described in section 501(c)(18) with respect to loans made, renewed or, in the case of demand loans, continued after December 31, 1969.

(d) See paragraph (b)(2) of § 1.503(b)-1 for the effective dates for the application of the definition of adequate security.

[T.D. 7428, 41 FR 34626, Aug. 16, 1976]

### § 1.503(f)-1 Loans by employers who are prohibited from pledging assets.

(a) *In general.* (1) Section 503(f) provides that section 503(b)(1) shall not apply to a loan made to the employer by an employees' trust described in section 401(a) if the loan bears a reasonable rate of interest and certain conditions are met. Section 503(f) also applies to the renewal of loans to the employer and, in the case of demand loans, to the continuation of such loans.

(2) The provisions of section 503(f) do not limit the effect of section 401(a) and § 1.401-2, relating to use or diversion of corpus or income of an employees' trust, or the effect of any of the provisions of section 503 other than section 503(b)(1). Consequently, although a loan made by an employees' trust described in section 503(a)(1)(B) meets all the requirements of section 503(f) and therefore is not treated as a loan made without the receipt of adequate security, an employees' trust making such a loan will lose its exempt status if the loan is not considered as made for the exclusive benefit of the employees or their beneficiaries. Similarly, a loan which meets the requirements of section 503(f) will constitute a prohibited transaction within the meaning of section 503(b)(6) if it results in a substantial diversion of the trust's income or corpus to a person described in section 503(b).

(b) *Conditions.* (1) Section 503(f) applies to a loan only if, with respect to the making or renewal of the loan, the conditions described in paragraphs (b) (2), (3), and (4) of this section are met. For purpose of this paragraph, the mere continuance of a demand loan is

not considered as the making or renewal of such a loan.

(2) The employer must be prohibited (at the time of the making or renewal of the loan) by any law of the United States or regulations thereunder from directly or indirectly pledging, as security for such a loan, a particular class or classes of his assets the value of which (at such time) represents more than one-half of the value of all his assets. If a loan is made or renewed when the employer is prohibited by a law of the United States (or the regulations thereunder) from pledging a class of his assets, the qualification of such a loan under section 503(f) will not be affected by a subsequent change in such law or regulations permitting the employer to pledge such assets, unless such loan is renewed after such change. See section 8(a) of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78h(a)), which prohibits certain persons from pledging a class of assets as security for loans, and 12 CFR 220.5(a) (credit by brokers, dealers, and members of national securities exchanges).

(3) The making or renewal, as the case may be, must be approved in writing as an investment which is consistent with the exempt purposes of the trust by a trustee who is independent of the employer, and such written approval must not have been previously refused by any other such trustee. A trustee is independent of the employer, for purposes of this subparagraph, if he is entirely free of influence or controlled by the employer. For example, if the employer is a partnership, then a partner in such partnership, or a member of a partner's family would not be considered independent of the employer. Similarly, an employee of the employer would not be considered independent of the employer. For purposes of this subparagraph, the term *trustee* means, with respect to any trust for which there are two trustees who are independent of the employer, both of such trustees and, with respect to any trust for which there are more than two such independent trustees, a majority of the trustees independent of the employer.

(4)(i) Immediately following the making or renewal, as the case may be, the aggregate amount lent by the trust to



the employer, without the receipt of adequate security must not exceed 25 percent of the value of all the assets of the trust.

(ii) For purposes of paragraph (b)(4)(i) of this section, the determination as to whether any amount lent by the trust to the employer is a loan made without the receipt of adequate security shall be made without regard to section 503(e). Thus, if an employees' trust makes a loan on January 2, 1959, to the employer without adequate security (but which loan is not considered as made without adequate security under section 503(e)), and if immediately after making such loan 10 percent of the value of all its assets is invested in such loan, then the trust may on that day invest not more than an additional 15 percent of its assets in a loan which would be considered made without adequate security if it were not for the provisions of section 503(f).

(iii) For purposes of paragraph (b)(4)(i) of this section, in determining the value of all the assets of the trust, there shall be used the fair market value of those assets on the day of the making or renewal.

(c) *Reasonable rate of interest.* Section 503(f) only applies if, in addition to meeting the conditions described in paragraph (b) of this section, the loan bears a reasonable rate of interest when it is made, renewed, or, in the case of demand loans, during the period of its existence.

(d) *Change of terms of loan.* A change in the terms of a loan (including a reduction in the security for a loan) is considered as the making of a new loan. If such a new loan is not adequately secured, the requirements of section 503(f) must be met at the time the terms of the loan are changed for such section to be applicable to such new loan.

(e) *Effective date.* (1) This section and section 503(f) are effective for taxable years ending after September 2, 1958, but only with respect to periods after such date. Thus, if a loan was made on or before September 2, 1958, without the receipt of adequate security and if, when such loan was made, it met all of the requirements of section 503(f) and this section, then the loan is not subject to section 503(b)(1) after Sep-

tember 2, 1958, and would not constitute a prohibited transaction after that date because of a lack of adequate security.

(2) See paragraph (b)(2) of § 1.503(b)-1 for the effective dates for application of the definition of adequate security.

[T.D. 7428, 41 FR 34626, Aug. 16, 1976]

**§ 1.504-1 Attempts to influence legislation; certain organizations formerly described in section 501(c)(3) denied exemption.**

Section 504(a) and this section apply to an organization that is exempt from taxation at any time after October 4, 1976, as an organization described in section 501(c)(3), and that ceases to be described in that section because it—

(a) Is an *action* organization within the meaning of § 1.501(c)(3)-1(c)(3)(ii) or (iv), on account of activities occurring after October 4, 1976, or

(b) Is denied exemption under the provisions of section 501(h) (see § 1.501(h)-3 or § 56.4911-9).

This section does not apply, however, to an organization that was described in section 501(h)(5) and § 1.501(h)-2(b)(3) (relating generally to churches) for its taxable year immediately preceding the first taxable year for which it is no longer an organization described in section 501(c)(3). An organization to which section 504(a) and this section apply shall not be treated as described in section 501(c)(4) at any time after the organization ceases to be described in section 501(c)(3). Further, an organization denied treatment as an organization described in section 501(c)(4) under this section may not be treated as an organization described in section 501(c) other than as an organization described in section 501(c)(3). For rules relating to recognition of exemption after exemption is denied under section 501(h), § 1.501(h)-3(d).

[T.D. 8308, 55 FR 35592, Aug. 31, 1990]

**§ 1.504-2 Certain transfers made to avoid section 504(a).**

(a) *Scope.* Under section 504(b), a transfer described in paragraph (b) or (c) of this section to an organization exempt from tax under section 501(a) may result in loss of exemption by the

transferee unless the Commissioner determines, under paragraph (e) of this section, that the original transfer did not effect an avoidance of section 504(a). For purposes of this section, the term *transfer* includes any use by, or for the benefit of, the recipient of the transfer, but does not include any transfer made for adequate and full consideration.

(b) *Transferor and transferee commonly controlled*—(1) *Loss of exemption*. A transfer is described in this paragraph (b) if it is described in paragraphs (b)(2) through (b)(6). The transferee of a transfer described in this paragraph will cease to be exempt from tax under section 501(a), unless the provisions of paragraph (e) of this section apply.

(2) *Transferor organization*. A transfer is described in this paragraph (b)(2) only if it is from an organization that—

(i) Is or was described in section 501(c)(3), but not in section 501(h)(5), and

(ii) Is determined to be an “action” organization (as defined in § 1.501(c)(3)-1(c)(3)(ii) or (iv)), or is denied exemption from tax by reason of section 501(h) and either § 1.501(h)-3 or § 56.4911-9.

(3) *Transferor and transferee commonly controlled*. A transfer is described in this paragraph (b)(3) only if, at the time of the transfer or at any time during the transferee’s ten taxable years following the year in which the transfer was made, the transferee is controlled (directly or indirectly), as defined in paragraph (f) of this section, by the same person or persons who control the transferor.

(4) *Time of transfer*. A transfer is described in this paragraph (b)(4) only if the transfer is made—

(i) After the date that is 24 months before the earliest of the effective date of the determination under section 501(h) that the transferor is not exempt, the effective date of the Commissioner’s determination that the transferor is an “action” organization (as defined in § 1.501(c)(3)(ii) or (iv)), or the date on which the Commissioner proposes to treat it as no longer described in section 501(c)(3), and

(ii) Before the transferor again is recognized as an organization described in section 501(c)(3).

(5) *Transferee*. A transfer is described in this paragraph (b)(5) only if the transferee is exempt from tax under section 501(a) but the transferee is neither—

(i) An organization described in section 501(c)(3), nor

(ii) An organization described in section 401(a) to which the transferor contributes as an employer.

(6) *Amount of transfer*. A transfer is described in this paragraph (b)(6) only if the amount of the transfer exceeds the lesser of 30 percent of the net fair market value of the transferor’s assets or 50 percent of the net fair market value of the transferee’s assets, computed immediately before the transfer. For purposes of this paragraph (b)(6)—

(i) The amount of a transfer by a transferor is the sum of the amounts transferred to any number of transferees in any number of transfers, all of which are described in paragraphs (b)(2) through (b)(5) of this section, and the time of the transfer is the time of the first transfer so taken into account; and

(ii) The amount of a transfer to a transferee is the sum of the amounts transferred by a transferor to the transferee in any number of transfers, all of which are described in paragraphs (b)(2) through (b)(5) of this section, and the time of the transfer is the time of the first transfer so taken into account.

(c) *Other transfers*—(1) *Transfers included*. A transfer is described in this paragraph (c) if it would be described in paragraph (b) of this section except that either—

(i) The amount of the transfer is less than the amount determined in paragraph (b)(6) of this section, or

(ii) The transferor and transferee are not commonly controlled as described in paragraph (b)(3) of this section, or

(iii) The transferee is an organization described in sections 501(c)(3) and 501(h)(4).

(2) *Loss of exemption*. The transferee of a transfer described in this paragraph (c) will cease to be exempt under

section 501(a) if the Commissioner determines on all the facts and circumstances that the transfer effected an avoidance of section 504(a). In determining whether a transfer effected an avoidance of section 504(a), the Commissioner may consider whether the transferee engages, or has engaged, in attempts to influence legislation and may also consider any factors enumerated in paragraph (e) of this section.

(d) *Date of loss of exempt status.* A transferee of a transfer described in paragraph (b), (c)(1)(ii), or (c)(1)(iii) of this section will cease to be exempt from tax under section 501(a) on the date that all requirements of paragraph (b), (c)(1)(ii), or (c)(1)(iii) (other than the determination by the Commissioner) are satisfied. A transferee of a transfer described in paragraph (c)(1)(i) of this section will cease to be exempt from tax under section 501(a) on the date of the last transfer preceding notification of the transferee that the Commissioner proposes to treat the transferee as other than an exempt organization.

(e) *Transfers not in avoidance of section 504(a).* Notwithstanding paragraph (b) of this section, if, based on all the facts and circumstances, the Commissioner determines that a transfer described in paragraph (b) did not effect an avoidance of section 504(a), the transferee will not be denied exemption from tax by reason of section 504(b) and this section. In making the determination called for in the preceding sentence, the Commissioner may consider all relevant factors including:

(1) Whether enforceable and effective conditions on the transfer preclude use of any of the transferred assets for any purpose that, if it were a substantial part of an organization's activities, would be inconsistent with exemption as an organization described in section 501(c)(3);

(2) In the absence of conditions described in paragraph (e)(1) of this section, whether the transferred assets are used exclusively for purposes that are consistent with the transferor's exemption as an organization described in section 501(c)(3);

(3) Whether the assets transferred would be describe in § 53.4942(a)-2(c)(3) before, as well as after, the transfer if

both the transferor and transferee were private foundations;

(4) Whether and to what extent the transfer would satisfy the provisions of § 1.507-2(a) (7) and (8) if the transferor were a private foundation;

(5) Whether all of the transferred assets have been expended during a period when the transferee was not controlled (directly or indirectly) by the same person or persons who controlled the transferor; and

(6) Whether the entire amount of the transferred assets were in turn transferred, before the close of the transferee's taxable year following the taxable year in which the transferred assets were received, to one or more organizations described in section 507(b)(1)(A) none of which are controlled (directly or indirectly) by the same persons who control either the original transferor or transferee.

(f) *Control.* For purposes of section 504 and the regulations thereunder—

(1) The transferor will be presumed to control any organization with which it is affiliated within the meaning of § 56.4911-7(a), or would be if both organizations were described in section 501(c)(3), and

(2) The transferee will be treated as controlled (directly or indirectly) by the same person or persons who control the transferor if the transferee would be treated as controlled under § 53.4942(a)-3(a)(3), for which purpose the transferor shall be treated as a private foundation.

[T.D. 8308, 55 FR 35592, Aug. 31, 1990]

**§ 1.505(c)-1T Questions and answers relating to the notification requirement for recognition of exemption under paragraphs (9), (17) and (20) of Section 501(c) (temporary).**

Q-1: What does section 505(c) of the Internal Revenue Code provide?

A-1: Section 505(c) provides that an organization will not be recognized as exempt under section 501(c)(9) as a voluntary employees' beneficiary association, under section 501(c)(17) as a trust forming part of a plan providing for the payment of supplemental unemployment compensation benefits, or under section 501(c)(20) as a trust forming part of a qualified group legal services plan unless notification is given to the Internal Revenue Service. The notification

required of a trust created pursuant to section 501(c)(20) and forming part of a qualified group legal services plan is set forth in Q&A-2. The notification required of an organization organized after July 18, 1984, and applying for exempt status as an organization described in section 501(c) (9) or (17) is set forth in Q&A-3 through Q&A-8. The notification required of an organization organized on or before July 18, 1984, and claiming exemption as an organization described in section 501(c) (9) or (17) is set forth in Q&A-9 through Q&A-11. However, an organization that has previously notified the Internal Revenue Service of its claim to exemption under section 501(c) (9), (17), or (20) or its claim to exemption under those sections pursuant to another provision of the Code, is not required, under section 505(c), to submit a renunciation (See Q&A-2 and Q&A-12).

#### SECTION 501(c)(20) TRUSTS

Q-2: What is the notice required of a trust created pursuant to section 501(c)(20) and forming part of a qualified group legal services plan under section 120?

A-2: (a) A trust claiming exemption as an organization described in section 501(c)(20) will be recognized as exempt if the exclusive function of the trust is to form part of a qualified group legal services plan or plans. Exemption of the trust under section 501(c)(20) will generally be dependent upon and coextensive with recognition of the plan as a qualified group legal services plan. Therefore, a trust organized pursuant to section 501(c)(20) after July 18, 1984, need not file a separate notice with the Internal Revenue Service of its claim to exemption because the notice required by section 120(c)(4) will suffice for purposes of section 505(c), provided a copy of the trust instrument is filed with the Form 1024 submitted by the group legal services plan. If the trust instrument has not been filed with the Form 1024 submitted by the group legal services plan, the trust must comply with (and exemption will be dependent upon) the filing applicable to a trust organized on or before July 18, 1984. For the notice required and effective dates of exemption of a qualified group legal services plan under section 120, see §1.120-3.

(b) A trust organized on or before July 18, 1984, that claims exempt status as a trust described in section 501(c)(20) and that forms part of a qualified group legal services plan which has been recognized as exempt under section 120, must file a copy of its trust instrument with the Internal Revenue Service before February 4, 1987. If a copy of the trust instrument is filed within the time provided, the trust's exemption will be recognized retroactively to the date the qualified group legal services plan was recognized as exempt under section 120. However, if a copy of the trust instrument is filed after the time pro-

vided, exemption will be recognized only for the period after the copy of the trust instrument is filed with the Internal Revenue Service. See Q&A-7 for a further discussion of *date of filing*. A trust that has previously filed a copy of its trust instrument with the Service need not refile that document.

#### SECTION 501(c)(9) AND (17) ORGANIZATIONS ORGANIZED AFTER JULY 18, 1984

Q-3: What is the notice required of an organization or trust, organized after July 18, 1984, that is applying for recognition of tax exempt status under section 501(c) (9) or (17)?

A-3: An organization or trust that is organized after July 18, 1984, will not be treated as described in paragraphs (9) or (17) of section 501(c), unless the organization notifies the Internal Revenue Service that it is applying for recognition of exemption. In addition, unless the required notice is given in the manner and within the time prescribed by these regulations, an organization will not be treated as exempt for any period before the giving of the required notice. The notice is filed by submitting a properly completed and executed Form 1024, "Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120" together with the additional information required under Q&A-4 and Q&A-5. The notice is filed with the district director for the key district in which the organization's principal place of business or principal office is located.

The notice may be filed by either the plan administrator (as defined in section 414(g)) or the trustee. The Internal Revenue Service will not accept a Form 1024 for any organization or trust before such entity has been organized.

Q-4: What information, in addition to the information required by Form 1024, must be submitted by an organization or trust seeking recognition of exemption under section 501(c) (9) or (17)?

A-4: A notice will not be considered complete unless, in addition to a properly completed and executed Form 1024, the organization or trust submits a full description of the benefits available to participants under section 501(c) (9) or (17). Moreover, both the terms and conditions of eligibility for membership and the terms and conditions of eligibility for benefits must be set forth. This information may be contained in a separate document, such as a *plan document*, or it may be contained in the creating document of the entity (e.g., the articles of incorporation or association, or a trust indenture). For benefits provided through a policy or policies of insurance, all such policies must be included with the notice. Where individual policies of insurance are provided to the participants, single exemplar copies, typical of policies generally issued to participants, are acceptable, provided they adequately describe all

forms of insurance available to participants. In providing a full description of the benefits available, the benefits provided must be sufficiently described so that each benefit is definitely determinable. A benefit is definitely determinable if the amount of the benefit, its duration, and the persons eligible to receive it are ascertainable from the plan document or other instrument. Thus, a benefit is not definitely determinable if the rules governing either its amount, its duration, or its recipients are not ascertainable from the plan document or other instrument but are instead subject to the discretion of a person or committee. Likewise, a benefit is not definitely determinable if the amount for any individual is based upon a percentage share of any item that is within the discretion of the employer. However, a disability benefit will not fail to be considered definitely determinable merely because the determination of whether an individual is disabled is made under established guidelines by an authorized person or committee.

**Q-5:** What is the notice required of collectively bargained plans?

**A-5:** If an organization or trust claiming exemption under section 501(c) (9) or (17) is organized and maintained pursuant to a collective bargaining agreement between employee representatives and one or more employer, only one Form 1024 is required to be filed for the organization or trust, regardless of the number of employers originally participating in the agreement. Moreover, once a Form 1024 is filed pursuant to a collective bargaining agreement, an additional Form 1024 is not required to be filed by an employer who thereafter participates in that agreement. When benefits are provided pursuant to a collective bargaining agreement, the notice will not be considered complete unless, in addition to a properly completed and executed Form 1024, a copy of the collective bargaining agreement is also submitted together with the additional information delineated in Q&A-4.

**Q-6:** When must the required notice be filed by an organization or trust, organized after July 18, 1984, that seeks recognition of exemption under section 501(c) (9) or (17)?

**A-6:** An organization or trust applying for exemption must file the required notice by the later of February 4, 1987 or 15 months from the end of the month in which the organization or trust was organized. An extension of time for filing the required notice may be granted by the district director if the request is submitted before the end of the applicable period and it is demonstrated that additional time is needed.

**Q-7:** What is the effective date of exemption for a new organization or trust, organized after July 18, 1984, that has submitted the required notice?

**A-7:** If the required notice is filed within the time provided by these regulations, the

organization's exemption will be recognized retroactively to the date the organization was organized, provided its purpose, organization and operation (including compliance with the applicable nondiscrimination requirements) during the period prior to the date of the determination letter are in accordance with the applicable law. However, if the required notice is filed after the time provided by these regulations, exemption will be recognized only for the period after the application is filed with the Internal Revenue Service. The date of filing is the date of the United States postmark on the cover in which an exemption application is mailed or, if no postmark appears on the cover, the date the application is stamped as received by the Service. If an extension for filing the required notice has been granted to the organization, a notice filed on or before the last day specified in the extension will be considered timely and not the otherwise applicable date under Q&A-6.

**Q-8:** What is the effect on exemption of the filing of an incomplete notice?

**A-8:** Although a properly completed and executed Form 1024 together with the required additional information (See Q&A-4 and Q&A-5) must be submitted to satisfy the notice required by section 505(c), the failure to file, within the time specified, all of the information necessary to complete such notice will not alone be sufficient to deny recognition of exemption from the date of organization to the date the completed information is submitted to the Service. If the notice which is filed with the Service within the required time is substantially complete, and the organization supplies the necessary additional information requested by the Service within the additional time allowed, the original notice will be considered timely. However, if the notice is not substantially complete or the additional information is not provided within the additional time allowed, exemption will be recognized only from the date of filing of the additional information.

#### SECTION 501(c)(9) AND (17) ORGANIZATIONS ORGANIZED ON OR BEFORE JULY 18, 1984

**Q-9:** What is the notice required of an organization or trust organized on or before July 18, 1984, that claims exempt status as an organization described in section 501(c) (9) or (17)?

**A-9:** Section 505(c) provides a special rule for existing organizations and trusts organized on or before July 18, 1984. Such an organization or trust will not be treated as described in paragraphs (9) or (17) of section 501(c) unless the organization or trust notifies the Internal Revenue Service in the manner and within the time prescribed in these regulations that it is claiming exemption under the particular section. The type of notice, the manner for filing that notice,

and the additional information required is the same as that set forth in Q&A-3 through Q&A-5 for new organizations.

Q-10: When must the required notice be filed by an organization or trust organized on or before July 18, 1984?

A-10: An organization or trust organized on or before July 18, 1984, that claims exempt status as an organization described in section 501(c) (9) or (17), must file the required notice before February 4, 1987. An extension of time for filing the required notice may be granted by the district director if the request is submitted before the due date of the notice and it is demonstrated that additional time is needed.

Q-11: What is the effective date of exemption for an organization or trust organized on or before July 18, 1984, that has submitted the required notice?

A-11: If the required notice is filed within the time provided by these regulations, the organization's exemption will be recognized retroactively to the date the organization was organized, provided its purpose, organization and operation (including compliance with the applicable nondiscrimination requirements) during the period prior to the date of the determination letter are in accordance with the applicable law. If, on the other hand, the required notice is filed after the time provided by these regulations, exemption will be recognized only for the period after the notice is received by the Internal Revenue Service. See Q&A-7 for a further discussion of *date of filing*. See also Q&A-8 for the effect on exemption of a notice that has been timely filed but is incomplete.

#### EXCEPTIONS TO NOTICE REQUIREMENT

Q-12: Are any organizations or trusts claiming recognition of exemption as an organization described in section 501(c) (9) or (17) excepted from the notice requirement of section 505(c)?

A-12: An organization or trust that has previously notified the Internal Revenue Service of its claim to exemption by filing Form 1024 is not required, under section 505(c), to renotify the Service. Thus, an organization that has filed a Form 1024 that is pending with the Service need not refile that form. Also, an organization that has received a ruling or determination letter from the Service recognizing its exemption from taxation need not submit the notification required by section 505(c).

[T.D. 8073, 51 FR 4330, Feb. 4, 1986]

#### § 1.506-1 Organizations required to notify Commissioner of intent to operate under section 501(c)(4).

(a) *Notification requirement*—(1) *In general*. Except as provided in paragraph (b) of this section, an organization

(whether domestic or foreign) described in section 501(c)(4) must, no later than 60 days after the date the organization is organized, notify the Commissioner that it is operating as an organization described in section 501(c)(4) by submitting a completed Form 8976, "Notice of Intent to Operate Under Section 501(c)(4)," or its successor (the notification). The notification must be submitted in accordance with the form and its instructions. The notification must include the information specified in paragraph (a)(2) of this section and be accompanied by payment of the user fee described in paragraph (a)(3) of this section. Additional guidance on the procedure for submitting the notification may be provided in published guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) or in other guidance, such as forms or instructions, issued with respect to the notification.

(2) *Contents of the notification*. The notification must include the following information:

(i) The name, address, and taxpayer identification number of the organization.

(ii) The date on which, and the state or other jurisdiction under the laws of which, the organization was organized (that is, formed as a legal entity). For an organization formed outside the United States, the jurisdiction is the foreign country under the laws of which it is organized.

(iii) A statement of the purpose of the organization.

(iv) Such additional information as may be specified in published guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) or in other guidance, such as forms or instructions, issued with respect to the notification.

(3) *User fee*. The notification must be accompanied by payment of the user fee set forth by published guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) or in other guidance, such as forms or instructions, issued with respect to the notification.

(4) *Extension for reasonable cause*. The Commissioner may, for reasonable cause, extend the 60-day period for submitting the notification.

(b) *Special rules for organizations that were organized on or before July 8, 2016—*

(1) *Notification requirement does not apply to organizations that filed with the IRS on or before December 18, 2015.* The requirement to submit the notification does not apply to any organization described in section 501(c)(4) that, on or before December 18, 2015, either—

(i) Applied for a written determination of recognition as an organization described in section 501(c)(4) in accordance with § 1.501(a)-1 and all applicable guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), forms, and instructions; or

(ii) Filed at least one annual information return or annual electronic notification required under section 6033(a)(1) or (i).

(2) *Transition relief available for organizations that filed with the IRS on or before July 8, 2016.* An organization described in section 501(c)(4) is not required to submit the notification if, on or before July 8, 2016, the organization either—

(i) Applied for a written determination of recognition as an organization described in section 501(c)(4) in accordance with § 1.501(a)-1 and all applicable guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), forms, and instructions; or

(ii) Filed at least one annual information return or annual electronic notification required under section 6033(a)(1) or (i).

(3) *Extended due date.* An organization that was organized on or before July 8, 2016, and is not described in paragraph (b)(1) or (2) of this section, satisfies the requirement to submit the notification if the notification was submitted on or before September 6, 2016.

(c) *Failure to submit the notification.* For information on the penalties for failure to submit the notification, the applicable reasonable cause exception, and applicable special rules, see section 6652(c)(4) through (6).

(d) *Acknowledgment of receipt.* Within 60 days after receipt of the notification, the Commissioner will send the organization an acknowledgment of such receipt. This acknowledgment is not a determination by the Commissioner that the organization qualifies for exemption under section 501(a) as

an organization described in section 501(c)(4). See paragraph (e) of this section.

(e) *Separate procedure by which an organization may request an IRS determination that it qualifies for section 501(c)(4) tax-exempt status.* Submission of the notification does not constitute a request by an organization for a determination by the Commissioner that the organization qualifies for exemption under section 501(a) as an organization described in section 501(c)(4). An organization seeking IRS recognition of its tax-exempt status must separately request such a determination in accordance with § 1.501(a)-1 and all applicable guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), forms, and instructions.

(f) *Applicability date.* This section applies on and after July 8, 2016.

[T.D. 9873, 84 FR 35306, July 23, 2019]

#### PRIVATE FOUNDATIONS

##### § 1.507-1 General rule.

(a) *In general.* Except as provided in § 1.507-2, the status of any organization as a private foundation shall be terminated only if:

(1) Such organization notifies the district director of its intent to accomplish such termination, or

(2)(i) With respect to such organization, there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act), giving rise to liability for tax under chapter 42, and

(ii) The Commissioner notifies such organization that, by reason of subdivision (i) of this subparagraph, such organization is liable for the tax imposed by section 507(c)

and either such organization pays the tax imposed by section 507(c) (or any portion not abated under section 507(g)) or the entire amount of such tax is abated under section 507(g).

(b) *Termination under section 507(a)(1).* (1) In order to terminate its private foundation status under paragraph (a)(1) of this section, an organization must submit a statement to the district director of its intent to terminate its private foundation status under section 507(a)(1). Such statement must set