

excess benefit transaction with respect to the series of compensatory payments during 1999 is deemed to occur on December 31, 1999, the last day of D's taxable year. In order to correct the excess benefit transaction on June 30, 2002, D must pay W, in cash or cash equivalents, excluding payment with a promissory note, \$5*t* (the excess benefit) plus interest on \$5*t* for the period from the date the excess benefit transaction occurred to the date of correction (*i.e.*, December 31, 1999, to June 30, 2002). Because this period is not more than three years, the interest rate D must use to determine the interest on the excess benefit must equal or exceed the short-term AFR, compounded annually, for December, 1999 (5.74%, compounded annually).

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

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

Example 4. The facts are the same as in *Example 3*, except that Property F has increased in value since January 1, 2000, the date the excess benefit transaction occurred, and on July 5, 2005, has a fair market value of \$13*v*. For purposes of correction, B's return of Property F to X is treated as a payment of \$10*v*, the fair market value of the property on the date the excess benefit transaction occurred. If \$10*v* is greater than the correc-

tion amount (\$4*v* plus interest on \$4*v* at a rate that equals or exceeds 6.21%, compounded annually, for the period from January 1, 2000, to July 5, 2005), then X may make a cash payment to B equal to the difference.

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

[T.D. 8978, 67 FR 3083, Jan. 23, 2002]

§ 53.4958-8 Special rules.

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

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

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

[T.D. 8978, 67 FR 3083, Jan. 23, 2002]

§ 53.4961-1 Abatement of second tier taxes for correction within correction period.

If any taxable event is corrected during the correction period for the event, then any second tier tax imposed with respect to the event shall not be assessed. If the tax has been assessed, it shall be abated. If the tax has been collected, it shall be credited or refunded as an overpayment. For purposes of this section, the tax imposed includes interest, additions to the tax and additional amounts. For definitions of the terms *second tier tax*, *taxable event*, *correct*, and *correction period*, see § 53.4963-1.

§ 53.4961-2 Court proceedings to determine liability for second tier tax.

(a) *Introduction.* Under section 4961 (b) and (c), the period of limitations on collection may be suspended and assessment or collection of first or second tier tax may be prohibited during the pendency of administrative and judicial proceedings conducted to determine a taxpayer's liability for second tier tax. This section provides rules relating to the suspension of the limitations period and the prohibitions on assessment and collection. In addition, this section describes the administrative and judicial proceedings to which these rules apply.

(b) *Initial proceeding*—(1) *Defined.* For purposes of subpart K, an initial proceeding means a proceeding described in subparagraph (2) or (3).

(2) *Tax Court proceeding before assessment.* A proceeding is described in this subparagraph (2) if it is a proceeding with respect to the taxpayer's liability for second tier tax and is commenced in accordance with section 6213 (a).

(3) *Refund proceeding commenced before correction period ends.* A proceeding is described in this subparagraph (3) if it is a proceeding commenced under section 7422, in accordance with the provisions of § 53.4963-1(e) (4) and (5) (relating to prerequisites to extension of the correction period during certain refund proceedings), and with respect to the taxpayer's liability for second tier tax.

(c) *Supplemental proceeding*—(1) *Jurisdiction.* If a determination in an initial proceeding that a taxpayer is liable for a second tier tax has become final, the court in which the initial proceeding was commenced shall have jurisdiction to conduct any necessary supplemental proceeding to determine whether the taxable event was corrected during the correction period.

(2) *Time for beginning proceeding.* The time for beginning a supplemental proceeding begins on the day after a determination in an initial proceeding becomes final and ends on the 90th day after the last day of the correction period.

(d) *Restriction on assessment during Tax Court proceeding.* If a supplemental proceeding described in section 4961 (b) and § 53.4961-2(c) is commenced in the Tax Court, the provisions of the second and third sentences of section 6213(a) and the first and third sentences of § 301.6213-1(a)(2) apply with respect to a deficiency in second tier tax until the decision of the Tax Court in the supplemental proceeding is final.

(e) *Suspension of period of collection for second tier tax*—(1) *Scope.* Except as provided in subparagraph (6), this paragraph (e) applies to the second tier tax assessed with respect to a taxable event if a claim described in subparagraph (2) is filed.

(2) *Claim for refund.* A claim for refund is described in this subparagraph (2) if, no later than 90 days after the day on which the second tier tax is assessed with respect to a taxable event, the taxpayer—

(i) Pays the full amount of first tier tax for the taxable period, and

(ii) Files a claim for refund of the amount paid.

(3) *Collection prohibited.* No levy or proceeding in court for the collection of the second tier tax shall be made,