



Intermediate Sanctions Checklist

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The intermediate sanctions rules prohibit tax-exempt organizations from providing more than fair market value economic benefits to their “disqualified persons.”

The intermediate sanctions rules apply to all section 501(c)(3) and section 501(c)(4) organizations except for private foundations, which are subject to special, private foundation “self-dealing” rules. All grantmakers that are public charities, a category that includes community foundations and public foundations, are subject to the intermediate sanctions rules.

To prevent violations of the intermediate sanctions rules, four steps should be taken:

- (1) **Identify Disqualified Persons;**
- (2) **Identify Transactions with Disqualified Persons;**
- (3) **Review and Approve Transactions with Disqualified Persons;**
- (4) **Prepare and Retain Adequate Contemporaneous Documentation.**

1. **Identify Disqualified Persons**

- a. **Definition:** A **disqualified person** is a person who is in a position to exercise substantial influence over the affairs of the organization.
- b. **Automatic Disqualified Persons**
 - i. Governing body members entitled to vote.
 - ii. Any person bearing the title of President, Chief Executive Officer or Chief Operating Officer, unless he or she does not perform the usual function of such an officer, i.e., having ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization.
 - iii. Any person who performs the function of a president, chief executive officer or chief operating officer, even if not bearing one of these titles.
 - iv. Any person bearing the title of Treasurer or Chief Financial Officer, unless he or she does not perform the usual function of such an officer, i.e., having ultimate responsibility for managing the finances of the organization.

- v. Any person who performs the function of a treasurer or chief financial officer, even if not bearing one of these titles.
 - vi. Any person with a material financial interest in a provider-sponsored organization in which a tax-exempt organization participates, such as a physician-hospital organization or a preferred provider network.
 - vii. Any person who has been in any of the above positions during the past 5 years.
- c. **Donor-Advised Funds (under the Pension Protection Act of 2006)**
- i. Donors and donor advisors are disqualified persons with respect to the donor-advised fund.
 - ii. Investment advisors who are compensated by the sponsoring organization (e.g., community foundation) either for managing the investment of or providing investment advice with respect to assets maintained in donor-advised funds are disqualified persons. Investment advisors do not include employees of the sponsoring organization.
 - iii. Family members and 35 percent controlled entities of the above (see Section 1.f. below).
- d. **Supporting Organizations (under the Pension Protection Act of 2006)**
- i. A disqualified person of a supporting organization is treated as a disqualified person of the supported organization.
- e. **Other Disqualified Persons:** Other persons are subject to a facts and circumstances test to determine if they are disqualified persons, i.e., to determine if they are in a position to exercise substantial influence over the affairs of the organization.
- i. **Facts Tending to Show Substantial Influence**
 - a. Founder of organization.
 - b. Substantial contributor to organization (given over the current fiscal year and the four preceding fiscal years more than \$5,000 and more than 2 percent of all contributions and bequests received during that five-year period by the organization).
 - c. Compensation primarily based on revenues derived from activities of the organization that that person controls.

- d. Has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation for employees.
- e. Manages a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole. An example of such a person would a program director with authority to manage a substantial portion of a community foundation's grantmaking program.
- f. Owns a controlling interest (measured by vote or value) in a corporation, partnership, or trust that is a disqualified person, including by virtue of being a 35 percent controlled entity (see below).
- g. Is a non-stock organization controlled, directly or indirectly, by one or more disqualified persons.

ii. **Facts Tending to Show a Lack of Substantial Influence**

- a. If a contributor, receives only such preferential treatment as is available to any other contributor making a comparable contribution as part of a solicitation intended to attract a substantial number of contributions.
- b. Is an independent contractor, such as an attorney, accountant, or investment manager or advisor, whose sole relationship to the organization is providing professional advice (without having decision-making authority) with respect to transactions from which the independent contractor will not economically benefit either directly or indirectly (aside from customary fees received for the professional advice rendered).
- c. Has a direct supervisor who is not a disqualified person.
- d. Does not participate in any management decisions affecting the organization as a whole or a discrete segment or activity of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization.
- e. Has taken a vow of poverty as an employee, agent, or on behalf, of a religious organization.

f. **Related Disqualified Persons**

i. **Family Members of Disqualified Persons**

- a. Spouse
- b. Siblings (by whole or half blood)
- c. Spouses of siblings (by whole or half blood)
- d. Ancestors
- e. Children
- f. Grandchildren
- g. Great grandchildren
- h. Spouses of children, grandchildren and great grandchildren

ii. **Thirty-Five Percent Controlled Entities**

- a. A corporation in which disqualified persons (other than 35 percent controlled entities) own, directly or indirectly, more than 35 percent of the combined voting power.
- b. A partnership in which disqualified persons (other than 35 percent controlled entities) own, directly or indirectly, more than 35 percent of the profits interest.
- c. A trust or estate in which disqualified persons (other than 35 percent controlled entities) own, directly or indirectly, more than 35 percent of the beneficial interest. Example: Mary Smith, a member of the governing body of the Sunny Acres Community Foundation, owns 15 percent of the voting shares in the Shady Valley Office Supply Corporation. Mary's husband, John, owns another 10 percent of the company's voting shares, and Mary's children, Rose and George, each own an additional 5 percent. Mary is automatically a disqualified person because she is a member of Sunny Acre's governing body. John, Rose, and George also are disqualified persons because they are Mary's spouse and children respectively. Because Mary, John, Rose, and George collectively own 35 percent of Shady Valley Office Supply's voting shares, Shady Valley also is a disqualified person.

g. **Persons Automatically Not Disqualified Persons**

- i. Employees who are not highly compensated are not disqualified persons unless they are automatic disqualified persons, related disqualified persons, or substantial contributors. An employee is not highly compensated if he or she receives less than \$85,000 in annual economic benefits, including compensation, amounts paid for property, and any other economic benefits; this \$85,000 figure is for 2001 and is adjusted annually for inflation and rounded to the nearest \$5,000.
- ii. Section 501(c)(3) tax-exempt organizations.

2. **Identify Transactions with Disqualified Persons**

- a. **Automatic Excess Benefit Transactions:** The Pension Protection Act of 2006, enacted on August 17, 2006, changed the intermediate sanctions rules by including a category of transactions that will be deemed to provide automatic excess benefits. These transactions are prohibited even if they do not provide more than fair market value benefit to a disqualified person. There are no exceptions or safe harbors for these transactions. Visit www.cof.org/ppa for more information on the Pension Protection Act, including guidance from the IRS on implementing the provisions.
 - i. **Donor-Advised Funds:** Grants, loans, compensation and similar payments to donors and donor advisors (including family members and 35 percent controlled entities) from the donor-advised fund are deemed to be automatic excess benefit transactions and hence prohibited.
 - ii. **Supporting Organizations:**
 - a. Grants, loans, compensation and similar payments to substantial contributors (including family members and 35 percent controlled entities) of a supporting organization (type I, II or III) are deemed to be automatic excess benefits and hence prohibited. In general, a substantial contributor is any person who contributed or bequeathed an aggregate amount which is more than \$5,000 and more than 2 percent of the total contributions and bequests received by the supporting organization before the close of the organization's taxable year in which the contribution or bequest is received by the organization from that person.
 - b. Loans to any disqualified person of a supporting organization are an automatic excess benefit transaction.
- b. **All Transactions that Provide an Economic Benefit:** The following transactions with disqualified persons are subject to the intermediate sanctions rules, whether the

transactions are done directly by the organization or indirectly through a controlled entity (taxable or tax-exempt) or an intermediary (defined below).

- i. **Compensation for Services, which includes:**
 - a. All cash or noncash compensation, including:
 - i. Salary, fees, bonuses, and severance payments.
 - ii. Deferred compensation that has been earned and vested or is no longer subject to a substantial risk of forfeiture, whether or not funded, paid under a qualified plan, or currently includable in taxable income.
 - iii. Payments from revenue-sharing arrangements.
 - b. Unless excludable from income as a fringe benefit described in section 132 (such as working condition and de minimis fringe benefits), all other taxable and nontaxable benefits including:
 - i. Payments to welfare benefit plans, such as medical, dental, life insurance, severance pay and disability plans.
 - ii. Expense allowances or reimbursements.
 - iii. Foregone interest on loans.
 - c. Unless excludable from income as a de minimis fringe benefit, premiums paid for liability insurance for, or reimbursement of:
 - i. Penalty, tax or expenses of correction owed under intermediate sanctions.
 - ii. Expenses not reasonably incurred by the person in connection with a civil judicial or civil administrative proceeding arising out of the person's performance of services on behalf of the organization.
 - iii. Expenses resulting from an act or failure to act with respect to which the person has acted willfully and without reasonable cause.
- iii. **Proper Treatment of Compensation:** The organization must clearly indicate its intent to treat such payments as compensation for services by having

contemporaneous written substantiation of such intent, unless the payment is for a nontaxable benefit (such as employer-provided health benefits or contributions to qualified pension, profit-sharing or stock bonus plans under section 401(a)). Failure to do so results in the amount not so documented being subject to intermediate sanctions even if the total amount paid does not exceed fair market value compensation for the services provided. Sufficient documentation includes:

- a. Reporting the payment(s) as compensation to the IRS, either by the organization reporting it as compensation on a Form W-2, on a Form 1099, or on its Form 990, or by the recipient reporting it as compensation on the recipient's annual tax return (e.g., Form 1040).
- b. Treating the payment(s) as compensation for services in the relevant written contract.

iii. **Purchases or Sales of Property**

iv. **Any Other Transaction Providing an Economic Benefit**

v. **Controlled Entities**

- a. A corporation in which the organization owns (by vote or value), directly or indirectly, more than 50 percent of the stock.
- b. A partnership in which the organization owns, directly or indirectly, more than 50 percent of the profits interest.
- c. A non-stock organization in which at least 50 percent of the directors or trustees are either representatives of or directly or indirectly controlled by the organization.
- d. Any other entity in which the organization owns, directly or indirectly, more than 50 percent of the beneficial interest.

vi. **Intermediaries**: Economic benefits are provided through an intermediary if:

- a. The organization provides economic benefits to the intermediary;
- b. The intermediary provides economic benefits to the disqualified person; and
- c. Either (i) there is an agreement or understanding (written or oral) that the intermediary will provide economic benefits to or for the use of a

disqualified person or (ii) the intermediary provides economic benefits to or for the use of a disqualified person without a significant business or exempt purpose of its own.

- c. **Initial Contract (“First Bite”) Exception:** An economic benefit provided to a disqualified person pursuant to a fixed payment provision in a written contract entered into before the person becomes a disqualified person (although he or she may have become a disqualified person by virtue of entering into the contract) is not subject to intermediate sanctions as long as the disqualified person substantially performs his or her obligations under the contract. For example, if a community foundation hires a new president, the compensation paid to the new president pursuant to a fixed payment provision in his or her initial contract is not subject to intermediate sanctions as long as the president was not a disqualified person before being hired and substantially performs his or her obligations under the contract.
- i. **Fixed Payment:** A fixed payment means an amount of cash or other property specified in the contract or determined by a fixed formula specified in the contract, which is provided in exchange for the provision of specified services or property. The formula may be dependent on future specified events or contingencies, including the amount of revenues generated by one or more activities of the organization, provided that no person exercises discretion when deciding whether to make the payment or in setting the amount of the payment.
 - ii. **Certain Plans:** Amounts payable pursuant to a pension, profit-sharing or stock bonus plan qualified under section 401(a) to an employee benefit program that is subject to and satisfies federal tax law coverage and nondiscrimination rules (other than nondiscrimination rules under section 9802 relating to discrimination based on health status) are treated as fixed payments even if the organization has discretion with respect to the plan or program and even if the disqualified person has the choice whether to accept any economic benefit.
 - iii. **Termination:** An initial contract is not subject to this exception as of the first date that the organization can terminate the contract without the other party’s consent and without substantial penalty.
 - iv. **Material Change:** An initial contract with a disqualified person that is materially changed, including by extension or renewal, is not subject to the initial contract exception as of the date that change is effective.
 - v. **Non-Fixed Payments:** Such payments are subject to the intermediate sanctions rules, even if part of an initial contract, and will be evaluated in combination with all consideration received by the disqualified person (including fixed payments that are part of an initial contract and so are otherwise not subject to

the intermediate sanctions rules). Reimbursements for expenses are considered non-fixed payments if the disqualified person exercises discretion over the amount of the expenses.

d. **Other Exceptions**

- i. Nontaxable fringe benefits under section 132, including working condition (such as reimbursement for organization-related travel), de minimis, no-additional-cost service, qualified employee discount, qualified transportation, and qualified moving expense reimbursement fringe benefits.
- ii. Economic benefits provided to a member of, or donor to, the organization if any non-disqualified person paying a membership fee or making a contribution above a specified amount is given the option of receiving substantially the same economic benefit and the disqualified person and a significant number of non-disqualified persons make a payment or contribution of at least the specified amount.
- iii. Economic benefits provided to a volunteer for the organization if the benefit is provided to the general public in exchange for a membership fee or contribution of \$75 or less per year.
- iv. Economic benefits provided solely as a member of a charitable class. Examples of such benefits include selection to participate in a clinical trial based on the same scientific criteria used to select the rest of the patients, and a scholarship awarded to a child who met the criteria for financial need and academic merit generally applied by the institution in awarding such reward.
- v. Economic benefits provided to governmental units exclusively for public purposes.

3. **Review and Approve Transactions with Disqualified Persons**: Meeting the following two requirements and maintaining the documentation described in the next section creates a “rebuttable presumption” that the transaction approved does not violate the intermediate sanctions rules. While not absolutely required, these procedures represent “best practices” that can help an organization avoid any violations of the intermediate sanctions rules.

- a. **Independent Approval**: A transaction with a disqualified person may be approved by the full governing body, a governing body committee (if state law and the organization’s governing documents allow), or another person or persons to which such power is delegated by the governing body (if state law and the organization’s governing documents allow). Generally, the more significant the transaction, the more advisable it is to have it considered by a governing body committee or even the full governing body, and a process should be in place to identify such transactions.

- i. **Independent Governing Body**: All persons with conflicts of interest must not be present during the debate and must not vote on the transaction at issue, although they may be present to answer questions. Persons with conflicts of interest are:
 - a. The disqualified person(s) benefiting from transaction.
 - b. Family members of the disqualified person(s).
 - c. Persons who have a material financial interest affected by the transaction.
 - d. Persons in an employment relationship subject to the direction or control of the disqualified person(s).
 - e. Persons who receive compensation or other payments subject to the approval of the disqualified person(s).
 - f. Persons who have a reciprocal arrangement with the disqualified person(s) (i.e., the disqualified person(s) has approved or will approve a transaction benefiting that person).

- ii. **Independent Governing Body Committee**: Must meet these requirements:
 - a. Any persons with a conflict of interest are not present during the debate and do not vote on the transaction at issue, although they may be present to answer questions.
 - b. Authorized to act on behalf of the organization under state law and the organization's governing documents, without ratification of its actions by the full governing body being required.
 - c. May have non-governing body members only if permitted by state law and the organization's governing documents.

- iii. **Other Independent Person or Body**: Must meet these requirements:
 - a. Governing body delegates the authority to approve the transaction or set of transactions at issue, and such delegation is permitted by state law and the organization's governing documents.
 - b. The delegation order specifies the procedures to follow.

- c. Any persons with a conflict of interest are not present during the debate and do not vote on the transaction at issue, although they may be present to answer questions.
- d. Authorized to act without ratification by the governing body.

iv. **Timing of Approval**

- a. General Rule: Approval generally should occur as near in time to when (but before) the contract or other agreement to enter into a transaction with a disqualified person is executed, so that the approval is based on the facts as they exist at that time.
- b. Non-Fixed Payments: For non-fixed payments, the rebuttable presumption can only arise after the exact amount is determined or a fixed formula for calculating the amount is specified. For example, if an agreement provides for a discretionary bonus, the three rebuttable presumption requirements must be met (taking into account all of the compensation received by that employee) based on the facts in existence at the time the amount is set.
- c. Caps: If a non-fixed payment is subject to a specified cap, the rebuttable presumption may arise at the time the contract containing the payment is approved if the appropriate data as to comparability indicates that the total possible compensation, including the maximum amount of the non-fixed payment, is no more than reasonable compensation and the other rebuttable presumption requirements have been met.

b. **Appropriate Data as to Comparability**

- i. **Fair Market Value Standard**: The data must provide sufficient information to determine that the economic benefit provided to a disqualified person does not exceed fair market value for the services or property provided by the disqualified person in return.
 - a. **Compensation** must be no more than the amount that would ordinarily be paid for like services by like enterprises under like circumstances (including the qualifications of the disqualified person and whether he or she had been undercompensated for services provided in earlier years).
 - b. **Fair Market Value for Buying or Selling Property** is the price at which property or the right to use property would change hands between a willing buyer and a willing seller.

ii. **Appropriate Data**

- a. Compensation: There is no absolute rule for what data will be sufficient; the basic requirement is that the data be sufficient to satisfy the fiduciary responsibility of the governing body to conduct appropriate due diligence. Sources of such data include:
 - i. A generally available compensation survey compiled by an independent organization (such as the Council on Foundations). Such survey data must be sufficiently differentiated (e.g., by size of organization and/or geographic location) to allow comparison to similar positions at similarly situated organizations (which may include both taxable and tax-exempt organizations).
 - ii. A customized compensation survey prepared by an independent firm for the organization.
 - iii. Actual written offers from similar organizations competing for the disqualified person.
 - iv. Other data showing compensation paid by similarly situated organizations for functionally comparable positions.
- b. **Special Rule for Compensation Paid by Small Organizations:**
 - i. This rule is available to organizations with average annual gross receipts (including contributions) of less than \$1 million over their three most recently completed fiscal years.
 - ii. For these organizations, the appropriate data requirement is satisfied if the approving body has data on compensation paid by three comparable organizations in the same or similar communities for similar services.
- c. **Property:** For purchases or sales of property, at least one, and, depending on the size and complexity of the transaction, possibly more than one independent appraisal should be obtained.
- d. **Revenue-Sharing Transactions:** Data similar to that relied upon for compensation decisions should be used for revenue-sharing transactions. Revenue-sharing transactions are subject to the same reasonableness standards as other financial transactions with disqualified persons.

- e. **Information About the Transaction:** The approving body should have all relevant information about the transaction. For example, for a compensation decision the approving body should know the job responsibilities and the qualifications of the disqualified person, as well as the total amount of compensation to be paid. If a customized compensation survey or an independent appraisal is commissioned, the independent firm conducting such survey or appraisal should also have all relevant information.

4. **Prepare and Retain Adequate Contemporaneous Documentation**

- a. **Adequate:** The documentation, e.g., minutes of the meeting during which the governing body or governing body committee approved the transaction, must contain:
 - i. The terms of transaction.
 - ii. The date approved.
 - iii. The members present during debate.
 - iv. The members who voted on the transaction.
 - v. The data obtained and relied upon, including how the data was obtained.
 - vi. Any actions taken (e.g., recusal) by a regular member of the approving board or committee who had a conflict of interest.
 - vii. Basis for any departure from the reasonable compensation/fair market value indicated by the data.
- b. **Contemporaneous:** To be the contemporaneous, the documentation must be prepared and approved as follows:
 - i. Prepared by the later of 60 days after final approval or the next meeting of the governing body or governing body committee.
 - ii. Approved within a reasonable time period after the next meeting.

Read the full text of the rule: [Section 4958](#)

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