

§ 7979—Prohibited Transactions

34 Am Jur 2d

eral Savings and Loan Insurance Corp., or their state equivalents.¹

1. Rev. Rul. 62-183, CB 1962-2, 143; Rev. Rul. 59-29, CB 1959-1, 121.
2. Rev. Rul. 62-183, CB 1962-2, 143.
3. Rev. Rul. 59-29, CB 1959-1, 121.
4. Rev. Rul. 62-183, CB 1962-2, 143.

§ 7979. Penalties where exempt organization engages in prohibited transactions. An otherwise exempt organization that engages in a prohibited transaction won't be granted an exemption application and, if it has previously been granted an exemption application, will have its exemption revoked.

Revocation isn't automatic. It applies only after notification by the Treasury and only for taxable years after that in which the organization is notified. But the revocation may apply to any taxable year during or prior to which the organization commenced the prohibited transaction if it entered into the transaction:

- ... with the purpose of diverting corpus or income of the organization from its exempt purposes *and*
- ... the transaction involved a substantial part of the corpus or income of the organization.¹

Engaging in a prohibited transaction also results in disallowance of the charitable contributions deductions for income, gift, and estate tax purposes to individuals, corporations, or estates or trusts that make donations to the organization that engaged in the prohibited transaction. The date from which deduction is denied depends on whether or not the organization entered into a prohibited transaction deliberately and whether or not the donor was a party to that transaction.

If the prohibited transaction was engaged in with the purpose of diverting corpus or income of the organization from its exempt purpose

and the transaction involves a substantial part of the corpus or income, charitable contribution deductions are denied for donations made:

... In the organization's taxable year in which it commenced such prohibited transaction or thereafter, *by a donor who was a party to it*. This includes an individual who wasn't a party himself if any member of his family was. Family includes brother, sisters, spouse, ancestors, and lineal descendants.

... After the organization's taxable year in which it engaged in such prohibited transaction, *by a donor who wasn't a party to it* (and no member of whose family (as defined above) was a party to it). Apparently the year in which the organization engaged in such prohibited transaction is that in which the diversion of the corpus or income becomes substantial.

If the prohibited transaction wasn't engaged in for the purpose of, and didn't involve, diversion of a substantial part of the organization's corpus or income from its exempt purposes, charitable contribution deductions are denied only for donations made in the organization's taxable years after that in which it is notified by the Treasury that its exemption has been revoked.²

Although a transaction between an otherwise exempt organization and one in a fiduciary relation to it may not in particular circumstances constitute a prohibited transaction, it may still result in loss of the organization's exemption if it violates any of the basic requisites for exemption. Thus the transaction may show that the organization isn't in fact being operated for the requisite exempt purpose.³

1. Code Sec. 503(a); Regs. § 1.503(a)-1(b).
2. Code Sec. 503(e) and (f); Regs. § 1.503(e)-1.
3. Regs. § 1.503(a)-1(e).

§ 7990. Unreasonable Accumulations and Improper Use or Investment of Income.

Exemption is denied to certain organizations in the broad religious, charitable, educational, etc. category if they improperly accumulate, use, or invest their income. An exempt organization that does this will lose its exemption, but may file a new exemption application when the improper accumulation, use, or investment has been corrected.

§ 7991. Organizations affected. The Code bars improper accumulation, use, or investment of an exempt organization's income. This rule applies to a smaller group of exempt organizations than the prohibited transactions rule. The unreasonable accumulations rule applies only to organizations in the religious, charitable, educational, literary, scientific, testing for

public safety, and prevention of cruelty to children or animals categories, *subject to important exceptions*, listed at § 7902.

It doesn't apply to employees' supplemental unemployment benefit trusts or qualified employee pension, profit sharing or stock bonus trusts (§ 7903); or to the group of exempt organizations listed at § 7904.