disqualified person and a private foundation. Section 4941(d)(1)(E) defines self-dealing to include any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation. Prior to this Treasury decision, § 53.4941(d)–2(f)(1) provided that provision of insurance for the payment of chapter 42 taxes by a private foundation for a foundation manager was self- dealing unless the premium amounts were included in the compensation of the foundation manager. The payment of chapter 42 taxes by the private foundation on behalf of the foundation manager was self-dealing whether or not the amounts were included in the manager's compensation.

Section 53.4941(d)–2(f)(3) provided that the indemnification of certain expenses by a private foundation for a foundation manager's defense in a judicial or administrative proceeding involving chapter 42 taxes was not self-dealing. Such expenses must have been reasonably incurred by the manager in connection with such proceeding. Also, the manager must have been successful in such defense, or such proceeding must have been terminated by settlement, and the manager must not have acted willfully and without reasonable cause with respect to the act or failure to act which led to the liability for tax under chapter 42.

This Treasury decision expands the scope of the regulations to cover indemnification and insurance payments made by a private foundation to or on behalf of a foundation manager in connection with any civil proceeding arising from the manager's performance of services for the private foundation. The regulations also clarify the distinction between the treatment of indemnification and insurance payments under chapter 42 and the treatment of these same items for income tax purposes.

The proposed regulations resulted in some confusion as to whether certain indemnification and insurance payments would be considered compensatory or non-compensatory. The final regulations have been revised to provide greater clarity. They divide indemnification payments and insurance coverage into non-compensatory and compensatory categories, described comprehensively in § 53.4941(d)–2(f) (3) and (4). The second and third sentences of § 53.4941(d)–2(f)(1) of the proposed regulations have been removed because their substance was incorporated into § 53.4941(d)–2(f)(4). Generally, the non-compensatory category includes indemnification and insurance payments that cover expenses reasonably incurred in proceedings that do not result from a willful act or omission of the manager undertaken without reasonable cause. These payments are viewed as expenses for the foundation's administration and operation rather than compensation for the manager's services. The compensatory category includes indemnification or insurance payments that cover taxes (including taxes imposed by chapter 42), penalties or expenses of correction, expenses that were not reasonably incurred, or expenses for proceedings that result from a willful act or omission of the manager undertaken without reasonable cause. These payments are viewed as being exclusively for the benefit of the manager, not the foundation.

The regulations provide that non-compensatory indemnification and insurance payments are not affected by the prohibition against self-dealing. Conversely, compensatory indemnification and insurance payments are considered acts of self-dealing unless they are added to the benefiting manager's total compensation for purposes of determining whether that compensation is reasonable. If the total compensation is not reasonable, the foundation will have engaged in an act of self-dealing.

In some instances, a foundation may purchase an insurance policy that provides both non-compensatory and compensatory coverage. Some commentators have recommended that no allocation of insurance premiums be required when a single policy of this sort is purchased. These commentators argue that the allocation requirement places an undue burden on private foundations. After careful consideration, the IRS and the Treasury Department have decided to retain the allocation provision in the final regulations. The self-dealing rules were meant to discourage foundations from relieving managers of penalties, taxes and expenses of correction, as well as expenses ultimately resulting from the manager's willful violation of the law. A rule that did not require an allocation to determine whether the disqualified person's compensation is reasonable for purposes of chapter 42 could have the opposite effect. The insurance allocation rules are now set forth in § 53.4941(d)–2(f)(5).

Some commentators requested a clearer statement of what is meant by the statement that indemnification or insurance premiums are to be treated as compensation to the benefiting foundation manager. The IRS and the Treasury Department agree that further clarification is desirable. Accordingly, § 53.4941(d)–2(f)(7) has been added. It provides that treatment as compensation for the limited purpose of determining whether compensation is reasonable under chapter 42 is separate and distinct from treatment as income to the benefiting manager under the income tax provisions. Whether any amount of indemnification or insurance is included in the manager's gross income for individual income tax purposes is determined in accordance with section 132, without regard to the treatment of such amounts under chapter 42.

Finally, a provision has been added to the regulations specifying that a foundation may disregard de minimis benefits when calculating the total amount of compensation paid to an officer, director or foundation manager for purposes of determining whether that compensation is reasonable. In this context, a de minimis benefit is one excluded from gross income under section 132(a)(4). This provision makes explicit a Service position that has previously been reflected in the instructions to the Form 990–PF.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this Treasury decision is Terri Harris, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements.