Free Speech
COALITION, INC.

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CC:M&SP:RU (REG-246256-96)
Room 5226
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Comments of the Free Speech Coalition, Inc., Regarding the Temporary Regulations Relating to Excise Taxes On Excess Benefit Transactions Under Section 4958 of the Internal Revenue Code [REG-246256-96]

Dear Sir:

In response to the Notice of Proposed Rulemaking, the Free Speech Coalition hereby submits the following comments on the temporary regulations regarding excess benefit transactions, as defined in section 4958 of the Internal Revenue Code.

The Free Speech Coalition, Inc. ("FSC") is an alliance of liberal, conservative and non-ideological issue-organizations which are particularly concerned with the preservation of the rights of nonprofit advocacy organizations. This diverse group, which came together in 1993, felt compelled to band together to defend the interests of Americans who want to participate fully in the formation of public policy in this country without undue governmental interference and restriction.

PRELIMINARY OBSERVATIONS

The nonprofit organizations which have joined FSC have a very strong interest in the excess benefit transaction regulations promulgated by the Internal Revenue Service implementing the section 4958 excise taxes. As a result, FSC filed comments in response to the proposed regulations regarding such transactions in November 1998, and now files these comments regarding the temporary regulations which were promulgated in January 2001. The IRS temporary regulations have incorporated some changes from the proposed regulations in response to concerns raised by FSC and other commenters.

For example, deleting, from the provisions defining "disqualified persons," individuals with authority to sign drafts or to authorize electronic transfers of funds, as well as individuals who serve as a key advisors to persons with managerial authority, is a positive step. FSC

encourages the IRS to adopt fully the statutory definition of disqualified persons found at IRC section 4946 when determining the existence of excess benefit transactions.

Likewise, the decision by the IRS to withdraw the language of the proposed regulations indicating that revenue sharing transactions are *per se* excess benefit transactions is responsive to concerns raised by FSC. Additionally, the IRS decision to submit any new regulatory provisions treating revenue sharing as an excess benefit transaction in proposed form, and providing for additional public comment, is appreciated by FSC.

In public hearings, FSC commented on the conflict between the proposed regulations and the United Cancer Council decision issued by the U.S. Court of Appeals for the Seventh Circuit. We note that the temporary regulations would not treat fixed payments under initial contracts as excess benefit transactions, which is another positive change.

However, other concerns which FSC raised in its November 1998 comments have not been addressed adequately in the temporary regulations. As a result, these comments will reiterate several concerns which were previously raised.

GENERAL ISSUES

FSC remains concerned that the IRS perceives itself as enjoying broad discretion to impose excise taxes on excess benefit transactions (sometimes called "intermediate sanctions") in conjunction with revocation of tax-exempt status. No standards are proffered that would define the propriety of such enforcement actions: "The IRS will publish guidance concerning the factors that it will consider in exercising its discretion as it gains more experience administering the section 4958 regime." 66 *Fed.Reg.* 2155. FSC submits that this approach is unwise, as the IRS already suffers from a widespread public perception that its audits of tax-exempt organizations in recent years may have been unduly influenced by improper considerations. It may be in the IRS' best interest (particularly before seeking to impose such a dramatic and severe penalty against a tax-exempt organization) to present a bright line standard which limits the IRS' discretion.

The IRS' explanation of the temporary regulations states that taxpayers will receive a notice of proposed deficiency 30 days before a notice of deficiency is mailed. 66 *Fed.Reg.* 2144. The explanation further states that the "200-percent tax under section 4958(b) is not to be assessed (and if assessed, is to be abated) if the excess benefit is corrected within 90 days after the mailing of the notice of deficiency for that tax." This clarification is appreciated, but assumes the IRS' right to impose an eight-fold increase in penalty on those organizations having the temerity to challenge the administrative position of the IRS. There should be no penalty imposed on taxpayers for disagreeing with the IRS. At minimum, FSC recommends that the final regulations identify precisely what notice will be provided to disqualified persons following the IRS' identification of a potential excess benefit transaction.

The regulations should provide expressly that the 200-percent excise tax will not be imposed during any period in which the 25-percent excise tax may be, or is being, contested by a taxpayer.

ADDITIONAL COMMENTS ON SPECIFIC ITEMS WITHIN THE TEMPORARY REGULATIONS

Among the remaining concerns which the temporary regulations raise for FSC members is the apparent requirement that a nonprofit organization hire experts to certify the fairness of certain outside and personnel contracts, to avoid placing its tax-exempt status at risk. The burdens which the temporary regulations place on the governing bodies (or their committees) of nonprofits to demonstrate the reasonable nature of their contracts with managers (and other disqualified persons) are excessive. For example, the temporary regulations discuss the acquisition of data regarding "compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions." Yet, there is no clear guidance as to what would constitute a similarly situated organization. There are no criteria defining what is functionally comparable (is it sufficient to ask what the organization pays its executive director, or is it necessary to obtain a list of the duties performed by that organization's executive director?). As to "the availability of similar services in the geographic area of the applicable tax-exempt organization," it is not clear whether this standard would apply only to vendors, or would speak to issues such as whether other nonprofits in the area have specialized employees (*e.g.*, media relations directors).

Where the IRS asserts that outside contractors, performing in accordance with an arm's-length contract, become disqualified persons because they exert control over the performance of their contractual duties, it stretches the concepts of disqualified person and excess benefit transaction to unreasonable limits. Not every IRC section 501(c)(3) and 501(c)(4) organization has either the resources or a sufficiently broad focus to compete successfully for large foundation and government grants. This provision of the temporary regulations will tend to kill off those tax-exempt organizations dependent on private contributions — especially newer, smaller groups. This, in turn, tends to entrench existing organizations and freeze out new perspectives, new voices in the free marketplace of ideas.

CONCLUSION

Overall, the proposed standards governing both the IRS' imposition of section 4958 excise taxes and the revocation of tax-exempt status continue to grant excessive discretion to the Service, raising constitutional issues as to their vagueness and overbreadth. The provisions of section 4958 of the Internal Revenue Code do not authorize the IRS to define the terms "disqualified person" and "excess benefit transaction" so broadly. Since the statute does not authorize the imposition of these burdens, and no justification for these burdens is provided, FSC believes that these requirements should be stricken from the temporary regulations before they are finalized, and urges the Treasury to do so.

Respectfully submitted,

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