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NYSSCPA
certified public accountants

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December 7, 2005

CC:PA:LPD:PR (REG-111257-05)
Room 5203
Internal Revenue Service
POB 7604
Ben Franklin Station
Washington, D.C. 20044

By e-mail: Comments@irscounsel.treas.gov

Re: COMMENTS PURSUANT TO INTERNAL REVENUE SERVICE PROPOSED REGULATIONS 111257-05

Proposed Rulemaking Standards for Recognition of Tax-Exempt Status if Private Benefit Exists or if an Applicable Tax-Exempt Organization Has Engaged in Excess Benefit Transaction(s)

To Whom it May Concern:

The New York State Society of Certified Public Accountants, the oldest state accounting association, represents approximately 30,000 CPAs that will implement the provisions of any guidance ultimately issued by the Treasury Department and the Internal Revenue Service (IRS) with regard to the above captioned proposed rulemaking standards. The NYSSCPA thanks the Treasury Department and the IRS for the opportunity to comment on and provide information with respect to proposed Regulation 111257-05.

The NYSSCPA Exempt Organizations Committee deliberated the proposed regulations and prepared the attached comments. If you would like additional discussion with the committee, please contact Alan Woghin, chair of the Exempt Organizations Committee at (212) 372-1608 or Ernest J. Markezin, NYSSCPA staff at (212) 719-8303.

Sincerely,

Stephen F. Langowski
President

Attachment

NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS PURSUANT TO INTERNAL REVENUE SERVICE PROPOSED REGULATIONS 111257-05

CONSIDERING STANDARDS FOR RECOGNITION OF TAX-EXEMPT STATUS IF PRIVATE BENEFIT EXISTS OR IF AN APPLICABLE TAX-EXEMPT ORGANIZATION HAS ENGAGED IN EXCESS BENEFIT TRANSACTION(S)

DECEMBER 7, 2005

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NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS PURSUANT TO INTERNAL REVENUE SERVICE PROPOSED REGULATIONS 111257-05; CONSIDERING STANDARDS FOR RECOGNITION OF TAX-EXEMPT STATUS IF PRIVATE BENEFIT EXISTS OR IF AN APPLICABLE TAX-EXEMPT ORGANIZATION HAS ENGAGED IN EXCESS BENEFIT TRANSACTION(S)

December 7, 2005

We support the proposed rules that attempt to clarify the relationship between Internal Revenue Code Sections 501(c)(3) and 4958, and how the Internal Revenue Service ("IRS" or "Service") will determine whether excess benefit transactions penalized by Code Section 4958 could jeopardize an organization's exempt status.

We have no doubt that, along with the IRS, we both share the goal of promoting charitable giving and charitable activities, which are a key foundation upon which much of our society's social framework is based. We are also sure we share the clear goal of preventing the abuse of our tax laws, including ensuring our tax laws designed to encourage charitable activities are not subject to abuse or misuse.

We commend the Service for seeking comments in considering potential clarification of application of intermediate sanctions and/or revocation of tax-exempt status if private benefit exists or if an applicable tax-exempt organization has engaged in excess benefit transaction(s), and welcome the opportunity to set forth its specific comments on these matters.

Background

It is incumbent upon public charities exempt under Section 501(c)(3) of the Internal Revenue Code (the "Code") to monitor their activities to ensure that private benefit does not exist in order:

- that each organization's purpose is being fulfilled (consistent with existing law), and
- to provide assurance to well-meaning donors that their funds are being utilized for their intended purposes, and not for the benefit of a well-connected few.

The private inurement doctrine under Section 501(c)(3) of the Code requires that the tax-exempt organization be organized and operated so that "no part of …[its] net earnings inures to the benefit of any private shareholder or individual." Under this doctrine, a public charity is forbidden to flow or transfer income or assets through or away from the organization, and the use or benefit of such income or assets by one or more persons having a significant relationship to the organization, for nonexempt purposes. The private inurement doctrine does not prohibit transactions between a Section 501(c)(3) organization and its insiders, but rather requires that transactions be subject to a standard of reasonableness. The IRS currently possesses the authority to revoke organizations' Code Section 501(c)(3) exempt status (or deny such status for organizations during the application process) if private inurement exists.

Under Section 4958 of the Code, "intermediate sanctions" can be imposed on certain insiders (known as "disqualified persons") in the event of "excess benefit transactions" with a Section 501(c)(3) public charity or Section 501(c)(4) social welfare organization (organization defined by the Code as "applicable tax-exempt organization"). The intermediate sanctions are penalty taxes due if an applicable tax-exempt organization pays an "excess benefit" to any disqualified person. A disqualified person is any person or entity in a position to exercise substantial influence over the organization. An excess benefit includes any economic benefit received by a disqualified person that exceeds the value of what the organization received in return.

The interaction between Sections 501(c)(3) and 4958 of the Code has not always been clear. The proposed regulations address the interaction between Sections 501(c)(3) and 4958 of the Code and indicate that "the imposition of excise taxes under Section 4958 does not foreclose revocation of tax-exempt status in appropriate cases." They also provide examples and attempt to illustrate how the IRS will determine whether excess benefit transactions under Section 4958 of the Code could jeopardize an organization's exempt status. The proposed regulations provide helpful guidance to exempt organizations and will encourage organizations to enhance their internal tax compliance measures.

Recommendations

Section 4958 and Application for Recognition of Tax-Exempt Status Under Section 501(c)(3)

The proposed regulations amend the regulations under section 4958 to clarify that the IRS has discretion to refuse to issue a ruling recognizing exemption under section 501(c)(3) to any applicant whose purpose or activities violate any provisions of section 501(c)(3), including the inurement prohibition and the limitation of private benefit, even though such violation could serve as grounds for imposing section 4958 excise taxes if the applicant's tax-exempt status were recognized.

The proposed regulations do not include administrative procedures in the case of an adverse determination. Presumably, the applicant will have the right to protest an adverse determination letter from the IRS through the IRS Appeals Office. The protest must be submitted within 30 days after the date of the adverse determination (Rev. Proc. 90-27, 1990-1 CB 514 modified by Rev. Procs. 93-23, 94-8, and 95-8;

Reg. 601.201(n)(5)). Applicants that have received an initial adverse determination from the IRS National Office have 30 days from the date of the determination to submit an appeal to the National Office. A protest to the National Office should contain the same information required for a protest to the Appeals Office.

Furthermore, if an organization receives a final adverse determination, either upon submission of its original application, or upon the revocation of its exemption, it can pursue judicial remedies.

We suggest that the proposed regulations be modified to include guidance in connection with adverse determinations and stipulate that administrative procedures are available pursuant to Regulation 601.201(n)(5).

Determining Whether Revocation of Tax-Exempt Status is Appropriate When Section 4958 Excise Taxes Also Apply

While the proposed regulations furnish examples of situations in which excess benefit transactions between an applicable tax-exempt organization and a disqualified person occur, they do not comment on the apparently different results based on when the excess benefit is identified or the timing of an IRS inquiry. For example, the facts in Example 1.(i) of Section 501(c)(3)-(1)(g)(2)(iv), illustrating the application of paragraph (g)(2)(ii) indicate that excess benefits begin to occur in Year 3 and continue to present. Upon examination at the end of Year 3, after applying the factors in Section 1.501(c)(3)-1(g)(2)(ii), the IRS would presumably conclude, based on the regulation, that the organization is no longer described in Section 501(c)(3) effective in Year 3 (i.e., revocation of tax-exempt status) and that the excess benefit transactions are subject to the appropriate excise taxes provided by Section 4958.

Example 2.(i) Section 501(c)(3)-(1)(g)(2)(iv), again illustrating the application of paragraph (g)(2)(ii), assumes the same facts as Example 1.(i), but indicates that the entire board of trustees had resigned (replaced by qualified members of the community) and the excess benefit transactions that occurred in Year 3 no longer occurred. Among other steps, the organization hired legal counsel to recover the excess benefits the organization had paid its former trustees, adopted a conflicts of interest policy, and implemented safeguards that are reasonably calculated to prevent future violations. Upon examination at the end of Year 5, after applying the factors in § 1.501(c)(3)-1(g)(2)(ii), the IRS would presumably conclude, based on the regulation, that the size and scope of the excess benefit transactions that occurred in Year 3 become less and less significant as compared to the size and extent of the organization's regular and ongoing exempt function activities that began in Year 4 and continued thereafter. Furthermore, the IRS would presumably conclude, based on the regulation that the excess benefit transactions occurring in Year 3 are subject to the appropriate excise taxes provided by Section 4958.

The proposed regulations do not comment on the apparent different results based on when the excess benefit is identified or the timing of an IRS inquiry. As illustrated above, the IRS would presumably conclude, based on the regulations, that the organization in Example 1 is no longer described in Section 501(c)(3) effective in Year 3, while for the very same organization illustrated in Example 2, having the benefit of two additional years of activity after the occurrence of identical excess benefit transactions in Year 3, the IRS would conclude that the organization continues to meet the requirements for tax exemption under section 501(c)(3). The proposed regulations would not provide an opportunity for applicable organizations (e.g., Example 1) to demonstrate that the "excess benefit transaction(s) has become less and less significant as compared to the size and extent of its regular and ongoing functional activities."

We suggest that the regulations be modified to address this apparent inequity.