Good afternoon. I am Dorothy Robinson, Vice President and General Counsel of Yale University. I am pleased to be here today to testify on behalf of the American Council on Education and the other higher education associations who joined with ACE in the written comments that were submitted on November 4, 1998. Our comments raised a number of issues and concerns with respect to the proposed regulations under Section 4958. My testimony today will highlight some of the issues we believe to be most important.

I. Introduction
I would like to begin with a general comment about the proposed regulations. The purpose of Section 4958 is quite straightforward. It is intended to provide the Internal Revenue Service with a new and effective enforcement tool to address cases of private inurement - in other words, to give the IRS another sanction, besides revocation of tax exempt status, with which to police unfair or abusive transactions between charities and insiders.

The statute is applicable only to (i) persons who are insiders for purposes of the private inurement rules, (ii) transactions which violate those rules, and (iii) organization managers who knowingly approve such transactions. While the proposed regulations clearly do address these cases, we believe that they go well beyond the intent of Congress in many respects. In doing so they create unwarranted administrative and economic burdens for exempt organizations, and particularly for large and complex organizations such as colleges and universities. We urge the IRS and Treasury to reexamine the proposed regulations in light of the intended purpose of Section 4958 and to eliminate provisions that carry them beyond that intent.
In urging that the proposed regulations be pared back, we note that private inurement transactions are relatively few and far between. The overwhelming majority of charities -- including colleges and universities -- have been and will remain in compliance with the "no private inurement" requirement without regard to the passage of Section 4958. Yet the administrative and economic burdens of the proposed regulations will nonetheless affect them, and will thus to some extent waste resources.

For instance, the specter of personal liability for various sets of individuals who are deemed disqualified persons or organization managers (and it is very unclear who those individuals would be) has driven many colleges and universities, as a protective matter, to commission compensation studies which otherwise would have been uncalled for, and has spawned the growth and aggressive advertising of services by consulting businesses eager to sell them those services.

Outside compensation studies are expensive, and also require the expenditure of staff time to put together information needed by the consultants to do the job. Even before the enactment of Section 4958, many colleges and universities had these studies done periodically for their top positions. But now, under the proposed regulations, these studies not only would be more frequent, but would not be limited to the college or university president and a few other top officials. In order to provide protection, they would have to cover a sizable -- but ill-defined -- pool of employees, many of whom would never be considered insiders under Section 501(c)(3) and do not meet the statutory standard of having "substantial influence over the affairs of the organization" in any common-sense use of the phrase. This makes the data collection process time-consuming, expensive and -- for the most part -- a waste of college and university resources.

The proposed regulations should be narrowed to their intended statutory purpose for the additional reason that in their current form they further burden competitive position of nonprofit organizations relative to the for-profit sector in hiring and retaining employees. The proposed regulations compound the disparity in the treatment of compensation between the two sectors by appearing to put substantial numbers of employees at personal risk with respect to the reasonableness of their compensation and the compensation of others.

And finally, we are concerned that the proposed regulations may have a negative impact on the ability of colleges and universities (and other types of exempt organizations) to recruit trustees, who generally serve on a purely voluntary basis, because of the imposition of excessive new administrative burdens and the risk of personal liability. Surely it was not the aim of Congress that this new provision should have such a consequence.
II. Specific Comments

With those general words as background, I would like to move now to identify more specifically several suggestions which we believe could go a long way to making the proposed regulations more reasonable and workable.

1. Better target the definition of "disqualified person."

First, we believe that the definition of "disqualified person" needs to be revised so that it is consistent with the statute but not overly inclusive. This is the most important step that the IRS and Treasury can take to make the regulations more workable for affected organizations. The proposed regulations should include only those persons who meet the statutory standard of having "substantial influence over the affairs of the organization." We believe that this means substantial influence over the affairs of the entire organization, not merely over a portion of it or one of its programs. Further, we believe that that "influence" means significant participation in the formal governance or executive structure of the organization.

In addition, the definition of "disqualified person" should not include persons who merely "share" responsibility and do not have the authority to take action without the supervision of a person holding one of the designated executive positions. It should not include lower-level managers who "share" responsibility (for example by being an authorized signatory on a payment form) or persons who are simply advisors to such managers. And it should not include persons solely because their compensation includes some component that is based on revenue-sharing. Colleges and universities have literally hundreds of employees who have one or more of these characteristics. None of them, however, demonstrates the requisite level of "substantial influence" over the affairs of the organization. These factors, which serve so drastically to enlarge the pool of "disqualified persons" are unwarranted and should be eliminated.

Finally, we are grateful for the inclusion of examples in the proposed regulations, but we believe that they should more real-world guidance. For example, the regulations should be clear, whether through text or in examples, that athletic coaches, Nobel Prize-winning scientists or other persons who have specialized responsibilities for which they may be highly compensated are not disqualified persons merely because of their compensation level or public stature, because they do not have the requisite influence over the affairs of the organization.

2. Administratively expand the presumption of reasonableness.

One of the most important safeguards in the proposed regulations is the presumption of reasonableness. As a practical matter, however, the presumption is not available to many persons because the presumption, as written, is only available where the
determination is made by the governing body or a committee of that body. While it is appropriate for governing bodies or board committees to review and approve compensation for the president and a relatively small number of other senior positions, it is not normally a board function to review compensation determinations for the many dozens of employees who, were the definition of "disqualified person" not to be narrowed, could fall within it. Moreover, the limited delegation allowed under the presumption is not available to organizations governed by state laws that do not expressly allow delegation of board functions to nonboard committees.

The final regulations should provide a realistic mechanism for all potential disqualified persons to obtain the benefit of the presumption of reasonableness. This would occur if the term "disqualified person" is appropriately narrowed to encompass only those senior officials who in fact have substantial influence over the affairs of the organization as a whole. If the definition is not so limited, the IRS and Treasury should, as an administrative matter, establish an additional rebuttable presumption for potential disqualified persons that are below the most senior level. This presumption would be available where compensation decisions are made by members of senior management who are not in a conflict of interest position, who rely on comparative compensation data, and who document the basis for their determination.

3. Expand allowable data to support the presumption.

The regulations should provide better examples about the type of data that may be relied on for the presumption of reasonableness. We believe that the institution should be able to use data developed by itself using publicly available sources (such as IRS Forms 990) or surveys by trade associations or news organizations. Although the proposed regulations state that organizations may rely on national surveys, the example chosen to illustrate this point -- involving compensation for a university president -- finds that the survey is inadequate, in part because of the compensation committee's lack of experience in higher education. It is critical that the examples provide positive guidance, and include guidance on alternatives to expensive custom compensation surveys.

4. Provide a safe harbor for standard revenue sharing arrangements.

Revenue-sharing arrangements created for the benefit of the organization are, we believe, a legitimate and beneficial use of institutional resources. There should be no special stigma attached to these arrangements so long as they are in line with existing practices of comparable institutions. The regulations should provide a safe-harbor for compensation received by disqualified persons under revenue-sharing arrangements (such as university patent policies) that are established as institutional policy; there is no basis for any further review, at the individual level, of amounts paid in accordance with these policies.
5. Simplify the items included in compensation.

We believe that the proposed regulations are unduly inclusive and complicated in defining the compensation that is included for purposes of determining whether an excess benefit has been conferred on an employee. We have three suggestions in particular.

First, all reimbursements to employees for ordinary and necessary business expenses in carrying out their responsibilities should be disregarded. This includes reimbursements of such expenses as first class airfare for senior officials and spousal travel expenses where the spousal travel has a bona fide business purpose. There simply is no basis in the statute for, in effect, imposing a new test on the propriety of these kinds of reimbursements where they otherwise meet IRS requirements for exclusion from income as business expense reimbursements.

Second, fringe benefits that are excluded from income should similarly be disregarded for purposes of determining whether there is an excess benefit. These benefits in some instances have purposes that are, at least in part other than compensatory -- for example, housing furnished for the convenience of the employer under Section 119. Or, in other instances the compensatory component may be difficult to value or it maybe grossly unfair attribute it to the time period in which it happens to be paid out, for example in the case of tuition scholarship benefits paid on behalf of employees or their children under Section 117(d). In the case of other nontaxable perquisites, it may be an extremely burdensome requirement to document these items and value them solely for these purposes.

Finally, the provisions of the proposed regulations on insurance premiums and indemnification create an unwarranted burden on institutions and individuals. The regulations should recognize that the provision of officers' and directors' insurance coverage will not result in excessive compensation and should disregard the payment of premiums for this insurance for purposes of determining whether there is an excess benefit. It is a needless waste of time and money for colleges and universities to try to ascribe a value to the tiny portion of their premiums that would be attributable to Section 4958 coverage and to find a mechanism for considering that as an item of compensation. The right to indemnification in accordance with state nonprofit corporation laws similarly should be regarded.


The regulations should clarify the treatment of deferred compensation so that charitable organizations can offer proper incentives without risk of inadvertently causing an excess benefit transaction. Deferred compensation should not be included in the value of
compensation for purposes of Section 4958 unless and until the deferred compensation vests. And, at the time deferred compensation vests, the vested amount should be allocated over the years of accrual using proper valuation techniques, so that deferred compensation is valued properly and does not result in overstatement of compensation in any year.

7. Exclude initial contracts.

When a president or other senior personnel is initially hired, compensation is invariably negotiated at arms* length by trustees or other responsible officials of the institution. At that time, the newly hired individual has no influence over the affairs of the organization. The regulations should provide that compensation under the initial contract will not be an excess benefit, at least for a reasonable term, such as three years, provided that there is no conflict of interest in the original negotiation.

8. Expand "advice of counsel" exception.

Most colleges and universities seek and receive professional advice concerning their compliance with the requirements of Section 4958. This advice, like any other legal advice, is commonly provided in a format other than a formal written legal opinion. It may be rendered through a written analysis or discussion which does not constitute a formal opinion of counsel; or it may be delivered orally. Colleges and universities should be able to rely in good faith upon legal advice regardless of the format in which it is rendered, and should not be required to go to the expense of obtaining formal legal opinions in the many circumstances where advice will be necessary or appropriate. In addition, many organizations rely on accounting firms or consultants for compensation or for tax advice. The regulations should expand the "advice of counsel" exception to cover advice in all recognized formats by qualified professional advisors.

9. Simplify the correction of excess benefit transactions.

Where an exempt organization has been the object of an excess benefit transaction, the proposed regulations require that the transaction be "corrected" and that the organization be made whole. This provision is, of course, intended to protect the exempt organization. The regulations should be revised, however, to provide specifically that correction may be accomplished by a cash payment and will not require an exempt organization to return or reacquire property.

10. Section 4958 should ordinarily be the sole sanction.

The legislative history of Section 4958 reflects Congressional intent that the provision ordinarily is to operate as the sole sanction for acts of inurement as long as the
organization's operations continue to be charitable in nature. This is an important protection for charitable organizations that should be reflected in the final regulations.

In conclusion, we believe that the proposed regulations are a commendable first effort at addressing the issues raised under Section 4958. However, in our view, there are numerous provisions in the proposed regulations, as I have outlined today, which require specific attention in order to conform to Congressional intent and be workable. We urge the IRS to ensure that final regulations do not create unwarranted and unnecessarily expensive burdens on the efficient operations of colleges and universities and other charitable organizations.