

Phone Forum – Draft Redesign Form 990 July 18-19, 2007

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Opening

Bobby: Good morning (afternoon). Welcome to our telephone forum on the draft Redesigned Form 990. Before we begin, please go to www.irs.gov/eo and click on Draft Redesign Form 990. Having this information in front of you will help you follow along with our discussion.

Today, we have two experienced speakers making the presentation. Theresa Pattara, who is the Project Manager for the Form 990 Redesign, and Elizabeth Goff, a Tax Law Specialist in Ruling and Agreements, who has been working closely with Theresa on this project.

Theresa and Elizabeth will begin by discussing the reasons the IRS is changing the form, the guiding principles behind the changes and the approach we have taken. Then they will move to an overview of the core form and the schedules, followed by information about the comment period. Many of you submitted questions for today's forum. Toward the end of the program, Theresa and Elizabeth will address those questions, with the help of Rich Crom, the CE&O staff assistant.

Let's begin. Theresa.

Background

Theresa: The IRS last revised Form 990 in 1979 - almost 30 years ago. Since that time, the number of exempt organizations has grown significantly. In addition, the organizations themselves have become more sophisticated and complex. For example, more organizations are conducting activities that appear more commercial in nature or are conducting activities overseas. Congress has also passed several laws governing tax-exempt organizations during the last 30 years.

Anytime a new law was enacted or we identified a compliance issue, we essentially had to “jury-rig” the form to add necessary lines. This is because the current form is numbered sequentially from 1 to 108 and inserting a new line essentially means reprogramming various IRS computer systems, which is extremely cost-prohibitive. (Note – when we refer to the current form we are referring the 2006 Form 990). So every time we needed to add a line, we had to either add it to the end of form or squeeze it in as an “a, b or c” to an existing question – even if the question was unrelated to the existing question. For

example, we added questions about donor advised funds and supporting organizations to line 89 as well as Schedule A of the existing form.

Our inability to renumber the form has led to haphazard and illogical form design. This in turn has increased the number of complaints from users about the form's complexity. Complexity in turn results in incomplete and incorrect returns. Not only do we not receive the information we request but the public in general also does not receive adequate information.

In developing the draft redesign, we were guided by three key principles: Improve transparency, improve compliance and reduce burden. These three principles lead us to develop a core form that would be completed by all organizations with a "menu" of 15 attached schedules that would be completed as needed. We believe this approach not only improves transparency and compliance but also reduces burden for some organizations. Let me explain.

In the 2006 Form 990, in addition to the two "structured" schedules – Schedules A and B – we require an organization to "attach a schedule", "attach a statement" or "describe" in at least 36 different places. These 36 different schedules present a number of challenges. Often times the required schedule is not attached, or if it is attached, does not contain the information described in the instructions. Information is often inconsistent from organization to organization either because of the differences in software or because organizations interpret the instructions differently.

In developing the redesigned Form 990, we reviewed all of the schedules to determine whether we needed the requested information for our compliance efforts or whether the information was needed for transparency purposes. As a result of this review, we either eliminated attachments or structured them in one of the 15 schedules. Thus, these schedules reflect those activities and issues for which we need additional information for compliance purposes. We believe this approach is consistent with our guiding principles because structuring the schedules ensures that information we request is not only provided but is provided in a consistent manner. This approach also reduces burden for a less complex organization as it only has to complete those schedules relevant to it.

This does mean, however, that larger, more complex organizations, such as hospitals and universities, may have to complete more than 10 of the schedules. In developing the redesign, we did consider developing a separate Form 990 for different types of organizations such as hospitals, universities, labor unions, etc. This also presented a number of challenges. There are approximately 30 different Internal Revenue Code sections which describe tax-exempt organizations and the majority of them file the Form 990. Developing multiple forms essentially means developing multiple computer systems to process the multiple forms. The reality is that IRS does not have the resources to do this. To add a little perspective, contrast the 140 million Forms 1040 the IRS processes

every year with the approximately 500,000 Forms 990. Our proposal to implement a core form applicable to all filers with the menu of schedules is most feasible from an IRS systems perspective.

So let's jump into our overview of the redesign. Elizabeth is going start us off with an overview of the core. Hopefully you have a copy of the draft redesign form in front of you. Elizabeth.

Overview of Core Form

Elizabeth: As discussed, our intent was to develop a core form that would be applicable to all filers. To that end, we moved to schedules information that would be applicable only to a small population of filers. As I walk through the form I will point this out as well as particular issues on which we are seeking comments.

Page 1

Given the length of the form, we thought it would be a good idea to provide a snapshot of the organization on the first page. So this page is essentially a summary page – everything on it comes from somewhere else in the core or the schedules. While this may seem new, the current page 1 has some of these elements such as a summary of expenses and net assets. One concept that is new is the calculation of certain efficiency and effectiveness indicators. We included those indicators that we understand users of the form to be calculating on their own. We are seeking comments on whether this makes sense and whether any lines or items should be deleted or added.

Page 2

While this page looks similar the existing schedule for officers, directors, trustees, and key employees, I want to point out some key changes. First, we have incorporated information regarding the five highest compensated individuals other than officers, directors, trustees, and key employees and this is for all filers of the 990. This information is currently requested on Schedule A so it only currently applies to 501(c)(3) organizations. Second, for all individuals listed in this schedule, organizations must use the amounts reported on the most recently filed Forms W-2 and 1099. In the current 990, organizations may choose to report amounts in Part V based on the organization's fiscal year or calendar year. We believe that forcing Form W-2 or 1099 reporting not only removes the ambiguity about what to report here but also ensures consistency in reporting. Note however that we still not require these amounts to reconcile to compensation expense reported on the expense statement. Third, we have created columns for compensation from related organizations with the definition of *related* being a more than 50 percent test. Finally, we are requesting the city and state or residence of the individuals listed. Over the years, we have

permitted the use of the organization's address to be listed for each individual. However, this does not provide adequate information about where an organization's officers, directors, trustees, and key employees are physically situated. We believe it is important to know, for example, if an organization is situated in New York City but all of its board members are in California.

Page 3

Many of you may be aware of the increased scrutiny of executive compensation as well as transactions with insiders. The questions on this page are intended to do two things: More clearly flush out the issues we were trying to flush out in questions 75a, b and c over the past few years and reduce the burden to organizations that do not have complex compensation arrangements. Our intent was to require organizations with such arrangements to complete Schedule J to provide that information. We are seeking comments on whether the thresholds for completing Schedule J are appropriate. In addition, we have inserted information on the five highest compensated independent contractors from Schedule A to this page. Again, this is information that is currently only required of (c)(3)s but in the redesign must be completed by all.

Page 4

This page is essentially brand new. In developing the items on this page, we considered the discussions that have been taking place over the past few years about governance, transparency and accountability for nonprofit organizations. Steve Miller, Commissioner of TE/GE, stated in a recent speech that a well-governed organization is more likely to be tax compliant. As a result, the questions we have included here have a two-fold purpose – to provide some insight into an organization's practices as well as to educate organizations about such practices. We are seeking comments on whether items should be deleted from or added to this section.

Page 5 – Statement of Revenue

In general, we have not significantly changed the format of these sections. The format of the revenue statement tracks the format for Part VII of the 2006 Form 990 – the Analysis of Income Producing Activities. We merged Part I with Part VII in order to eliminate the redundancy in reporting revenues. In doing so, we also eliminated the use of exclusion codes. Our thought is that it is easy to identify why a certain item of income is not considered income simply because of the title of the line. For example, we would know that interest and dividend income is excluded under section 512 so an exclusion code is not really needed. We also expanded the application of business codes so they are required for all items of revenue. This will help us in identifying an organization's various sources of income. Finally, in the revenue statement we replaced the lines for direct and

indirect support with a breakdown of the types of contributions. These categories are currently described in the instructions for line 1 of the 2006 Form 990.

Page 6 – Statement of Expenses

On the expense statement, the changes are essentially limited to changes in the categories of expenses that must be separately stated. We feel these categories better reflect the most common expenses incurred by organizations today.

Three new lines I would like to point out are lines 1, 2 and 3. These lines essentially break apart the lines 22 and 23 of the current 990 which is where we added a checkbox for foreign grants in the past few years. In addition, the attached schedules for these lines are now structured in Schedules I and F.

Page 7 – Balance Sheet

The balance sheet has remained essentially the same. We are proposing segregation of certain assets and liabilities by their relation to programs. The major change, however, is the elimination of some of the attached schedules and the consolidation of others on Schedule D. Theresa will talk more about this when she goes over the schedules.

Pages 8 & 9

These reflect a revision of the existing section of questions. While we have deleted some, we have added others. We segregated the questions into two categories. Part VII includes questions about certain activities for which we would like additional information. This section contains most of our “triggers” – those questions that, if answered “yes” would require the completion of one of the 15 schedules. In contrast, Part VIII includes questions about those activities that may require the organization to file another form with the IRS – separate from the 990 -- for example, the Form 4720, 990-T or employment tax returns. We are seeking comments on whether the questions in both of these sections are appropriate and whether there are questions to be added.

Page 10

This brings us to the last page. Again, this page should look familiar to most of you. The focus here is on the statement of program service accomplishments. A key change is the addition of the column for “direct revenue”. We deleted the existing Part VIII – *Relationship of Activities to the Accomplishment of Exempt Purposes*. Since this arguably provided some sense of the revenue associated with certain programs, we are proposing that organizations that may have direct revenue (not contributions) from a program, report that with the related expenditures. We are seeking comments on whether this makes sense.

That's it for the core form. Theresa will now provide a quick overview of the various schedules.

Overview of Schedules

Theresa: At this point, you may want to turn to your package of schedules. As you know, our proposed draft contemplates 15 schedules. I like to break these 15 schedules down into two separate categories: "Old" schedules – those that contain information that we currently require and "new" schedules – those that are completely brand new. Let's start with the old schedules.

Schedule A

Schedule A is still only required to be completed by section 501(c)(3) organizations but it has been streamlined. It now only contains information about private foundation status, the public support test, and information about supporting organizations. Note that we have separated the public support test for 170(b)(1)(A)(vi) organizations from the public support test for 509(a)(2) organizations. In addition, we are proposing a five-year period instead of four in order to align this public support test with that required at the end of the advance ruling period. For those that may not be familiar with the process, currently a new 501(c)(3) organization that does not receive a definitive ruling as to its public charity status at the time it receives exemption, must complete a Form 8734 at the end of its first five years of existence. It is our intent to merge the advance ruling public support test with the 990 public support test.

Other information that currently requested on Schedule A has been moved to either the core or to other schedules. Elizabeth discussed the movement of compensation information to the core. In addition, questions about activities have been moved to pages 8 and 9 of the core and information about transfers with noncharitable beneficiaries has been moved to Schedule R. The private school questionnaire has moved to Schedule E with no change to the questions or the organizations required to complete the schedule. Finally, information on lobbying has moved to Schedule C.

Schedule B

We do not currently have any proposals for redesigning this schedule. However, we are considering it and welcome comments and suggestions on it.

Schedule C

In addition to moving lobbying information from Schedule A, there is also some new information regarding inter-corporate transfers, particularly as they related to section 527 organizations.

Schedule D

Schedule D is a mix of old and new information. It aggregates the attachments required for various lines of the balance sheet. We also moved to this schedule the reconciliation of revenue and expenses to audited financial statements as well as the reconciliation of net assets. We find that these sections do not apply to the majority of organizations, however, we would appreciate comments on whether this is a fair assessment. In addition, we have structured in table format information on donor advised funds and conservation easements that we added to the 2006 Form 990. Finally, we have requested new information from organizations that maintain historical collections, “off balance sheet” escrow accounts or that are required to disclose uncertain tax positions in their audited financial statements under FIN 48. There is a lot of information packed into Schedule D so we welcome comments on whether the aggregation of this information makes sense.

Schedule E

As I mentioned earlier Schedule E is the private school questionnaire from the existing Schedule A. I am going to skip some of the new schedules for now and continue going through some of the old ones.

Schedule I

This schedule structures the attachments that are required for current lines 22 and 23 – grants to organizations and specific assistance to individuals. While we have added some information about an organization’s grant making policies and procedures, the information in the tables is essentially what is required now in the instructions.

Schedule L

This schedule structures those attachments that are required for current lines 50 and 63 – receivables and payables from and to officers, directors, trustees, etc. The information in the tables is what we currently require now in the instructions.

Schedule N

This schedule structures the attachment that is required for current line 79 which asks if the organization liquidated, dissolved, terminated or had a substantial contraction of its assets. One thing that is new, however, is that organizations must now report all significant dispositions of assets (more than 25 percent) regardless of whether the transfer of assets was at fair market value. This is the last of our “old” schedules so I am going to now talk about the “new” schedules.

Schedule F

Parts II and III of this form mirror the information requested in Schedule I for grants to organizations and specific assistance to individuals and, again, tracks what we currently require in the attachments for lines 22 and 23. Unlike Schedule I, an organization must indicate the countries in which it provides assistance to individuals. Part I is brand new and requires an organization to list the countries in which it maintains bank accounts, offices, employees or agents. The intent is to get a picture of an organization's activities overseas on a country by country basis.

Schedule G

Schedule G contains mostly old information which is located in parts two and three – these sections contain information that is required now in the attachment to line 9, special events. However, gaming must now be reported separately from special events and there is new information regarding an organization's gaming activities. Part I is completely new. This part requests information about third party fundraisers – including officers, directors, trustees and other key employees that may contract with the organization in their individual capacity. Note that it is our intent that an organization's development officer would not be listed here if that person only conducted fundraising in his or her capacity as an employee of the organization.

Schedule H

This is a brand new schedule that is only required of hospitals and certain other healthcare organizations. The Schedule requires reporting on community benefit, billing and collection practices and joint ventures.

Schedule J

This is a brand new schedule that must be completed by organizations that answer "yes" to any of questions 6 through 9 on page 3 of the **core** form. If only one employee meets that criteria, the organization does not need to list on Schedule J all individuals listed on page 2 of the core – it has to list on Schedule J only those individuals who meet the specific criteria listed in questions 6 through 9. The intent was to simplify compensation reporting by organizations that do not have complex compensation arrangements for its directors or employees.

Schedule K

This is a brand new schedule that we developed in conjunction with the Tax Exempt Bonds office here at the IRS. Only certain organizations with tax-exempt bonds must complete this schedule.

Schedule M

This is a brand new schedule that keys off the amount of non-cash contributions reported on the revenue statement. It requires an organization to break down the amount reported on that line – line 1g – into the various categories indicated on the schedule. If an organization does not enter an amount on line 1g of the revenue statement (page 5 of the core) it does need to complete this schedule.

Schedule R

This schedule contains mostly old information. However, we classify it as new since it combines Parts IX, *Information Regarding Taxable Subsidiaries and Disregarded Entities*, and XI, *Information Regarding Transfers To and From Controlled Entities* (added as a result of the Pension Protection Act) of the existing Form 990 with Part VII, *Transfers with Noncharitable Beneficiaries*, of the existing Schedule A. We are aware that this schedule needs some work. For example, by combining information on transfers with noncharitable organizations with information required for unrelated business income under section 512(b)(13), we ensnared transfers between charitable organizations. Your comments on this are greatly appreciated.

So that's a quick overview of the schedules. Before we get into some of the questions, Elizabeth is going to talk a little bit about implementation and timeframes.

Next Steps

Elizabeth: As you may know, the deadline for comments is September 14. This deadline is essentially driven by our technology division. They have informed us that we have a window of opportunity to implement this for the 2008 form – that is January 2009 for the 2009 filing season. If we do not take advantage of this opportunity, we may not be able to implement this new form until 2012 or later. We believe 2009 would be better than five years now and hopefully you agree.

However, in order to have all our systems up and running for January 2009, our technology division needs final forms by December 1 of this year – just five months from now. Thus, we need comments by September 14 so that we can incorporate them and make any changes by December 1. Note however that we will have a few extra months to finalize instructions. For example, if we agree that we want a box for compensation from related organizations on the core form, we need to know this fall where that box is going. However, the parameters for what to include in that box, for example the definition of “related” or the definition of “compensation” can be hashed out in the instructions a little later.

We hope that we will be able to release updated forms which reflect all of the comments in during the winter of 2008 along with updated instructions. We have to coordinate this with our Tax Forms and Publications office – the office responsible for getting the forms ready for printing, including making everything look nice! Implementing this new form requires significant coordination across various offices. To name just a few, coordination will be required with our technology division, forms and publication office, processing center in Ogden, toll-free help line, our exam function in Dallas and chief counsel. This is of course in addition to our various external stakeholders such as the state charity officials and software developers.

This is why the September 14 deadline is so important to us. Our hope is that by participating in forums we will get questions and feedback in advance of that deadline. It is helpful to us as we are continuing to work issues as they are identified throughout the summer. Some of you are aware of our e-mail address for comments – it is Form990Revision@irs.gov. We encourage you to use this to ask questions as they occur to you. We are monitoring this on a daily basis. While we may not respond to your specific question, we do hope to post answers on our website shortly.

Throughout the presentation today, you heard us point out specific areas for comments. These specific areas as well as others are listed on the last page of the document titled “Background Paper on Draft Redesigned Form 990”. For example, we are extremely interested in hearing comments regarding how the revised 990 will impact your organizations in terms of recordkeeping and your bookkeeping methods and practices. In light of these changes, will transition periods be needed to ease the burden of these new reporting requirements? If so, what suggestions do you have for the structure of transition periods and what areas specifically will take the most time to for you to implement?

Another area in which we are seeking comments is the ever constant struggle and balance between protecting privacy and the transparency required by law. Have we achieved an optimum balance between privacy concerns and transparency?

As Theresa mentioned earlier in the presentation, one of our guiding principles throughout this entire project has been to reduce the burden for filing organizations. One of the other ways we are considering further reducing the burden is to raise the threshold for filing the Form 990-EZ and moving some of those filers into the new e-postcard which will be implemented in January 2008 which I will speak about in a bit. Another idea is to eliminate the Form 990 EZ and have the “new” EZ be some subset of the redesigned Form 990. We are open to any and all suggestions you may have.

And last but not least of the areas in which we are seeking comments has to do with group returns. We are considering the elimination of group returns. It is

important to recognize that we are not at this time proposing eliminating group rulings, just group returns. For those who may be unaware of this process, organizations that have a group exemption may elect to file a group return. This group return is not like a consolidated return, however, since the “parent” files its own return and a dummy EIN is provided for the separate return that includes all of the information for the “subordinates”. We believe that this frustrates transparency.

In addition, the process is administratively burdensome. Our folks in Ogden mail an annual letter to the parent asking the parent to indicate which subs it will be including in the group return and we need to receive the response before the returns are filed so that we can process them correctly. The information the parent provides rarely matches the subordinate view so that we often do not receive a return for a subordinate that is supposed to be filing its own return. Thus the elimination of group returns will reduce administrative burden for us but also we believe for some of the organizations themselves. We would appreciate thoughts on this.

I would like to mention at this time that organizations that would be required to file may not necessarily have to complete the Form 990. Depending on its gross receipts, it may be able to file Form 990-EZ or the new Form 990-N “e-postcard”. The Pension Protection Act of 2006 created a new electronic filing requirement for the smallest organizations – those with less than \$25,000 of gross receipts. Organizations in this bucket must file basic information – name, address, EIN, name of principal officer among other things. This new filing requirement will be implemented on January 1, 2008. You can find more information about the e-postcard on the charities and nonprofits page of irs.gov.

Please note however that we are seeking comments and questions on all aspects of the return – not just the ones we have highlighted today or in the background document.

Closing

Bobby: Thank you, Theresa, Elizabeth and Rich, and thank you all for joining us today. You will receive an email confirming your attendance and asking you to complete a few questions about the phone forum. Please respond to this evaluation forum--we need your feedback (good or bad), and your ideas for future programs, to help us help you comply with the tax law.