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October 4, 2007

Ms. Linda Stiff
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments Concerning Discussion Draft of Redesigned Form 990 for Tax-Exempt Organizations

Dear Acting Commissioner Stiff:

Enclosed are comments concerning the discussion draft of redesigned form 990 for tax-exempt organizations. These comments represent the views of the American Bar Association Section of Taxation and the Health Law Section. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stanley L. Blend
Chair, Section of Taxation

Andrew J. Demetriou
Chair, Health Law Section

Enclosure

cc: Donald L. Korb, Chief Counsel, Internal Revenue Service
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**AMERICAN BAR ASSOCIATION
SECTION OF TAXATION AND HEALTH LAW SECTION COMMENTS
CONCERNING DISCUSSION DRAFT OF REDESIGNED FORM 990 FOR
TAX-EXEMPT ORGANIZATIONS**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and Health Law Section. These Comments have not been approved by the House of Delegates or Board of Governors of the American Bar Association, and should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Michael A. Clark, Chair of the Section of Taxation’s Exempt Organizations Committee and a Vice-Chair of the Health Law Section’s Tax and Accounting Interest Group. Substantive contributions were made by Brian C. Bernhardt, Victoria B. Bjorklund, Eve Borenstein, Bonnie S. Brier, Bernadette M. Broccolo, Thomas E. Chomicz, Ralph E. DeJong, David M. Flynn, Robert W. Friz, Laura Gabrysch, Julius Green, Karen A. Hayes, Barbara B. Lindsay, Lauren K. Mack, Melissa S. McMorrow, Elizabeth M. Mills, Barbara A. Rosen, Jack B. Siegel, and Gwen Spencer, members of the Section of Taxation’s Exempt Organizations Committee or Administrative Practice Committee or the Health Law Section’s Tax and Accounting Interest Group. The Comments were reviewed by Phillip A. Pillar, Chair of the Section of Taxation’s Administrative Practice Committee; Joseph E. Lundy of the Section of Taxation’s Committee on Government Submissions; Emily Parker, Council Director for the Section of Taxation’s Administrative Practice Committee; and Frederick J. Gerhart, Co-Chair of the Health Law Section’s Committee on Government Submissions and Policy.

Although the members of the Section of Taxation and the Health Law Section who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: October 4, 2007

EXECUTIVE SUMMARY

On June 14, 2007, the Internal Revenue Service (the “Service”) released for public comment the first fundamental redesign of Form 990, the annual information return for tax-exempt organizations required under section 6033, in more than 25 years.¹ The discussion draft of the redesigned Form 990 includes a “Core Form,” which all exempt organizations required to file will complete, and fifteen new Schedules, which will be completed as needed by the filing organization, depending upon its activities. In addition to the new form, the Service also released 47 pages of instructions to the Core Form, instructions to the various schedules (the “Instructions”), a five page Highlights of Redesigned Form 990 (the “Highlights”), a nine page Draft Form 990 Redesign – Glossary (the “Glossary”), and a five page Background Paper Redesigned Form 990 (the “Background Paper”). These Comments respond to the Service’s request for comments on the discussion draft of the Form 990, especially as to its goals of increased information transparency and use as a tool for increasing compliance.²

As stated in IR-News Release 2007-117, three guiding principles served as the foundation for the Form 990 redesign:

- Enhancing transparency to provide the Service and the public with a realistic picture of the organization;
- Promoting compliance by accurately reflecting the organization’s operations so the Service may efficiently assess the risk of noncompliance; and
- Minimizing the burden on filing organizations.

The redesigned Form 990 makes commendable progress towards the first two goals. The third goal may be inconsistent with the first two goals. However, the redesigned Form 990 also achieves much needed simplification in some areas, most notably in the elimination of the filing of Form 8734 by newly created organizations at the end of their advance ruling period as a result of the incorporation of Form 8734’s contents in the redesigned Schedule A.³

Most organizations likely will see an increase in the time needed to complete their annual information return filing as a result of the redesign. For large organizations required to complete multiple new schedules, such as larger hospitals and colleges and universities, as well as organizations engaged in foreign grantmaking, this increase may be substantial. However, for the vast majority of organizations, the time should increase only modestly (after the first year) as organizations gain experience with the new Form 990 and adopt systems to collect the new

¹ Unless otherwise indicated, all references to sections are to the Internal Revenue Code of 1986, as amended (the “Code”), and all references to regulations are to the Treasury Regulations promulgated under the Code.

² IR-News Rel. 2007-117, available on the Service’s web site at <http://www.irs.gov/newsroom/article/0,,id=171329,00.html>.

³ Prior comments submitted by the Section of Taxation also suggested the elimination of the requirement of filing Form 8734 by organizations that have obtained an advance ruling that they are likely to meet the “public support” test under section 170(b)(1)(A)(vi) or 509(a)(2). See Comments Pursuant to Internal Revenue Service Announcement 2002-92, 2002-41 I.R.B. 709 on Proposed Revisions to IRS Form 1023 and Instructions, available at <http://www.abanet.org/tax/pubpolicy/2002/021202eo.pdf>.

information required. We suggest that an increase in the filing threshold,⁴ and perhaps a new Form 990-EZ, be considered to ease the burden on small organizations which are least able to bear the costs of increased reporting burdens.

These Comments contain a number of specific suggestions for the improvement of the new Core Form 990 and the related Schedules. Our Comments include the following suggestions:

1. Modify the first page of the Core Form to add room for a description of the organization's three most significant programs and the expenditures on such programs; eliminate questions that are not "key" to an understanding of the organization's purposes and operations.
2. Eliminate the percentage "efficiency indicators" from page one of the Core Form because they do not provide meaningful information.
3. Revise the questions regarding conflict of interest policies to encourage their use and elicit information regarding their contents.
4. Eliminate the separate lines on the Statement of Functional Expense and the Balance Sheet for compensation and loans to "disqualified persons" who are not officers, directors, or key employees, because the standards for determining the identities of such persons are not clear.
5. Modify Schedule C and the related questions on the Core Form to (a) make it clear that the definitions of lobbying and political activity reported differ based on the type of exempt organization that is involved, (b) eliminate the requirement to collect and report volunteer hours, and (c) eliminate questions asking an organization to determine whether its lobbying activity was "substantial."
6. Rather than requiring organizations to report only their FIN 48 footnote, permit organizations to include their entire audited financial statements (as well as any other attachments necessary to explain responses on the return), and ask organizations to report any activity that may jeopardize their exempt status.
7. Permit hospitals to report other community benefit expenditures, including portions of bad debts that may be reasonably determined to represent charity care.
8. Eliminate the requirement that grants to "friends-of" groups based in the United States be treated as foreign grants, rather than grants to organizations in the United States.

⁴ See Report of National Taxpayer Advocate, Annual Report to Congress 427-28 (2006), available at http://www.irs.gov/pub/irs-utl/2006_arc_section2_v2.pdf. As noted by the Taxpayer Advocate, the filing threshold has not been adjusted for inflation in approximately 25 years. The Taxpayer Advocate recommends increasing the filing threshold to \$50,000 from its current level of \$25,000.

9. Eliminate from Schedule J the reporting of nontaxable fringe benefits and nontaxable expense reimbursements in order to produce more accurate compensation information.

At the end of these Comments, we also respond to the specific questions the Service posed in the Background Paper. In these responses, we recommend that there be transition rules for Schedules F, H, and K in order to provide exempt organizations filing the new information called for by these Schedules time to adjust to collecting the information and determining how it is to be reported.

SPECIFIC COMMENTS ON FORM AND INSTRUCTIONS

I. COMMENTS ON CORE FORM

A. Core Form, Page One and Part I, Summary

1. General Comments

According to the Background Paper, the stated goal of the first page of the Core Form is to “provide a snapshot of the organization’s key financial, compensation, governance, and operational information.” We agree that the principal goal of the first page of the Core Form should be to summarize the filing organization’s “key” information for the various users of Form 990, including state regulators and members of the public. However, we question whether some of the information requested is either “key” or appropriate for “snapshot” presentation.

Under section 6104, the Service and exempt organizations are required to make Form 990 available for public inspection.⁵ With the advent of organizations such as Guidestar, members of the public and journalists use Form 990 as an important source of information about exempt organizations. The first page of the Core Form offers an important opportunity to provide meaningful information—thus enhancing transparency—to users of Form 990.

In determining what should be on the first page—particularly because much of the information is drawn from elsewhere in the Core Form—we believe that the information on page one should be relevant to evaluating the organization and understandable to the average reader without the need for reviewing instructions or understanding complex definitions. The filing organization’s significant purposes and programs, and the amounts of the organization’s revenues, expenses, assets, liabilities, and fund balances, are clearly relevant to evaluating the organization. In addition, certain basic organizational details, such as the organization’s location and contact information, its organizational form and type of exempt status, and its accounting method, are key to understanding all that follows on the return. These items therefore belong on page one of the Core Form.

For the reasons set forth below, however, we believe other information called for by the first page of the draft Core Form is not particularly relevant to an evaluation of the filing organization or is likely to be more misleading than illuminating. Our recommendations for various lines of the Core Form are set forth below.

2. Organization information

a. Item B checkboxes

The “Termination” box has been added, presumably to alert organizations that are winding-up to the need to fill out new Schedule N. Line 10 accomplishes the same purpose.

⁵ IRC § 6104(b), (d).

We recommend that the Service consider including a “Final return” box, as it has in versions of the form for prior years, either in lieu of or in addition to the “Termination” box. There are situations not involving an organization’s “termination” where an organization may no longer be obligated to file an annual information return. For example, a religious organization may have become an integrated auxiliary of a church, or a small organization’s revenues may have fallen below the return filing threshold for the foreseeable future. A “final return” box is more appropriate for such situations than a “termination” box would be.

b. *Box H*

Box H calls for the gross receipts of the exempt organization. In keeping with the limitation of page one of the Core Form to “key” information, we suggest that the Service reconsider whether this box is necessary. Total revenue already is summarized on page one of the Core Form on Line 16.

c. *Box J*

Box J calls for the location of the organization’s books and records. While this information may be necessary for compliance purposes, both for the Service and for State regulatory authorities, it seems unlikely to be particularly useful to public users of Form 990. We recommend that the Service consider relocating this information to another part of the Core Form.

d. *Box M*

Box M calls for the State of legal domicile of the organization. This question seems incomplete in the absence of information as to the form of the entity. A corporate entity is domiciled in its State of incorporation, but the domicile of a charitable trust or unincorporated association depends upon various facts and circumstances. We recommend that the Service consider modifying the question to ask whether the organization is a corporation, trust, or other form of entity. The question should also ask for the current State of incorporation if the entity is a corporation, or ask for the State of organization if the organization is organized by virtue of some document filed with a State, such as a limited liability company.

3. *Part I Summary*

a. *Lines 1 and 2*

We recommend that, in lieu of the existing questions for Lines 1 and 2, the Service consider incorporating in page one of the Core Form the program service expenditure amounts and descriptions now relegated to the tenth page of the Core Form in Part IX, Summary of Program Service Accomplishments. As currently proposed, the first page of the Core Form provides almost no space for a description of an exempt organization’s activities. The programs upon which an exempt organization spends its resources are perhaps the single most telling indication of the organization’s priorities. Highlighting this information on the first page of the Core Form will aid users of the Form 990 in understanding the organization’s purpose and principal activities.

Consideration also might be given to deleting the activity codes from page one because the average reader will not know (without paging through the Instructions) what the codes mean. Leaving the codes on Part IX is appropriate, but they are not likely to be meaningful for most readers and therefore need not be highlighted on page one.

b. *Lines 3 through 9*

Although perhaps of interest to some readers of Form 990, we question whether the information required by Lines 3 through 9 is consistent with the Service's stated goal of providing readers of the Form 990 with "key" information. For interested readers, the size of the organization's board can be determined from the information on Part II of the Core Form, which begins on page two of the Core Form. In the absence of some demonstrable relationship between board size and organizational effectiveness or opportunities for mismanagement, we question whether this information (required by Line 3) is likely to be particularly useful, let alone "key."

Line 4 asks for the number of "independent members" of the governing body. The Glossary defines "independent member of governing body" to include (a) a person "who does not receive, directly or indirectly, material financial benefits, except, if applicable, as a member of the charitable class served by the organization," and (b) a person "who is not a spouse, sibling, parent, or child of any individual who is employed by, or receives compensation or other material benefits from, the organization." For determinations involving the first category, no definition or concept of "materiality" is provided, and difficult questions of interpretation are likely to arise. For example, are all physicians with medical staff privileges at a hospital included, even though they are not compensated by the hospital? In addition, if this question is retained, it would be helpful for the Instructions to provide objective criteria or other guidance concerning "materiality."

The second category excludes from the concept of independence spouses, siblings, parents, or children of anyone who receives "other material benefits [not limited to financial benefits] from the organization." Again, if this question is retained, and the responses to the question are to produce reliable and consistent information, significant guidance and objective criteria will be needed to assist organizations in determining "materiality." Guidance as to the non-financial benefits intended to be covered would also be helpful.

Often, an affiliate relies on its parent to provide an independent board. The affiliate's board may not be independent. It would be helpful if the Core Form offered space for explanation, or to allow attribution of the "controlling" independent board to the filing organization.

We also question whether Line 5, which asks for the number of employees of the organization, provides "key" information. For an organization which operates primarily with volunteers, this information may be of little, if any, relevance. If it is believed that this question is of sufficient significance to warrant inclusion on the first page of the Core Form, perhaps space might also be provided for an estimate of the number of the organization's volunteers.

Lines 6 through 8 request information about the total number of employees receiving compensation above a threshold amount, the highest compensation amount for any employee, and the ratio of total officer, director, trustee, and key employee compensation to program service expenditures. The information about employee, officer and director compensation is also available on the next page of the Core Form.

If the goal is to determine what percentage of dollars (either total or program service) is expended on compensation, the Core Form's approach likely will not accomplish that. Most organizations required to complete the functional expense columns in Part V of the Core Form⁶ will reflect much of the executive compensation as "Management and General" and not as "Program Service" expenses. For those organizations, the numerator on Line 8a will be zero. If it is thought that a comparison of total executive compensation to program services expense is meaningful (which we doubt in most cases), then the Service may wish to consider changing the numerator to include Part V, Line 5, Column A (total officer, director, and key employee compensation), rather than Column B. The Service might also consider changing the denominator to Part I, Line 20, rather than Line 17, to reflect total compensation over total expenses.

The "efficiency indicators" set forth in Line 8b may be particularly misleading for integrated health systems, colleges and universities, or other integrated organizations that include several reporting organizations under more or less common control. For example, an integrated health system may have one organization (frequently the parent organization) that employs staff who perform functions for the benefit of more than one hospital. This arrangement may result in an extremely high percentage on Line 8b for that organization, even though the system when viewed as a whole has a low percentage. We recommend that the Service consider permitting reporting on a consolidated basis. If consolidated reporting is not possible, we recommend that a checkbox for this question and similar percentage calculations be added to indicate that the reporting organization is part of a larger system.⁷ It also would be helpful for space to be added to insert the value of the indicator on a consolidated basis, in addition to the value of the indicator for the reporting organization alone.

Finally, Line 9 requests information about the organization's unrelated business income. It is not clear why this information may be deemed to be of special or "key" significance.

We recommend that the Service consider eliminating Lines 3 through 9 from the first page of the Core Form, and instead use this space for the program expenditure information we have suggested be provided on Lines 1 and 2. The information sought by Lines 3 through 9 is not clearly significant in the overall evaluation of the effectiveness of an exempt organization and, in any event, can in many cases be found on the second page of the Core Form.

⁶ Only organizations described in sections 501(c)(3) and 501(c)(4) are required to complete the functional expense information.

⁷ Line 19b asks for a comparison of fundraising expense to total contribution revenue, and Line 24b asks for a comparison of total expenses and net assets.

c. Lines 11 through 26

(i) Line 11

Line 11 requires reporting of contributions and grants. There appears to be an error in the cross reference to Part IV for the amount of total contributions. The source of total contributions and grants is Part IV, Line 1h, Column A, rather than Line 1g.

(ii) Line 19b

It appears that the percentage of total contributions that fundraising expenses represent is to be included on Line 19b itself, rather than in the two columns at the right of the page. We recommend that both columns on Line 19b be shaded to indicate to organizations filing the return and readers of the Form 990 that no entry is required in those columns.

We question whether the percentage calculation required by Line 19b will be helpful to readers of the Form 990. There is no universal agreement on what the “right” percentage should be in evaluating the effectiveness of exempt organizations. Various groups have guidelines as the appropriate amount of fundraising costs,⁸ but any “snapshot” of such costs taken on an annual basis may be misleading. For example, if an organization is beginning or concluding a capital campaign, or is in its start-up phase, fundraising costs are likely to be somewhat higher than what might otherwise be the norm for that organization. On the other hand, if an organization receives an unusual gift or bequest, fundraising costs may be artificially low.

Standard setting organizations recognize that some organizations exercising reasonable care in the management of their funds may nonetheless have difficulty in raising funds due to the unpopularity of the cause concerned, or for the transitory reasons previously mentioned.⁹ As noted above, this percentage may also be misleading for multi-entity related organizations if reporting is not permitted on a consolidated basis. Accordingly, we recommend that the Service consider eliminating the percentage calculation required by Line 19b or, alternatively, providing space for the organization to explain the reasons that the percentage may to some readers appear to be excessive.

(iii) Line 24b

We recommend that the Service consider eliminating this calculation, which calls for the organization to compute the percentage expenses represent in comparison to the organization’s net assets. We are not aware of any commonly accepted guidelines for this ratio. In addition, for many organizations, this ratio also will be misleading for many organizations if not computed on a consolidated basis. For example, an entity whose function is to operate a hospital in a facility leased from another organization in the system will have a result on Line

⁸ The Better Business Bureau Wise Giving Alliance suggests that total fundraising expenses should account for no more than 35% of gifts, grants, and bequests received. See BBB Wise Giving Alliance Standards for Charity Accountability, Standard 9, available at <http://www.give.org/standards/newcbbbstds.asp>.

⁹ *Id.*

24b (expenses as a percentage of net assets) quite different from that of an entity that operates its own facility, even though the overall result to the system is the same.

(iv) Line 25

Line 25 requires the reporting of gaming activity. Consistent with our recommendation that page one of the new Core Form focus only on “key” information with respect to the reporting exempt organization, we recommend the elimination of Line 25. In our experience, the vast majority of organizations filing Form 990 will not have any activity to report on Line 25. Moreover, for those readers that are interested, Schedule G, Part III contains two pages of information with respect to gaming activity. Accordingly, the Service may wish to consider deleting this line from Part I of the Core Form.

(v) Line 26

Line 26 requires the reporting organization to list the aggregate amount of payments to fundraisers and the amounts raised through such fundraising, and to list the percentage of gross funds raised that is retained by the organization. The amounts on Line 26 summarize information that is reported in detail on Schedule G. For the reasons stated above with respect to Line 19b, we recommend that Line 26 be deleted from Part I of the Core Form, or, alternatively, that Part I of the Core Form provide space for the organization to explain the reasons why the percentage of gross funds raised retained by the organization may appear to be too low.

B. Core Form, Part II, Compensation and Other Financial Arrangements with Officers, Directors, Trustees, Key Employees, Highly Compensated Employees, and Independent Contractors

1. *Section A*

a. *General Comments*

The disclosure of compensation of highly compensated employees who are not key employees is a totally new requirement for organizations other than section 501(c)(3) organizations (such as section 501(c)(4) social welfare organizations and section 501(c)(6) trade and professional organizations). Both section 501(c)(3) organizations and section 501(c)(4) organizations are applicable tax-exempt organizations for purposes of section 4958,¹⁰ and therefore the expansion of the compensation reporting to cover section 501(c)(4) organization employees who might be disqualified persons for purposes of section 4958 likely will further the goal of promoting compliance.

We have reservations, however, as to whether the expansive compensation disclosure required by Part II of the Core Form is appropriate for other types of organizations that have not previously had to report such information, such as section 501(c)(6) trade and professional organizations. Trade and professional organizations do not receive the benefit of tax deductible charitable contributions under section 170 and are operated to serve the common business

¹⁰ I.R.C. § 4958(e)(1).

interests of their members.¹¹ Such members presumably have an interest in the organization's expenditures and exercise appropriate oversight over employee compensation.¹² In addition, trade and professional associations will, because of the expansion of officer, director, and key employee compensation called for by Part II of the Core Form, be reporting substantial additional information with respect to compensation. We recommend that the Service consider limiting the disclosure of compensation of non-key employees to section 501(c)(3) organizations and section 501(c)(4) organizations.

Part II of the Core Form provides that the threshold for reporting compensation of individuals who are not officers, directors, or key employees will increase from \$50,000 to \$100,000. Although Form 990 may be a useful tool for checking salary comparability for smaller organizations, and an increase in the compensation reporting threshold may eliminate the reporting of helpful information for such organizations, on balance, we support this increase in order to eliminate the reporting of relatively low levels of compensation and limit compliance burdens.

Part II of the Core Form now requires that the compensation information shown for officers, directors, key employees, and others reported on Part II match the compensation for such individuals shown on the Form W-2 or 1099 issued to such individuals. However, the Instructions do not state which Form 1099 and/or W-2 to use for a fiscal year filer. For example, a college with an August 31 fiscal year is quite likely to have Form W-2 information for the most recent calendar year before the college files its Form 990. Certainly all fiscal year organizations will have available Form W-2 data for the calendar year that ends within the organization's fiscal year. The Service may wish to clarify this requirement in the Instructions. To provide comparable information to users of Part II and Schedule J, data for the most recent calendar year available at the time the organization files its return would be the most helpful. In any event, the calendar year for the compensation information should be indicated on the Form 990.

We also recommend that the Service consider options to minimize confusion between the calendar year information on Part II and the aggregate fiscal year compensation information on redesigned Part V. For example, the Service may wish to include a "Caution" on the Core Form indicating that for a fiscal year organization the Part II compensation totals for officers, directors, key employees, and highly compensated employees might not equal the amounts shown on Part V. Alternatively, the Service could provide the option for non-calendar year filers to continue to file compensation information based on the fiscal year, which is most relevant to the other financial information reported on the Form 990, which will be reported on a fiscal year basis.

b. *Column A*

Part II requires the disclosure of a reported individual's city and State. Through a disclosure of a person's city and state of residence, it is relatively easy to find a person's street

¹¹ Reg. § 1.501(c)(6)-1.

¹² The same is likely true of other "membership" type exempt organizations, such as social clubs described in section 501(c)(7).

address through publicly available search websites. Although at one time this may not have been a concern, for privacy and security reasons, we recommend that the Service consider requiring disclosure only of whether such individuals reside in the same State in which the reporting organization has its principal offices. Alternatively, the Service could take steps to ensure that the reporting of city and State of residence is redacted from the publicly available copy of the Form 990.

2. *Section B*

a. *Line 3*

Line 3 of Part II, Section B, asks whether, for the reporting organization’s “CEO, Executive Director, Treasurer, and CFO,” the compensation determination process includes three procedural steps. These steps appear intended to mirror the three steps for qualifying for the rebuttable presumption of reasonableness under section 4958,¹³ including an independent governing body, appropriate comparability data, and substantiation.

Section 4958 applies only to disqualified persons with respect to section 501(c)(3) and 501(c)(4) organizations. Line 3 is likely to be confusing to organizations, such as trade associations described in section 501(c)(6), that are not subject to section 4958. Even though such organizations may have taken appropriate steps to determine the reasonableness of the compensation, they are likely to answer “no” to Line 3 because they do not regard their process as designed to qualify for the rebuttable presumption. We recommend that Line 3 be limited to section 501(c)(3) or section 501(c)(4) organizations or, alternatively, that the Instructions for Line 3 indicate that a “yes” answer is appropriate irrespective of whether the organization’s compensation process was intended to satisfy the requirements for the rebuttable presumption.

Line 3 also refers to “independent members of the governing body.” The Glossary defines “independent member of the governing body” by reference to the draft principles published by the Panel on the Nonprofit Sector. The Glossary definition, however, will in some cases treat individuals as lacking independence when they would have been eligible to participate in the decision for purposes of satisfying the conditions for the rebuttable presumption of reasonableness under section 4958. For example, assume that the duly constituted compensation committee of University A’s board of directors is determining the compensation of Dr. Y, the Chief Executive of the University Hospital, a part of University A. The committee assembles appropriate comparability data documenting the reasonableness of Dr. Y’s compensation and contemporaneously documents the decision. Dr. Z, the Provost of the University, is a member of the compensation committee. Dr. Z is not subject to the direction or control of Dr. Y, and therefore would be treated for purposes of section 4958 as a member of the compensation committee who is not subject to a conflict of interest, and who therefore may participate in the decision as to Dr. Y’s compensation¹⁴ However, under the Glossary definition, an employee of the exempt organization cannot be an “independent member of the governing body.” Thus, Dr. Z’s participation in the process might be deemed to require a “no” answer for

¹³ Reg. § 53.4958-6(c).

¹⁴ Reg. § 53.4958-6(c)(iii).

Line 3, while the standards for the rebuttable presumption of reasonableness for purposes of section 4958 would have been satisfied.

The section 4958 standards are well known to section 501(c)(3) and section 501(c)(4) organizations. Accordingly, we recommend that the Service revise Line 3 and the related Instructions to make it clear that meeting the standards for the rebuttable presumption of reasonableness under section 4958 justifies an affirmative response to the question. The question could be reworded to read as follows:

Sections 501(c)(3) and (c)(4) Organizations. For both the highest ranking management officer and the highest ranking financial officer, did the organization use a process for reviewing and approving compensation that was intended to qualify for the rebuttable presumption of reasonableness under section 4958?

b. *Line 4*

Line 4 requires the organization to disclose accruals of more than \$100,000 in nonqualified deferred compensation (in the reporting year) for each current officer or employee listed in Section A. While it may be relevant to elicit information on employer-provided deferred compensation accruals, it clouds the issue to mix in any voluntary, elective deferrals made by the individuals out of their current compensation. A “yes” answer to Line 4, a “yes” answer to Line 8, and/or the disclosure of deferred compensation on Schedule J (Line 1, Column D) could lead the reader to conclude that all disclosed amounts were provided by the employer (in addition to all other forms of compensation). It would be more accurate and helpful to limit the disclosure of nonqualified deferred compensation to amounts accrued and provided by the employer, and to exclude any amounts that are deferred out of current compensation in accordance with a voluntary election by the individual.

c. *Line 5*

Line 5 requires the disclosure of certain business and family relationships involving anyone who was an officer, director, trustee or key employee within the previous five years. The scope of this question requires the organization to ferret out all relationships involving anyone who served in any of these capacities in the rolling five-year period subject to reporting.

For an organization with scarce resources, or with high turnover in these positions, such investigation presents a substantial administrative burden. Moreover, information on business and family relationships involving individuals *currently serving* as officers, directors, trustees and key employees would appear to be much more useful for purposes of monitoring compliance than information on relationships involving someone who is not currently in such a position (and may not have been in such a position for at least four years). The blending of information involving current and former officers, directors, trustees and key employees (particularly where an organization has substantial board turnover) may undermine the usefulness of the information collected in this section of the Form 990. We recommend that the Service consider limiting the required disclosures with respect to former officers, directors, trustees, and key employees, perhaps to individuals who have served in such positions within the last one or two years.

The Instructions for Line 5 also define the term “business relationships” to include situations involving one or more “contracts of sale, lease, license, loan, performance of services, or other business transactions involving transfers of cash or property valued in excess of \$5000 in the aggregate during the tax year.” It is unclear from this definition whether the \$5000 aggregate threshold applies to all the types of listed transactions or only to “other business transactions involving transfers of cash or property.” We recommend that, to avoid confusion, the \$5000 aggregate threshold be applied to all types of contracts and business relationships included in the definition.

Line 5 requires the disclosure of any business relationship (valued at more than \$5000 for the year) with another listed person/entity or with any entity of which the other listed person is a trustee, director, officer, key employee or greater-than-35 percent owner. In providing this degree of disclosure, a listed person not only would need to evaluate each business relationship involving more than \$5000 for the year, but would need to know or learn for each such business relationship whether another listed person also is a trustee, director, officer, key employee or greater-than-35 percent owner of the other entity involved. Such inquiries may be so burdensome that individuals would be reluctant to serve as volunteer board members. To avoid excessive burdens upon board members, we recommend that the Service consider clarifying the Instructions to state that a reporting organization will have compiled sufficient information to respond to the question on Line 5 if it requires that its officers, directors, trustees, and key employees disclose the requested information to the best of their personal knowledge without further inquiry.

Even with the foregoing recommended modifications to Line 5 and the Instructions, the required disclosures called for by Line 5 represent a substantial burden on reporting organizations and their current and former officers, directors, trustees and key employees. In many cases, the required disclosures will produce information having little apparent relevance to the enforcement of material tax law rules for exempt organizations.

The requirement of disclosure of family relationships among individuals listed in Section A continues to appear to be of little usefulness to the Service or to the public. Information that members of the same family, related perhaps only by marriage, or perhaps being at least two generations apart and involving members of distinct households and economic family units, serve in some capacity with respect to the organization, seems unlikely to generate any meaningful enforcement information for the Service. The mere fact of relatedness, without any additional information, does not reveal anything that could reasonably be considered a compliance risk or enforcement priority.

For example, little would be gained by the Service in knowing that a former director’s brother-in-law has a 40 percent ownership interest in an entity that conducted \$6000 of business with the organization in the reporting year (which Line 5 as drafted would require to be disclosed). Rather, it would appear most important for the Service to be aware of significant business relationships among individuals listed in Section A and with the organization that are most likely to result in hidden loyalties potentially and materially contrary to the best interest of the organization and its exempt purposes. To capture only these significant business relationships, we recommend that the Service consider replacing Line 5 with the following disclosure requirements:

During the tax year, did any current officer, director, trustee or key employee:

Have a business relationship with any other person listed in Section A?

Directly, or through a family member, serve as an officer, director, trustee or key employee of an unrelated entity that engaged in business with the organization for which the organization paid more than \$5000 and which represents five percent or more of the unrelated entity's gross revenues for the year?

C. Core Form, Part III – Statements Regarding Governance, Management, and Financial Reporting

1. Line 1a

This question asks for the number of voting and nonvoting members of the governing body. We recommend that the Service consider removing the reference to nonvoting members, as their inclusion may provide a misleading indicator of the number of actual decision makers in the organization's governance.

Many organizations have honorary or life trustees who are entitled to attend meetings in recognition of their long service but who are not entitled to vote. The number of these nonvoting trustees may be substantial in comparison to the number of voting members of the governing body. Including nonvoting trustees may give the misleading impression that the organization has a very large board when it in fact does not.

2. Line 3b

Line 3b asks how many transactions were reviewed under the organization's conflict of interest policy. This question raises several problematic issues.

First, it is unclear how to measure the number of transactions that were in fact reviewed. Is a transaction "reviewed" if a director's firm participates in bidding for a project and does not emerge as the low bidder selected for the project? Second, the identity of the reviewing bodies or employees is unclear, and tracking the number of times a potential conflict is analyzed by multiple reviewers could be quite difficult and burdensome. For example, many large universities have employee conflict of interest policies, as well as faculty conflict of interest and conflict of commitment policies, and the number of persons who could potentially review a transaction could be quite large.

Third, and most importantly, the "right" answer to the question is unclear. The fact that many transactions were reviewed could indicate a lack of sensitivity to the avoidance of conflicts or a high rate of diligent oversight. The review of only a few transactions could indicate institutional avoidance of conflicts or a low rate of diligent oversight.

The question also may discourage proper handling of conflicts of interest. A conflict of interest policy is designed to highlight transactions so that they can be handled pursuant to the

organization's conflict of interest policy. If an organization is required to reveal the number of transactions that have been reviewed under the policy it could be that:

- Organizations will not be at liberty to choose board members that bring the most value to the organization because conflicts of interest might arise, or
- Requiring organizations to disclose the number of transactions reviewed under the policy could discourage conflicts from being elevated.

For organizations of any meaningful size, and particularly for organizations such as healthcare systems or colleges and universities with multiple organizations and substantial research activities, there will be hundreds—if not thousands—of disclosures made, reviewed and assessed.

We believe that the most important indicator of good governance for exempt organizations with respect to potential conflicts of interest is that an organization has a conflict of interest policy (including procedures and disclosure forms) that provides an effective means of identifying, assessing and managing potential conflicts. Therefore, we suggest that the Service consider revising Part III, Line 3b to ask the following questions instead of asking about the number of transactions that have been reviewed:

- a. To whom does the organization's conflict of interest policy apply?
- b. Do the policy and corresponding procedures require periodic disclosure of interests that could give rise to conflicts and regular updates of such disclosures as changes occur?
- c. Does the policy specify a procedure for determining whether there is a conflict of interest and if so the limitations on participation by the person(s) with the conflict of interest?
- d. Does the organization regularly and consistently monitor and enforce compliance with the policy?

3. *Line 9*

Line 9 asks if the organization has an "audit committee." Some organizations may have a committee that is responsible for overseeing the audit that is not formally designated as an "audit committee." For example, the finance committee of the organization may have responsibility for traditional audit committee functions. As a result, we recommend that consideration be given to modifying this question to ask: "Does the organization have an audit committee or another committee of its governing body that assumes responsibility for oversight of the organization's annual audit and selection of independent auditors?"

4. *Line 10*

This question asks whether the organization's governing body has reviewed the Form 990 before filing. The question suggests that this would be a "best practice." Accordingly, organizations will want to answer this question "yes."

Many organizations currently do not have their governing body review the organization's Form 990. It has just been over the past few years that some organizations have started to include a board or board committee review during or at the conclusion of the Form 990 filing process. Review by a governing body will require organizations to complete their returns earlier in the year so that the governing body review can occur before the filing deadline. Finance professionals at tax-exempt organizations often wear several hats. In many cases, individuals involved in the preparation of the tax returns also are responsible for conducting/assisting with the audit. They may also be involved in the budgeting process. Organizations may need to secure additional resources in order include the review of the governing body as a step that takes place before the filing deadline.

For many organizations, review by their governing body could result in a substantial commitment of time (unless a "summary" or cursory review would suffice) and significant additional expense (internal and perhaps external). Additional guidance in the Instructions would be helpful so that organizations can understand what steps would constitute a review of the Form. For example, would it satisfy the requirement if the organization sends the Form to the governing body for their review before the return is filed, but the Form is not formally discussed at a meeting?

In many cases, a governing body may designate a committee, such as the finance committee, audit committee, or a committee that assumes responsibilities for audit/finance committee functions, to review the Form 990. We recommend that the Service consider modifying the question to ask whether the organization's Form 990 has been reviewed by its governing body or by a designated committee thereof.

D. Core Form, Part IV – Statement of Revenue

1. *In general*

Generally, the boxes on this page allow very little room for the financial information requested, particularly for large organizations with revenues of \$100 million or more. Consideration should be given to redesign of this page to allow sufficient room for providing the requested information. This problem is particularly acute for Lines 1, 9, 10, 11 and 12, where Part IV calls for information not in Columns A through D, and there are boxes to the left of the columnar boxes for required entries.

2. *Line 2a*

The Instructions to the Core Form state that Line 2a should include all medical revenue. However, Line 2a on Part IV reflects only "Medicare/Medicaid payments." The Service may wish to revise the Line 2a description to be consistent with the Instructions.

3. *Program service revenue section*

It is not clear from the enumerated descriptions for Lines 2a, 2b, and 2c why those items were chosen as, presumably, the most likely items of program service revenue. “Fees and contracts from government agencies” or “Revenue from related investments” seem unlikely to be used by the vast majority of Form 990 filers. We suggest that the Service consider adding the following two items to cover common types of revenue:

Tuition and Fees – colleges/universities/schools; and

Resident fees – retirement communities.

4. *Lines 4 and 5*

The rationale for separation of the lines for “Dividends and interest from securities” and “Interest on savings and temporary cash investments” has never been clear to many users and preparers of Form 990. Many organizations have a somewhat difficult time breaking the interest and dividends into these categories, particularly when the interest-bearing securities are short-term or when the securities are money market mutual funds or other cash equivalents. We recommend that the Service consider combining these line items into one line for “Dividends and Interest.” Alternatively, if the concern is that readers of the Form 990 should be informed as to the organization’s income from short-term cash equivalents (such as interest on short-term Treasury securities, money market mutual funds, and bank savings accounts) and longer-term investments (such as equity securities, long-term bonds, and certificates of deposit), the Instructions and the Line descriptions might clarify this distinction, rather than attempting to classify investments based on whether they qualify as “securities.”

5. *Line 6*

The Instructions for Line 6 would benefit from clarification and expansion. Because only organizations that have outstanding tax-exempt bonds will answer these questions, expanded guidance, including plain language definitions of key terms, could be included in the Schedule K Instructions or in an appendix that would also be used in completing Schedule K (rather than the general Instructions or the Glossary). In either case, the Instructions for the Core Form could refer organizations to the appropriate document. In addition, the Service may wish to consider whether it is appropriate to include earnings on advance refunding and other defeasance escrows.

6. *Line 9*

The 2006 Form 990, part VII, lines 97a and 97b, required disclosure of rent revenue from debt-financed facilities. The Core Form does not appear to contain any place for the presentation of information regarding debt-financed property.

E. Core Form, Part V – Statement of Functional Expense

1. Line 6

Line 6 asks for compensation not included on the preceding line (compensation of officers, directors, and key employees) that is paid to “disqualified persons” for purposes of section 4958(f)(1) and 4958(c)(3)(B). Section 4958(f)(1) is the definition of “disqualified person”, which has now been in the Code for over ten years. Section 4958(c)(3)(B) is a recently added special definition that relates only to supporting organizations described in section 509(a)(3).

Under section 4958, certain officers (the President or CEO and the Treasurer or CFO) and all directors are presumed to be disqualified persons.¹⁵ In addition, various individuals (such as certain individuals who receive modest compensation and are not otherwise *per se* disqualified persons) are presumed not to be disqualified persons.¹⁶ However, all other individuals and entities must be evaluated under section 4958(f)(1)(A), which includes any person who, at present or during the preceding five years, was in a position to exercise “substantial influence” over the exempt organization.

The “substantial influence” category does not provide a bright-line standard. Instead, organizations are left to sort through a list of various facts and circumstances,¹⁷ including, with respect to employees, whether the employee controls a “substantial portion” of the exempt organization’s capital or operating budgets or employee compensation, or whether the employee manages a “discrete segment or activity of the organization” that accounts for a “substantial portion of the activities, assets, income, or expenses of the organization.”¹⁸ Although exempt organizations often attempt to identify their “disqualified persons” as part of the periodic compensation review process, this analysis generally results only in a list of employees who “might” be “disqualified persons,” since the application of the “substantial influence” standard is subject to considerable uncertainty.

While uncertainty as to whether particular persons meet the “substantial influence” standard may cause exempt organizations to exercise heightened scrutiny in its transactions with a broader range of employees and other persons than it would with a clearer standard, such uncertainty makes it more difficult to determine the correct amounts to report on an information return. In addition, compensation information with respect to employees that might meet the “substantial influence” standard often already will be reported on Part II of the Core Form. Therefore, we recommend that the Service consider eliminating Line 6 of Part V.¹⁹

¹⁵ Reg. § 53.4958-3(c).

¹⁶ Reg. § 53.4958-3(d).

¹⁷ Reg. § 53.4958-3(e)(2).

¹⁸ Reg. § 53.4958-3(e)(2)(iv), (v).

¹⁹ If Line 6 is eliminated, the Service might also consider changing the description for Line 5 to include compensation for all current officers, directors, and employees listed on Part II. Although the Form W-2 based

If nonetheless it is determined that the information on Line 6 will be required, there appears to be no justification for requiring this information from organizations that are not described in section 501(c)(3) or section 501(c)(4). Trade and professional associations described in section 501(c)(6), and other exempt organizations that are not subject to section 4958 will be unfamiliar with the concepts required to determine the information to be reported on Line 6 and will not have any reason to determine their “disqualified persons” other than to complete Line 6. Accordingly, we recommend that the Service consider indicating on Line 6 or in the Instructions that this information does not have to be provided by organizations that are not described in either section 501(c)(3) or section 501(c)(4).

2. *Line 11d*

Line 11d requires the filing organization to report fees for services provided by non-employees for lobbying. The accompanying Instructions define “lobbying” to include “legislative liaison” and contacts with non-legislative bodies, stating, “[i]nclude amounts for lobbying before federal, state, or local executive, legislative or administrative boards.” Filing organizations that complete this line also may answer “Yes” on Part VIII, Line 2, and complete Schedule C. However, the Instructions for Schedule C define lobbying using definitions that, for the most part, do not include actions by executive or administrative bodies.

The amount reported as lobbying on Form 990, Part V, Line 11d should not extend beyond the amounts that most filers would report as lobbying on Schedule C. The use of a more expansive definition of lobbying activity in Part V on Form 990 may result in inconsistent reporting on the Core Form and Schedule C and provide the Service with unreliable information about the lobbying expenditures of filing organizations.

We suggest that the Service consider revising the definition of “lobbying” in the Instructions for Part V, Line 11d to conform to the principal definitions used on Schedule C. The second sentence of the definition could read: “Include amounts for lobbying on foreign, national, state, or local legislation. Do not include lobbying to influence actions by executive, judicial, or administrative bodies.”

3. *Line 11f*

The Service may wish to consider modifying the Instructions to clarify that investment fees reportable on Line 11f do not include any fees incurred by an investment fund (such as a mutual fund or an investment partnership) at the fund level. This exclusion has been a source of confusion in the past.

In addition, the Service might also consider Instructions clarifying that investment expenses must be reported in Column C as management and general expenses *if* they do not directly relate to the organization’s exempt purposes.

disclosure for Part II will not necessarily match the amounts from the organization’s financial statements reported in Part V, this change would allow for a reasonably accurate and convenient analysis of how much of the compensation reported on Part II is actually paid to current officers and employees, as opposed to former officers, directors, and key employees.

F. Core Form, Part VI – Balance Sheet

1. Line 6

For the reasons set forth above with respect to Part V, Line 6, we recommend that Line 6 of the balance sheet, which calls for a listing of loans to disqualified persons who are not current officers, directors, or key employees, be eliminated. Completion of Line 6 requires an organization to determine the identity of its “disqualified persons” for purposes of section 4958, which is a task which cannot be completed with any certainty. In addition, for organizations not described in section 501(c)(3) or section 501(c)(4), a response to this question will require application of concepts and records that generally will not be available or used for any other purpose.

2. Line 10

The Instructions for Line 10 provide: “Enter the total value of publicly traded securities held by the organization as investments. Publicly traded securities include stocks, bonds, Treasury bills and mutual funds.” There is no requirement to provide a detailed description or listing of the publicly traded securities.

We believe Line 10 strikes an appropriate balance between transparency and compliance burdens. Sufficient transparency is provided by indicating that an organization has investments in publicly traded securities and a listing of the amount thereof. There is no need or requirement from a transparency viewpoint to require detailed listings, which may run to many pages for a large organization.

G. Core Form, Part VII – Statements Regarding General Activities

1. Line 3

Line 3 asks if the filing organization provides “credit counseling, debt management, credit repair, or debt negotiation services.” If so, the organization is directed to complete Part XI, Schedule D, which asks whether the organization is an agent or other intermediary for contributions not listed on the organization’s balance sheet (Part VI of the Core Form 990).

Part XI, Schedule D, appears to apply to all filing organizations that serve as an agent or intermediary for another organization, and it thus is not clear why there should be a specific direction for credit counseling organizations to complete this portion of Schedule D.

2. *Lines 6a-d*

The Instructions may be confusing for some organizations. The Service may wish to expand these Instructions. For example, it may be helpful to have distinct instructions for “on behalf of” issuers on the one hand, and a conduit borrower on the other. It also may be helpful to provide additional guidance for situations involving a single bond issue that benefited multiple organizations.

The terms used in these questions and the related Instructions are consistent with the terminology used in sections 103 and 141 through 150 and the related Regulations. However, many exempt organizations will not be familiar with these terms. The Service may wish to include plain language definitions of these terms. As discussed above, the Service may wish to use the Instructions to Schedule K or an appendix for this purpose.

3. *Lines 8a-c*

This question asks whether the organization conducted “all or a substantial part of its exempt activities” using one or more partnerships, limited liability companies, or corporations.²⁰ The Instructions elaborate on the “substantiality” test by suggesting that it would be met if the partnership, limited liability company, or corporation accounts for a “substantial” part of the reporting organization’s capital expenditures or operating budget, or a discrete segment of activities of the organization representing a “substantial” portion of the organization’s assets, income, or expenses as compared to the organization as a whole.

As noted above in connection with the discussion of Part V, Line 6, the “substantiality” concept in the Instructions is applied in determining whether an individual is a “disqualified person” for purposes of section 4958. However, no bright-line standards have been provided concerning the measurement of “substantiality” for this purpose. It seems clear that in the absence of such standards there will be no uniformity in reporting, and exempt organizations and return preparers will be left to make reasonable judgments as to “substantiality” that will undoubtedly not be consistent with the judgments made by other exempt organizations and their advisors.²¹

In addition, it is unclear why “corporations” are included in this question. Unlike partnerships and limited liability companies, the activities of corporations generally are not attributed to their exempt organization owners.²²

²⁰ The Service presumably is interested in this subject in order to examine whether there is control of exempt activities by non-exempt partners or unrelated business income. *See* Rev. Rul. 2004-51, 2004-1 C.B. 974; Rev. Rul. 1998-15, 1998-1 C.B. 718.

²¹ For certain purposes in the exempt organizations area, “substantially all” means 85 percent or more. *See, e.g.*, Reg. § 1.514(b)-1(b)(ii). Accordingly, some have argued that 15 percent of whatever exempt organization activity is being measured must be “insubstantial.”

²² *See, e.g.*, PLR 199721038 (Feb. 28, 1997) (operation of mortuary by a taxable subsidiary of a section 501(c)(13) exempt cemetery company not attributed to the exempt cemetery company).

We suggest that the Service consider changing the focus of Lines 8a and 8b to request information regarding the organization's participation in partnerships or limited liability companies (excluding disregarded entities) which produce income (or loss) reported as revenue substantially related to the organization's exempt purpose on Part IV, Column B. With this information, both transparency and compliance would be enhanced, because the Service and readers of Form 990 would, in one location, have a list of all of the various joint ventures in which the exempt organization participates to carry on its exempt activities.

We also suggest that the Service consider clarifying the Instructions to remove any doubt that investment joint ventures need not be reported on Line 8b. If a joint venture, regardless of ownership or control, is engaged substantially in investment activities generating only passive or portfolio income such as interest, dividends, rents, royalties, and capital gain, we suggest that detailed disclosure can be excessively burdensome. Many large endowments invest in a significant number of such entities as part of their investment programs. Ownership of all controlled entities must be disclosed in full on Schedule R so that there is no need for duplicative disclosure in Part VII. All income generated by such entities must be disclosed in the appropriate places on the Core Form or Schedules as currently drafted. Information giving the names and proportionate ownership is not meaningful in the context of investment vehicles. The investment function is an adjunct to the exempt activity, but should not generally be regarded as the exempt activity itself.

Consistent with the discussion above, we suggest that the Service consider refining Line 8c to provide for a specific definition of what constitutes "control" by taxable entities. For example, does the requisite level of control exist if a tax-exempt partner or member has voting control of the board or other governing body of the entity, yet has ownership of less than 50 percent of the profits or capital of the entity?

4. *Line 9*

This question asks "did the organization operate or maintain a facility to provide hospital or medical care," and states that any such organization should complete Schedule H (Hospitals). We recommend that this definition be clarified regarding the types of facilities that must answer "yes" to this question and complete Schedule H.

Irrespective of the facilities that might qualify as a "hospital" under the Code,²³ the questions on Schedule H are clearly directed at inpatient facilities. Accordingly, we suggest the following definition of a "facility to provide hospital or medical care" for purposes of Line 9, which triggers the obligation to complete Schedule H:

A facility to provide hospital or medical care is an inpatient facility (and all of its components) with an organized medical staff and professional staff that provides medical, nursing, and related services for ill and injured patients 24 hours per day, seven days per week, and that is licensed or recognized in its state as a hospital. Some examples of a hospital are a general hospital, rehabilitation hospital, acute long term

²³ I.R.C. § 170(b)(1)(A)(iii).

care hospital, children's hospital, psychiatric hospital, or a hospital for treating certain disease categories. Examples of facilities that are not hospitals are a nursing facility (including a skilled nursing facility), convalescent home, home for the aged, free standing outpatient clinic, community mental health or drug treatment center, physician group practice, faculty practice plan, physician office, facility for mentally retarded or developmentally disabled, facility for treating alcohol and drug abuse, or a hospital wing of a school, prison or convent.

To enhance transparency, we further recommend that for an organization that meets this definition, all activities conducted by the reporting organization (not only those directly related to the hospital facility) should be accounted for in connection with completing Schedule H.

H. Core Form Part VIII – Statements Regarding Other IRS Filings

1. Line 1

In the Core Form 990, the first question in Part VIII asks: “Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office?” A “yes” answer directs the filing organization to complete Schedule C, Political Campaign and Lobbying Activities. This question is intended to prompt all filers, including section 501(c)(3) organizations, groups exempt under other paragraphs of section 501(c), and section 527 political organizations, to do so even though the definitions of political activities that may apply to the filing organization and the consequences vary significantly under different sections of the Code.

For instance, the set of offices covered by section 527 includes appointive and political party positions²⁴ that may not match the set of offices covered by the campaign prohibition in section 501(c)(3). Further, the word “indirect” has a specific meaning and consequence under the Regulations interpreting section 527(f)²⁵ that may have a tax result that is inconsistent with the Regulations under section 501(c)(3).²⁶ This could confuse many filers, especially section 501(c)(4) and other non-(c)(3) entities, which may be subject to both provisions.

We recommend that the Service consider rewording Part VIII, Line 1, to read: “Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office? If “Yes,” complete the applicable portions of Schedule C, Political Campaign and Lobbying Activities.” This slight change will alert organizations that they may not be subject to the entire Schedule.

In addition, we suggest that the Service revise the Glossary definition of “political campaign activity” to read as follows:

²⁴ I.R.C. § 527(e)(2).

²⁵ Reg. § 1.527-2(c)(2).

²⁶ Reg. §§ 1.501(c)(3)-1(b)(3), -1(c)(3)(iii).

All activities that directly or indirectly support or oppose candidates for elective foreign, national, state or local public office, including office in a political organization. It does not matter whether the candidate is elected. A candidate is one who offers himself or is proposed by others for the public office. Political campaign activity does not include any activity to encourage participation in the electoral process, such as voter registration or voter education, provided that the activity does not directly or indirectly support or oppose any candidate. Include all attempts to influence the selection, nomination, or election of any individual to a public office, whether or not such activities constitute express advocacy of the election or defeat of the candidate.

The description of “political campaign activity” in the existing Glossary definition is based on the Regulations,²⁷ which apply to section 501(c)(3) charities prohibited from participating or intervening in candidate electoral campaigns. Any activities that constitute prohibited campaign intervention for section 501(c)(3) organizations will not be considered as promoting social welfare for section 501(c)(4) organizations; therefore, campaign intervention must be a less-than-primary activity for a section 501(c)(4) entity to keep its exempt status.²⁸

The same is true for all other section 501(c) organizations. If political campaign activities are primary, the entity can be tax-exempt only under section 527 as a political organization. The definition of “exempt function” in section 527(e)(2) for political organizations is worded somewhat differently, but is close enough to the section 501(c)(3) definition to be regarded as congruent for most elective offices.²⁹ Therefore, the proposed revision to the definition of “political campaign activity” should serve reasonably well for all Form 990 filers.

The proposed revision takes a broad view of political campaign activity, including candidates in foreign elections and offices in political parties, and attempts to influence the candidate selection process that may not rise to the level of express advocacy. These issues are further discussed below in relation to Schedule C, Part I-A.

We recommend that the word “intended” be removed from the Glossary definition, to avoid the implication that evidence of intent is relevant to a determination whether political campaign activity has occurred.

The existing draft Glossary definition includes the sentence: “For organizations other than section 501(c)(3) organizations, political campaign activities include activities that support or oppose candidates for appointive federal, state, or local public office.” For reasons to be discussed below, such a statement could be misleading in the general definition in the Form 990 Glossary. Detail regarding appointment advocacy should be deferred to Schedule C, Part II-C.

²⁷ Reg. § 1.501(c)(3)-1(c)(3)(iii).

²⁸ Rev. Rul. 1981-95, 1981-1 C.B. 332.

²⁹ See PLR 199652026 (Oct. 1, 1996).

2. *Line 2*

In the Core Form 990, the second question in Part VIII asks: “Did the organization engage in lobbying activities? If “Yes”, complete Schedule C.” No Instruction is provided to aid in answering this question, and the filer is directed to consult the Glossary. The Code provides at least three different definitions of lobbying applicable to tax-exempt organizations filing Form 990:

- a. section 4911 for public charities electing under section 501(h);
- b. the section 501(c)(3) “no substantial part” test for non-electing public charities; and
- c. section 162(e) for some section 501(c)(4), (5), and (6) organizations.

For other categories of section 501(c) organizations, there is no definition of, or limitation upon, lobbying in the Code or Regulations. Accordingly, we suggest that the Service reword Part VIII, Line 2, to read: “Section 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) organizations. Did the organization engage in lobbying activities? If “Yes,” complete the applicable portions of Schedule C.”

The 2006 Form 990 and Schedule A only ask section 501(c)(3), (c)(4), (c)(5), and (c)(6) organizations to report on lobbying activities. Other types of section 501(c) entities are not subject to any restrictions on the amounts of their lobbying activities, nor are such organizations required to report lobbying expenditures to members or contributors. Accordingly, there is no reason for such organizations to report lobbying expenses on Form 990.

In addition, we recommend that the Service consider revising the definition of “lobbying” in the Glossary. The word “intended” should be removed from the entry to avoid the implication that evidence of intent is relevant. Also, organizations need to know that communications with government officials other than legislators may be covered. Filers should be alerted to the existence of differing definitions, exceptions, and accounting rules depending on the tax classification of the organization.

We suggest the following definition of “lobbying”:

All activities that attempt to influence foreign, national, state or local legislation. Such activities include direct lobbying (communications to legislative or other government officials) and grassroots lobbying (communications about legislation to the general public). Many specific definitions and exceptions apply. For section 501(c)(3) organizations, requirements depend upon whether the filer has elected to report on an expenditure basis under section 501(h). For section 501(c)(4), (c)(5), and (c)(6) organizations, non-legislative contacts with certain federal executive branch officials are included, and the exceptions and accounting rules are different than for section 501(c)(3) organizations.

3. *Line 3b*

Line 3b asks if the exempt organization filing the return has received a notification that it “was or is a party to a prohibited tax shelter transaction.” The Instructions to the Core Form do not provide any guidance with respect to the completion of Line 3b.

We recommend that the Service clarify Line 3b and issue Instructions that provide guidance to exempt organizations that receive somewhat more ambiguous notices from taxable parties. Because of uncertainty as to whether a transaction may fit within the definition of prohibited tax shelter transaction,³⁰ taxable parties frequently will provide notices to exempt organizations that a transaction “may be” a prohibited tax shelter transaction. The Proposed Regulations under section 4965 indicate that such notices generally will not be treated as a conclusive indication that a transaction “is” a prohibited tax shelter transaction.³¹

If the Service’s goal with respect to Part VIII, Line 3b, is to identify potential targets for examination with respect to prohibited tax shelter transactions, then the Service may wish to clarify Line 3b by providing that an exempt organization should answer “yes” if it received a notification that it was or may have been a party to a prohibited tax shelter transaction. Although this more expansive disclosure likely will sweep in a large number of exempt organizations that are not likely to be treated as a “party” to a prohibited tax shelter transaction under section 4965,³² it would provide the Service with the broadest listing of potential audit targets. On the other hand, if the Service wishes to obtain information only with respect to organizations that have received notices stating that a transaction “is” a prohibited tax shelter transaction (irrespective of whether the organization actually is a “party” to such transaction), then we recommend that the Instructions state that less definitive notifications from taxable parties do not warrant a “yes” answer to Line 3b.

I. Core Form Instructions and Miscellaneous Core Form Comments

1. *General Comments*

We recommend that defined terms be bolded or italicized. We also recommend that the Glossary be made part of the Instructions.

The new Core Form and the related Schedules ask for detailed financial information in a manner that may pose significant difficulty and create significant additional expense for reporting organizations. Where the requests for information desired by the Service can be gleaned from existing business records, such as annual audit reports and other reports,³³ we recommend that the Service consider permitting use of the information required by such reports.

³⁰ I.R.C. § 4965(e)(1).

³¹ Prop. Reg. §§ 53.4965-6(b)(1)(ii), -(b)(3), 72 Fed. Reg. 36934 (July 6, 2007).

³² See Prop. Reg. § 53.4965-4, 72 Fed. Reg. 36932 (July 6, 2007).

³³ *I.e.*, Medicare cost reports.

In many cases, the new Core Form and related Schedules (or the Glossary or Instructions) ask a return preparer to make judgments concerning “materiality” and/or “substantiality” of certain matters without providing any guidance or objective criteria on the basis of which the return preparer can have reasonable assurance that the Form and its Schedules have been prepared in a manner that is accurate and complete (even in situations in which the information requested may have no bearing on the reporting organization’s qualification for tax-exempt status). For uniformity in reporting and attempting to assure usefulness of the information that is reported, it is recommended that some form of objective standard be provided in these circumstances, even if the standard provided is unrelated to existing legal requirements (and that fact is so stated in the Instructions).³⁴

2. *Instructions Page 12*

The Instructions indicate that an organization should not attach “any other forms or schedules” to the Form 990. In certain instances it is important for reasons of clarity and transparency to provide an explanation for a particular answer, and insufficient space is provided on the Core Form and Schedules. We suggest the Service clarify that it is permissible to include an attachment when further explanation for an answer is required in order to provide a complete answer. Such attachments would also make the Form 990 more informative to the public.

3. *Instructions Page 26*

The Instructions contain two fundraising examples that are confusing. The first example discusses a fundraising dinner at which the organization received \$1000 in gross receipts for goods valued at \$400. The example says the organization must report the \$400 as gaming revenue. The facts do not indicate that any games of chance were involved in the fundraising dinner. Based upon the facts as written, the \$600 should be reported as contribution revenue.

The second example discusses a fundraising dinner at which souvenir mugs are given to attendees. The example says to report the entire amount received from this event as a contribution, presumably because the souvenir mug is an item of nominal value. However, the example does not consider the fair market value of the dinner or state that the mug is of nominal value. We recommend that the example be expanded to consider the fair market value of the dinner and the mug.

4. *Instructions Page 27*

The Instructions for the statement of functional expenses, Part V, Line 11c, state that the net income from fundraising events may be reported only in Column C or Column D as either unrelated business revenue or excluded revenue. If this is the case, Column B should be shaded relative to related/exempt function income for Line 11c.

³⁴ See, e.g., Reg. § 1.514(b)-1(b)(ii); IRM [7.8.1] 27.10.1 (May 25, 1999) (the withdrawn section 501(m) audit guidelines).

5. *Instructions Page 29*

In the middle of Page 29, there is an example relating to an employee who works on fundraising 40 percent of the time and devotes the remainder of the employee's time to programs of the organization. The example says to allocate 40 percent of the employee's salary should be allocated to fundraising. The Service may wish to consider also stating that the organization must allocate to fundraising 40 percent of the employee's benefits, pension, and payroll taxes as well.

6. *Instructions Page 37*

The second line on this page (relating to Column A of Part V) references Line 37. We believe this was intended to reference Line 35; there is no Line 37 on the balance sheet. If so, the reference should be modified accordingly.

II. COMMENTS ON SCHEDULE A

A. Overall Comments

1. *Design*

For 2006 and prior years, section 501(c)(3) organizations were required to provide on one schedule (Schedule A) information relating to six generally unrelated aspects of compliance with the requirements of section 501(c)(3). Section 501(c)(3) organizations were required to complete separate parts of the form relating to (a) their classification as an organization other than a private foundation under section 509(a) (a "public charity"), (b) the limitation on lobbying activities, (c) the special requirements for organizations operating private schools, (d) transactions with organizations not described in section 501(c)(3), (e) compensation, and (f) a hodgepodge of questions that had expanded over the years to deal with new legislative initiatives or areas of specific compliance concern.

Making Schedule A a separate schedule focusing exclusively on the public charity status of a section 501(c)(3) organization is a welcome change. New Schedule A's specific application will be readily understood by filers and simplifies the overall Form 990 structure.

The draft Schedule A incorporates three significant changes from the current form relating to public charity status reporting:

- a. Parts II and III each represent separate public support test schedules, one for organizations qualified under section 509(a)(1) by application of section 170(b)(1)(A)(vi) (herein referred to as the "section 170(b)(1)(A)(vi) public support test"), the other for those qualified under section 509(a)(2).

- b. For the section 170(b)(1)(A)(vi) public support test, use of the cash method to report revenues is no longer required.³⁵
- c. The support schedules now report revenues not only for the prior four tax years but include a fifth column for revenues in the filing year (thus using a five-year computation period to comport with the same period that an advance ruling period evaluates).³⁶

All these changes reduce the burden on filing organizations and accordingly, are welcome. The removal of the current form's requirement that the cash basis of reporting be used in completing the section 170(b)(1)(A)(vi) public support test is an especially helpful change and will substantially reduce the administrative burden upon the entities qualifying under this test.

B. Use of Schedule A to Replace Form 8734

Within 90 days of the close of a section 501(c)(3) organization's advance ruling period, an organization that has received an advance determination that it is likely to meet one of the public support tests is required to file Form 8734 to show that it met one of the possible public support tests. Because new organizations often do not have a permanent mailing address, the Form 8734 is often sent to the wrong address, and many organizations that should complete the form fail to do so on a timely basis. The Service in practice will classify organizations as public charities if they would have so qualified by timely filing Form 8734.³⁷ In addition, the separate mailing and processing of the Form 8734 undoubtedly imposes administrative burdens on the Service.

We support use of the Schedule A to replace Form 8734 for organizations that have completed all five years in their advance ruling period. The separate mailing and filing of Form 8734 is burdensome on both the Service and exempt organizations. All the information that was required on Form 8734 is included in the new Schedule A, and we therefore recommend that the Service eliminate the use of Form 8734 as soon as the new Form 990 is implemented. We

³⁵ The Service has in the past required organizations attempting to meet the section 170(b)(1)(A)(vi) support test to do so based on the cash method of accounting, notwithstanding that the Regulations do not require it. *See* GCM 39109 (Jan. 20, 1982); GCM 39287 (Sept. 20, 1984). The Regulations under section 509(a)(2) specifically require use of the cash method, although the two cited GCMs indicate that the reason for such a requirement is not clear. Reg. § 1.509(a)-3(k).

³⁶ Regulation sections 1.170A-9(e)(4) and 1.509(a)-3(c)(1) provide for a four-year determination of publicly supported status under the section 170(b)(1)(A)(vi) and section 509(a)(2) public support tests, respectively. However, for a newly created organization that has received an advance ruling that it is likely to be publicly supported, public support is measured over a five-year period. Form 1023, Part X, question 6a, and related Instruction. This five-year period has been in place since Congress directed the Treasury to provide a five-year advance ruling period for new organizations. H.R. Rept. No. 861, 98th Cong., 2d Sess. 1090 (1984). The Regulations, however, still provide for a maximum period of five or six years, depending upon the number of months in the first taxable year of the organization. *See* Reg. §§ 1.170A-9(e)(5), 1.509(a)-3(d).

³⁷ *See* Instructions to Form 8734, page 1.

further recommend that organizations that qualify under either the section 170(b)(1)(A)(vi) or section 509(a)(2) public support tests and can signify such result by checking boxes 18 or 19 on Part II or box 18 of Part III then be listed upon the Exempt Organizations Master File as having successfully completed their advance ruling period.

At present, the Regulations³⁸ provide that organizations filing evidence that they have met the relevant public support test within 90 days of the end of their advance ruling period may continue to rely on their advance ruling that they qualify for public charity status until the Service determines otherwise. A conforming amendment to these Regulations would be appropriate to lengthen the 90-day period to coincide with the time for filing Form 990, as extended.

C. Comments on Draft Instructions

1. Part I. Reason for public charity status

The term “public charity” is not included in the Glossary. While we understand that this term is synonymous with being classified as “other than a private foundation,” the Instructions should state this fact.

2. Part I, Lines 1 through 11. Reason for public charity status

The Instructions state that an organization should “[c]heck one of the boxes on these lines to indicate the reason the organization is not a private foundation. The organization’s exemption letter states this reason.” In our experience, exempt organizations often were confused by this question on the prior Schedule A, interpreting the question to call for some choice on the part of the organization, rather than an indication of its existing classification determined by the Service. We recommend that the Instructions be clarified to indicate that no “choice” is generally involved, as follows: “Check one of the boxes on these lines to indicate the reason, as indicated in the organization’s IRS exemption letter, that the organization is not a private foundation.”

It is unclear, however, whether there are two instances in which a “choice” is permitted. The Instruction for Part II’s Line 20 directs organizations which have failed to qualify under the section 170(b)(1)(A)(vi) public support test for two sequential years to “complete the Support Schedule in Part III to determine if the organization qualifies as a publicly supported organization under section 509(a)(2).” The Part III Line 20 Instructions direct organizations that do not qualify under the section 509(a)(2) public support test to try completing Part II to see if they qualify under the section 170(b)(1)(A)(vi) public support test.

As a practical matter, it is of little consequence which public support test an organization meets. Accordingly, it would be appropriate to add to the Instruction recommended in the preceding paragraph a sentence indicating that organizations should check box 7 or 9 depending upon whether the organization checked Part II, boxes 18 or 19, or Part III, boxes 18 or 19.

³⁸ Reg. §§ 1.170A-9(e)(5)(iii), 1.509(a)-3(e)(2).

3. *Part I, Lines 7 and 8; Line 9*

An organization that is still in its five-year advance ruling period will not have an exemption letter stating a “reason” by which the organization is not a private foundation. Exemption letters containing an advance determination of public support typically indicate that it can be expected that the organization will qualify under section 170(b)(1)(A)(vi) and/or 509(a)(2).

The Instructions do not give clear guidance as to which box organizations are to check during the course of their five-year advance ruling period. Specific guidance should be added for these lines indicating that organizations holding an advance ruling that they are likely to be publicly supported should check the box corresponding to the support test they are most likely to meet.

4. *Part I, Line 11h*

In general, the table for this question provides an extremely limited amount of space, particularly for Column i, which calls for the name of the supported organization.

There is an error in the cross reference for Column iv. The supported organization(s) shown in the supporting organization’s governing instrument should be the organization(s) shown in Column i, not “(a).”

D. Part II, Support Schedule for Organizations Described in Section 170(b)(1)(A)(iv) and Section 170(b)(1)(A)(vi)

1. *Change to public support measurement period*

The new Schedule A provides a five-year measurement period for public support for both newly created organizations and existing organizations, rather than the prior Form’s five-year period for new organizations and four-year period for existing organizations. Although this may to some extent increase the recordkeeping burden on existing organizations, we believe this change is a desirable simplification. As part of the implementation of this change, it would be appropriate to modify the Regulations³⁹ to conform to the new five-year period for both existing and newly created organizations.

2. *Opening Instructions regarding section 507(b)(1)(B) terminations*

The “Caution” that starts the Instruction notes that Part II must be completed by organizations terminating their private foundation status under section 507(b)(1)(B). However, the Instructions do not indicate when such foundations are to use Schedule A. The current administrative practice of the Service for such terminating organizations has been that they continue to file a Form 990-PF for the first four years of the 60-month termination period, and file Form 990 in the fifth and final year of the termination period. Because private foundations terminating their status cannot rely on an advance ruling that the foundation is likely to qualify as

³⁹ Reg. § 1.170A-9(e)(4).

a public charity,⁴⁰ and therefore ordinarily will comply with the minimum distribution requirements under section 4942 during the 60-month termination period, the Form 990-PF is the most appropriate form for such private foundations during the first four years of the 60-month termination period. However, it is appropriate for such organizations to use Form 990 for the fifth and final year of the termination period. The Schedule A Instructions should state that Form 990 and Schedule A are mandated for the fifth (and presumably final) year of the 60-month termination, but not for prior years in the termination period.

In addition, as a result of the incorporation of Form 8734 in the new Schedule A, the 60-month termination process also could be simplified. The Regulations currently require that successful completion of the 60-month termination period be established by the filing of information evidencing that the organization qualifies as a public charity under sections 509(a)(1), (2), or (3) within 90 days of the close of the 60-month period.⁴¹ We suggest that the Service consider using the new Schedule A to establish compliance with the 60-month termination requirements, and modify the Regulations to permit satisfaction of the requirement by a timely filed Form 990 and Schedule A for the fifth year of the 60-month termination period.

3. *Other opening Instruction Comments*

The text describing the “Public Support Test” explains that the relevant tests will look to whether specific percentages of total support come “from governmental agencies, contributions from the general public, and contributions or grants from other public charities.” As noted earlier, the Glossary does not define the term “public charity.”

In addition, use of “public charities” in this context is inconsistent with the specific Instructions for Part II, Line 5, which recognize that only contributions from “publicly supported organizations” (organizations that are either classified by the Service as publicly supported organizations described in section 170(b)(1)(A)(vi), or that are otherwise classified but nonetheless described in section 170(b)(1)(A)(vi)⁴²) are excluded from the two percent public support calculation. It would be a desirable simplification of the “public support” calculations to permit all contributions from organizations described in sections 170(b)(1)(A)(i) through (vi) to count in full as public support, but the Regulations would have to be amended to permit this approach.⁴³

The last sentence of the paragraph describing the “Public Support Test” also is unduly complicated and potentially misleading. An organization still may qualify as publicly supported under section 170(b)(1)(A)(vi) even if it has substantial gross receipts from performing its exempt function so long as it meets the one-third public support test with respect to its other support. The Instructions would be clearer if they simply stated that, “for purposes of computing

⁴⁰ Reg. § 1.507-2(e)(4).

⁴¹ Reg. § 1.507-2(b)(4).

⁴² See, e.g., Rev. Rul. 1978-95, 1978-1 C.B. 71; Rev. Rul. 1976-416, 1976-2 C.B. 57.

⁴³ See Reg. § 1.170A-9(e)(6)(v).

the public support test in Part II, an organization’s gross receipts from performing its tax-exempt function (*i.e.*, fees from program services or admissions to educational or cultural programs conducted as part of the organization’s mission) are not included.”

Given that Part II now does not mandate use of the “cash method of accounting,” the Instructions should explain that the same method of accounting used to complete the Form 990 is to be applied to complete Part II. We also recommend that the Instructions note that the requirement of the use of the cash method of accounting imposed for prior years is no longer applicable.

4. *Line 1. Gifts, grants and contributions received*

The draft Instructions to this Part address only two items, “Support from a Governmental Unit” and “Unusual Grants.” Government grants are to be reported on Line 1, but unusual grants are not. However, the Instructions do not indicate what other items are to be reported on this line. We recommend that this Instruction start out with a simple explanation that Line 1 includes all direct and indirect contributions to the organization that are reportable on Line 1 of the Form 990, including individual and foundation contributions and contributions from other exempt organizations, with the exception of “unusual grants.”

The provisions of the Instructions addressing “Support from a Governmental Unit” also could be more clear. The draft Instruction abbreviates language from the Regulations⁴⁴ to explain that “Support from a Governmental Unit” includes “amounts received in connection with a contract . . . for the performance of services . . . unless they are amounts received from exercising or performing the organization’s tax-exempt purpose or function.” The Regulations themselves make distinctions that are difficult to apply even for experienced practitioners. We suggest that the Instructions provide more direct guidance, such as the following:

Include on this line government grants that do not require any specific services by the organization or that only require the provision of services that are directly available to the general public, such as a library or health care facility. Do not include government grants that require the performance of a specific service for the benefit of the agency issuing the grant, such as a research study primarily used by the granting agency to evaluate the effectiveness of programs conducted by the agency.

5. *Lines 2 and 3. Tax revenues . . . and value of services . . . , respectively*

Instructions are not provided for these lines. In our collective experience, we find that these items often are overlooked by exempt organizations, and guidance relating to these lines would be helpful. It is particularly important to provide an explanation as to the inclusion of these items in the section 170(b)(1)(A)(vi) public support test because these amounts may not otherwise be reported on the Core Form itself. For example, the value of rent not charged for office space provided by a government agency to an exempt organization is not required to be

⁴⁴ See Reg. § 1.170A-9(e)(7)(i), (8).

reported as revenue received by the organization in the revenue presentation on Part IV of the new Core Form.

6. *Line 5. Amounts included . . . [from those] whose total payments . . . exceeded 2%*

The Instruction does not explicitly identify the “publicly supported organizations” whose contributions to the organization are not subject to the two percent limitation imposed by the Regulations.⁴⁵ The Regulations refer specifically to contributions received from organizations described in section 170(b)(1)(A)(vi). As noted above, it would be a desirable simplification to treat all contributions from organizations described in sections 170(b)(1)(A)(i) through (vi) as public support and to amend the Regulations to so provide.

In addition, if the support test now is going to be measured over a five-year period, the reference in the Line 5 Instructions to the required list the organization must retain detailing contributions that exceed two percent of public support should refer to contributions over the last five years, rather than four years.

7. *Line 8. “Passive” income from interest, dividends*

Sometimes exempt organizations receive income from interest or dividends from investments that are made to carry out the organization’s exempt purpose. For example, an organization that makes low-cost student loans may receive interest income on the loans. We suggest that the Instructions to Line 8 (and Line 13) clarify whether such income is to be reported as “passive” income on this line, or instead as gross receipts from performing the organization’s exempt function.

8. *Line 10. Gross receipts from activities that are not an unrelated trade or business under section 513*

The Instructions for Line 10 indicate that total support for Part II includes receipts that are not treated as contributions from fundraising events, bingo revenues, and various other receipts that are not treated as unrelated business income. In so doing, Line 10 and the Instruction change the longstanding treatment of revenues received in the course of fundraising and activities that are statutorily excluded from characterization as an unrelated trade or business under section 513.⁴⁶ We believe that this change is inconsistent with the applicable Regulations.

Regulations section 1.170A-9(e)(7) defines “support” for purposes of section 170(b)(1)(A)(vi) as follows:

(7) Definition of support; special rules and meaning of terms—

⁴⁵ Reg. § 1.170A-9(e)(6)(i).

⁴⁶ Section 513 excludes from the definition of an “unrelated trade or business” a number of activities, including activities carried on by volunteers; activities of a section 501(c)(3) organization for the convenience of its members, students, and patients; resale of donated merchandise; various convention or trade show related activities; certain gambling activities; and the distribution of low-cost articles in connection with fundraising activities.

(i) Definition of support. For purposes of this paragraph, the term support shall be as defined in section 509(d) (without regard to section 509(d)(2)).

Section 509(d)(2) includes “gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in *any activity which is not an unrelated trade or business (within the meaning of section 513).*” (Emphasis added.) Under the Regulations, receipts from the activities excluded from unrelated trade or business income treatment by section 513 (including, for example, thrift shop receipts, convention or trade show receipts, and nondeductible amounts paid by donors for the cost of fundraising events) are thus outside of “support” for section 170(b)(1)(A)(vi) purposes.

9. *Line 11. Other income*

The new Schedule A requires inclusion of a schedule of “other income” as provided in the Instructions. However, the Instructions give no guidance as to what “other income” might include. In the current Form 990, the similar line has been a source of confusion for preparers.

We suggest that the Instructions for Schedule A, Line 11, indicate that Line 11 should not include capital gain or loss or any amounts reportable on Line 13. In addition, an example of “other income” that does not fit anywhere else on Schedule A would be helpful.

10. *Line 13. Gross receipts from . . . any activity that is related to the organization’s tax-exempt purpose*

No Instruction is provided for Line 13. As noted above, the clarity of the Instructions for Line 1 would be enhanced by an example of the sort of government grant that would be reported on Line 13. In addition, given the importance of the exclusion of exempt function gross receipts from the section 170(b)(1)(A)(vi) public support calculation, and the fact that many exempt organizations that use that test nonetheless have some gross receipts from program services or other activities related to the performance of their exempt function, one or more examples would be helpful.

11. *Lines 16 and 17. Date of exemption and first five years*

Line 16 asks for the effective date of the filing organization’s exemption letter, and Line 17 indicates that the organization need not answer questions 18 or 19 (relating to whether the organization meets the one-third or ten percent public support tests) if the return is for one of the first five years after the effective date of the organization’s exemption letter. No Instructions are provided for either Line.

Under current procedure, some organizations request a “definitive ruling” that they meet the public support test when they file their original exemption application (Form 1023). Under the Form 1023 instructions, an organization that has completed a taxable year consisting of at least eight full months can obtain a definitive ruling that it meets the public support test under either section 170(b)(1)(A)(vi) or section 509(a)(2). If this Line is to apply only to organizations that are in the process of completing a five-year advance ruling period, Line 17 or the Instructions should so state.

In addition, some organizations may have an effective date of exemption that differs from the five-year advance ruling period. For example, it is not uncommon for organizations to originally receive recognition of exemption as part of a group ruling, and later to obtain their own exemption letter with an advance ruling on the organization's public charity status. In this case, the Service presumably would want the organization to check box 17, but the Form does not appear to call for an affirmative response in this situation. Instructions should be provided to deal with this situation.

12. *Line 18 (33-1/3% test)*

The Line 18 Instructions state that an organization that has met the one-third public support test based on the current year's data shown on Line 14 or has done so on the prior year's Schedule A Line 14 (to be shown on Line 15) means that "the organization qualifies as a 509(a)(1) publicly supported organization for the current year and the subsequent year." This appears to be consistent with the Regulations, which provide that an organization meeting the public support test for a four-year period qualifies as a publicly supported organization for the next two succeeding taxable years.⁴⁷ However, because the Regulations speak in terms of a four-year measuring period, and do not generally use a five-year period (except in the case of a "material" change in the sources of the organization's support⁴⁸), a modification of the Regulations to clearly match the procedure specified in the new Form 990 would be helpful.

13. *Line 19. Ten percent public support/facts and circumstances test*

Line 19 provides that an organization will meet the section 170(b)(1)(A)(vi) public support test if the organization has more than ten percent public support for *both* the five-year period including the current year and the five-year period ending immediately before the current year. Under the Regulations, meeting the ten percent public support test for *one* four-year period qualifies the organization as publicly supported for the following two years.⁴⁹ The Service may wish to conform Line 19 to the Regulations (albeit with the new five-year period).

14. *Line 20. Private foundation*

The addition of new Line 20 to Schedule A is a welcome change because it alerts filing organizations to the possibility that, even though they may have previously met the section 170(b)(1)(A)(vi) support test, failure to meet the test does not mean that they may not still avoid classification as a private foundation by meeting the alternative section 509(a)(2) public support test. However, as noted above, clarification should be provided in the Instructions or Schedule A to guide such organizations as to the appropriate box to check for their public charity classification.

⁴⁷ Reg. § 1.170A-9(e)(4).

⁴⁸ An organization that has substantial and material changes in its sources of support that do not result from unusual grants (which may be excluded from the support calculation altogether) is permitted to calculate its public support percentage based on the year of the substantial and material change in support and the four preceding taxable years. Reg. § 1.170A-9(e)(4)(v).

⁴⁹ Reg. § 1.170A-9(e)(4)(ii).

E. Part III, Support Schedule for Organizations Described in Section 509(a)(2)

1. *Change to public support measurement period*

As noted above with respect to Part II, the new Schedule A provides a five-year measurement period for public support for both newly created organizations and existing organizations, rather than the prior form's five-year period for new organizations and four-year period for existing organizations. Although this may to some extent increase the recordkeeping burden on existing organizations, we believe this change is a desirable simplification. As part of the implementation of this change, it would be appropriate to modify the Regulations⁵⁰ to conform to the new five-year period for both existing and newly created organizations.

2. *Recommendations for opening Instructions*

The "Caution" at the beginning of the Instructions to Part III states that Part III should be completed *only* by organizations checking the box on Line 9 of Part I indicating that the organization has received a determination from the Service that it is described in section 509(a)(2). However, the Instructions to Part II, Line 20, direct organizations that were classified as section 170(b)(1)(A)(vi) organizations but that do not meet the section 170(b)(1)(A)(vi) public support test to also complete Part III to see if the organization qualifies as publicly supported under section 509(a)(2). The Service may wish to consider clarifying the Instructions to address the possibility that an organization that does not meet the section 509(a)(2) public support test nonetheless may meet the section 170(b)(1)(A)(vi) public support test.

In addition, as discussed in the Comments with respect to the similar provision in the Instructions for Schedule A, Part II, clarification would be beneficial as to the circumstances in which Part III must be completed by private foundations completing a 60-month termination period.

3. *Line 1. Gifts, grants, contributions and membership fees received*

As with Part II, Line 1, we believe the Instructions would be improved by beginning with a simple direct statement as to what is to be included on Line 1. References to the appropriate line of the Core Form for the information would be helpful.

Because "membership fees" are included in the description of Line 1 on Part III of the Schedule A, we also suggest that a sentence be included in the Instructions to explain that "membership fees" includable on this line are those received as payments from "members" that are equivalent to charitable contributions rather than payments for goods or services that are provided to "dues paying" members.

⁵⁰ Reg. § 1.509(a)-3(c).

4. *Line 2. Gross receipts from . . . an activity that is related to the organization's tax-exempt purposes*

As noted in the Comments to Schedule A, Part II, Line 8, it is unclear whether exempt function gross receipts include program-related investment income. The Service may wish to clarify this point with an Instruction for Line 2 as well.

5. *Lines 4 and 5. Tax revenues . . . and value of services . . . , respectively*

Instructions are not provided for these lines. As suggested in the Comments with respect to Schedule A, Part II, Lines 2 and 3, we recommend that the Instructions explain what should be reported on these lines, as they are often overlooked because they do not appear in the Core Form.

6. *Line 10a. Gross income from interest, dividends*

As noted in our comment above for Part III, Line 2, the Instructions could benefit from an explanation of where to report program-related investment income.

7. *Line 10b. Unrelated business taxable income*

No Instruction is provided for this Line. A directive to obtain the applicable number from Form 990-T, and then subtract taxes for the year as calculated on that form, would be helpful.

8. *Line 11. Net income from unrelated business activities not included in line 10b, whether or not the business is regularly carried on*

No Instruction is provided for this Line. Line 19 of part IV-A of the Schedule A currently in use is similar to this line, and it is not well understood by preparers. We suggest that there be an Instruction to include net income from activities that are not reported as unrelated business income only because the activity that gave rise to the income was not regularly carried on.

9. *Line 12. Other income*

As noted in the Comments to Schedule A, Part II, Line 11, examples as to the sorts of income that should be reported on this line would be helpful.

10. *Lines 16-17. Effective date of exemption and first five years*

No Instructions are provided for these Lines. As noted in the Comments to Schedule A, Part II, Lines 16-17, because there are various situations where the first five years of the organization's exemption will not correspond to the commencement of the organization's advance ruling period, guidance would be helpful to explain the proper completion of these questions in such circumstances.

11. *Line 20. Private foundation*

The addition of new Line 20 to Schedule A is a welcome change because it alerts filing organizations to the possibility that, even though they may have previously met the section 509(a)(2) public support test, failure to meet the test does not mean that they may not still avoid classification as a private foundation by meeting the alternative section 170(b)(1)(A)(vi) public support test. However, as noted above, clarification in the Instructions or Schedule A to guide such organizations as to the appropriate box to check for their public charity classification would be helpful.

III. COMMENTS ON SCHEDULE B

Schedule B is substantially unchanged from the current form.

IV. COMMENTS ON SCHEDULE C

A. Introduction

With the new Schedule C, the Service is attempting to consolidate the reporting of all political and lobbying activities by all categories of exempt organizations on a single form. This is a difficult task. The requirements imposed under the Code differ considerably for the various types of organizations that file Form 990. Some are very specific, with specific tax consequences, while others are quite general and far from self-evident. In some cases, the collection of information would serve no purpose; in others, organizations choose to report even though they have no activity.

B. Part I-A, Political Campaign Activity

1. *General Comments on political campaign activity description*

In prior years, exempt organizations were asked simply to “enter direct and indirect political expenditures.”⁵¹ The Instructions defined political expenditures using language derived from section 527(e)(2). Ironically, section 527 organizations were cautioned that they were not required to answer this question. Some information was given to assist section 501(c) organizations in understanding the implications of the question, but it was far from complete.

The draft Schedule C, Part 1-A, asks all filers to “provide a description of the filing organization’s direct and indirect political campaign activities.” The Instructions, under Definition of Terms, define “Political Campaign Activities” in exactly the same words as the Glossary. The line-by-line Instruction further states: “For organizations other than section 501(c)(3) organizations, political campaign activities also include activities that support or oppose candidates for appointive federal, state, or local public office or office in a political party.” Unlike the previous form, Schedule C and the Schedule C Instructions say nothing about

⁵¹2006 Form 990, part VI, line 81a.

the relationship a section 501(c) organization may have with a separate segregated fund (“SSF”) formed under section 527.

The new Schedule C, like the question on the form for prior years, attempts to elicit an answer to a single question that has multiple implications for multiple filers. It would be helpful if the purpose or purposes of Part I-A could be more precisely understood and expressed, so that the Service can receive useful information and exempt organizations can appreciate the implications of their answers.

In our experience, political campaign activity is the exception, rather than the norm, for section 501(c)(3) organizations that will be filing Form 990 and the new Schedule C. Thus, we believe that it cannot be assumed that all exempt organization filers will have political campaign activities. For section 501(c)(3) organizations, an inadvertent answer to this question or even a failure to answer “None” could be taken as an admission of activity justifying revocation of exemption.

We recommend that the Service consider rewording Part I-A, Line 1, to read: “Provide a description of the filing organization’s direct and indirect political campaign activities, if any.” Adding the phrase “if any” to the existing text of Line 1 should help prevent inadvertent inappropriate responses which will only cause unnecessary expenditures of time and resources by the Service and the filing organization.

2. *“Political Campaign Activities” definition (Schedule C Instructions, Page 3)*

The standard for determining whether political campaign activities occurred should be the same for all section 501(c) organizations, and it should be based on the section 501(c)(3) campaign intervention prohibition. For section 501(c) organizations that are not described in section 501(c)(3), political campaign activities reported here must be “less-than-primary,” so that the organization can demonstrate continued qualification for exemption by virtue of fulfilling primary social welfare, labor, agricultural, business, professional, or other purposes required by the Code.

We believe that, contrary to what is stated in the draft Instruction for Part I-A, Line 1, no section 501(c) organization should be required to include any activities that support or oppose candidates for appointive offices in this description. Attempting to influence confirmation votes by legislative bodies considering judicial and other executive branch appointments has been widely understood to be an acceptable form of lobbying activity for section 501(c) organizations. Influencing appointments can further the primary charitable, social welfare, labor, or business purpose of an exempt organization, although the activity may be subject to limitation under the lobbying rules for section 501(c)(3) organizations or subject to the section 6033(e) proxy tax or the section 527(f) investment tax.⁵²

The Service has, in internal training materials, made clear that it is not feasible to adopt the “express advocacy” standard applied under the Federal Election Campaign Act.⁵³ The

⁵² See GCM 39694 (Feb. 1, 1988).

⁵³ Judith E. Kindell & John Francis Reilly, *Election Year Issues*, Exempt Organizations Continuing Professional

Service continues to assert that statements “favoring” a candidate, or that are “biased” or “partisan” violate the section 501(c)(3) prohibition even though they may not rise to the level of express advocacy of the election or defeat of the candidate. This is an important interpretation that should be included in the definition of political campaign activities wherever it appears in the new Form 990 or Schedule C.

For the reasons stated above, the Instructions should aim for as much uniformity as possible in the reporting of political campaign activities by all section 501(c) organizations. A small addition to the activities reported by section 501(c)(3) organizations must be made to accommodate the candidate-related section 501(c)(3) entities that have taxable expenditures under section 4955(d)(2), as the current form does.

To take into account the foregoing considerations, we suggest that the Service consider revising the definition of “Political Campaign Activities” in the Definition of Terms in the Schedule C Instructions to read as follows:

All activities that directly or indirectly support or oppose candidates for elective foreign, national, state or local public office, including office in a political organization. It does not matter whether the candidate is elected. A candidate is one who offers himself or is proposed by others for the public office. Political campaign activity does not include any activity to encourage participation in the electoral process, such as voter registration or voter education, provided that the activity does not directly or indirectly support or oppose any candidate. Include all attempts to influence the selection, nomination, or election of any individual to a public office, whether or not such activities constitute express advocacy of the election or defeat of the candidate.

In addition, we suggest that the Service consider revising and expanding the Instruction for Part I-A, Line 1, to read as follows:

Provide a detailed description of the organization’s direct and indirect political campaign activities. The purpose of reporting this information is to determine the organization’s continued qualification for exemption from federal income tax. If additional space is needed, attach a separate sheet.

All section 501(c) organizations should describe such activities using the definition provided in the Definition of Terms above. Section 501(c)(3) organizations used or controlled by a candidate or prospective candidate should also describe certain activities related to such individual as set forth in section 4955(d)(2).

3. *Coordination with section 527*

Unlike the Form 990 in prior years, the new Schedule C and Instructions say nothing about the relationship a section 501(c) organization may have with a SSF formed under section

527. It is extremely important that the Instructions address the issue of SSFs, because many non-charitable section 501(c) organizations maintain such funds. The 2006 Form 990 attempts to do so, but does not address certain important issues. Filers need to be informed that the SSF is subject to its own federal tax reporting, that the activities and finances of the SSF should not be presented here, that “prompt and direct” transfers of certain earmarked funds made under the Regulations should be disregarded,⁵⁴ but that all other payments by the section 501(c) entity to the SSF for political uses should be reported here as the section 501(c) organization’s political campaign activities and expenditures.⁵⁵

Under section 501(c), political campaign activities are defined in relation to “public offices” without specifying the level of government or even the nation involved. In fact, tax-exempt organizations in the United States have sometimes taken an interest in elections in foreign countries, such as Israel, Nicaragua, and South Africa, while observing the same limitations that section 501(c) rules impose on election activity in the United States. However, section 527(e)(2) seems tied closely to the political system existing in the United States, referring to “Federal, State, or local” offices and “Presidential or Vice-Presidential electors.”

Another point of difference between section 501(c) and section 527(e) concerns offices in political parties and other political organizations. The section 501(c)(3) standard has been interpreted to reach party offices such as precinct committeemen where a public vote is taken,⁵⁶ but section 527(e) does not require that the political organization office be a public one.

With respect to the phrase “direct and indirect” political campaign activity, there is potential for ambiguity.⁵⁷ The definition of “indirect” under section 527 is the more detailed and specific one, and the Service therefore may wish to consider applying this definition consistently throughout Schedule C. No detailed elaboration is needed in Part I-A, but a more specific explanation would be appropriate in Part I-C, where indirect expenditures must be adjusted out of political campaign activities in the calculation of exempt function expenditures for non-charitable section 501(c) groups.

For the small segment of section 527 organizations that are required to file Form 990, the Service has reversed its position in prior years and now desires such organizations to describe their activities. This is not unreasonable, but in view of the statutory anomalies in the text of section 527(e), such organizations cannot use the normal section 501(c) definition without making certain expressly-stated modifications. Thus, the Service should consider advising section 527 organizations to describe the “nexus” between certain activities and the organization’s political purposes where the connection may not be apparent. For example, the organization may make grants to other groups, participate in ballot measure campaigns, or

⁵⁴ See Reg. § 1.527-6(e).

⁵⁵ If a section 501(c) organization makes expenditures to influence appointments that should be included in exempt function expenditures reported under section 527(f), such expenditures can be recognized and an adjustment made in Part I-C as discussed below.

⁵⁶ GCM 39811 (Feb. 20, 1990).

⁵⁷ Compare Reg. § 1.501(c)(3)-1(c)(3)(iii) with Reg. §§ 1.527-2(c)(2) and 1.527-6(b)(2).

engage in lobbying, in order to build alliances, attract members, increase favorable voter turnout, or influence the public's impression of the candidates.⁵⁸

To address the above considerations, we suggest that the Service consider revising and expanding the Instruction for Part I-A, Line 1, by adding the following language (after the language suggested in the preceding discussion regarding the definition of "Political Campaign Activities"):

Section 501(c) organizations other than those exempt under section 501(c)(3) may sponsor separate segregated funds for political activities under section 527(f)(3). If so, the separate segregated fund is subject to its own tax return filing requirements. The separate segregated fund's activities, receipts, expenditures, and balance sheet items should not be included on its sponsoring section 501(c) organization's Form 990 or Schedule C. If the sponsoring section 501(c) organization collects political contributions or member dues earmarked for the segregated fund, and then promptly and directly transfers them to the segregated fund as prescribed in Regulations section 1.527-6(e), such amounts are disregarded by the section 501(c) sponsor. However, any other payments made by the section 501(c) sponsor to the segregated fund for political uses are regarded as the section 501(c) organization's political campaign activities and should be reported here.

For section 527 organizations, the description of direct and indirect political campaign activities should be modified as follows: (1) do not include activities involving foreign candidates; (2) include activities related to the selection of individuals for offices in political organizations, whether public or not; (3) include activities to influence appointments to public offices or offices in political organizations; (4) include, if applicable, the office or newsletter activities of elected officials; and (5) if not apparent from the nature of an activity, describe the nexus or connection between the activity and the political candidate selection process.

4. *Volunteer Hours*

The last unnumbered Line of Schedule C, Part I-A asks all filing organizations to report the number of hours of volunteer labor used in the conduct of the organization's political campaign activities. The Instructions provide no additional guidance about what constitutes "volunteer labor." The "Volunteer hours" Line is just below the Line for reporting total "Political expenditures." This question appears designed to give the Service another way to measure the existence and extent of an organization's political activities. Even without any political expenditures, a charity's political campaign activities using volunteers could violate section 501(c)(3). Likewise, the consideration of a non-charitable section 501(c) group's volunteer hours could result in a different determination of the organization's primary activity than an assessment made only on an expenditure basis.

⁵⁸ See PLR 199925051 (Mar. 29, 1999).

One of the Service's stated core principles guiding the revision to Form 990 is minimizing the burden on filing organizations. One reason for this principle presumably is that it is not in the public interest to dampen volunteerism in the United States, or to impose reporting burdens on exempt organizations that do not provide meaningful information.

The Service has never before used the annual information return filed by exempt organizations to require reporting of volunteer hours devoted to political campaign activity. As proposed, the volunteer hours question on Schedule C is likely to impose significant burdens on filing organizations without providing the Service with reliable information to evaluate compliance with the organization's tax-exempt status. Expenditures are still the best indicator of an organization's activities.⁵⁹ Based upon the analysis that follows, we therefore recommend that the Service eliminate the requirement to report volunteer hours from Schedule C.

The use of volunteers is common, varied and usually difficult to track. Most organizations that use volunteers do not have a volunteer hour tracking system in place. The new question is likely to be interpreted as imposing mandatory collection of volunteer time information on all politically-active exempt organizations, so that the filer does not make a material omission on its Form 990.

An organization may use volunteers in its offices, or it may rely on a much more diffuse and remote network of supporters to help accomplish its goals. Participants at a rally may later advance the work of the organization on their own; e-mail subscribers may take action in response to an alert from the organization; or an organization may recruit new activists at a meeting. An organization cannot reliably identify which of these participants count as volunteers or determine how many hours of volunteer labor each provided to the organization. How far must an organization go to collect the information from volunteers who have not reported?

Moreover, the volunteer information requested does not inform the Service about whether the political campaign activities of a section 501(c) organization constitute its "primary" activity. To make that determination, the Service must also know either the total volunteer hours or the proportion of volunteer hours attributable to political campaign activity. In some cases, 50 hours of volunteer time might suggest that political activity is primary; in others, 5000 hours of campaign work could be a small fraction of the organization's total program activity. To provide a meaningful picture, an organization would need to collect volunteer hours on all of its activities in order to put political campaign hours in proper perspective.

If an exempt organization is using volunteers to conduct substantial political campaign activity, there will be plenty of evidence of that fact on the organization's website, in the public press, and in the internal and external communications made by the organization. The group's adversaries will be aware of it. If the Service selects the organization for examination based on such evidence of campaign activity, it can readily determine the breadth and depth of the group's volunteer program from membership lists, electronic records, expenditures made, and other visible evidence. A blanket requirement to collect and report volunteer time, imposed on all filing organizations, will impose substantial additional burdens on exempt organizations without

⁵⁹ See, e.g., I.R.C. § 4911(h)(1).

materially improving compliance or transparency, since the information to be collected and reported will in most cases be incapable of being determined with reasonable precision. We therefore recommend that the Service reconsider including this question on Schedule C.

C. Part I-C, Organizations Not Described in Section 501(c)(3)

1. “Own internal funds”

Part I-C is to be completed by organizations that are not described in section 501(c)(3). Questions on this part of Schedule C appear to be directed at assuring compliance with the requirements of section 527 of the Code.

Part 1-C, Line 2 asks filers to “enter the amount of the filing organization’s own internal funds contributed to other organizations....” In the Instructions for Lines 1 and 2 of Part I-C, the phrase “the amount of its own funds” is used to indicate expenditures or transfers the organization is to report.

In the 2006 Form, the term “its own funds” appears in the Instructions for section 501(c) organizations reporting political expenditures on line 81a. The same phrase is used in the Instructions for new Schedule C, Part II-B, referring to grants (Line 1f) and public forums (Line 1h) paid out of the organization’s “own internal funds.”

There is no provision in the Code or Regulations defining the term “own internal funds” or “its own funds” in relation to political or lobbying activities. These phrases are probably the result of Regulations promulgated under section 527(f)(3) referring to political contributions or dues collected (typically from members) by a section 501(c) organization and then promptly and directly transferred to an SSF.⁶⁰ Earmarked check-off union dues are a familiar example. Prompt and direct transfers of such monies are not exempt function expenditures for the section 501(c) parent under section 527(f). All other payments made by a section 501(c) organization to its SSF for political use are treated as exempt function expenditures and are thus potentially taxable. These other payments became informally known as made from “treasury funds” or “internal funds.”

This informal nomenclature is potentially confusing and misleading. Filing organizations, without a definition of “internal” or “own” funds, may mistakenly believe that any assets supplied by others, including grants, loans, donations, rents, and sales—even investment income—are not internal funds. The result could be inaccurate reporting and underreporting of taxable amounts. Schedule C and the related Instructions will be most useful in promoting compliance and transparency if they clearly identify non-taxable prompt and direct transfers to an SSF, and request information regarding all other expenditures without confusing references regarding the source of funds. Accordingly, we recommend that the Service cease using the phrases “own internal funds” and “its own funds” in the Lines on Schedule C and in the related Instructions.

⁶⁰ See Reg. § 1.527-6(e).

2. *Calculation of section 527(f) exempt function expenditures*

For section 501(c) organizations making political expenditures (other than section 501(c)(3) organizations that are not supposed to make any such expenditures), a calculation is needed to determine “exempt function expenditures” under section 527(f). The section 501(c) organization is liable for tax on the lesser of those expenditures or its net investment income for the year, which is reported and paid with form 1120-POL. Lines 1, 2, and 3 of Part I-C attempt to lead the filing organization through a calculation of exempt function expenditures. However, the draft Schedule C and Instructions could be clarified in several respects.

As drafted, Lines 1, 2, and 3 use potentially confusing terminology, such as “directly expended,” “own internal funds,” and “direct and indirect.” We believe that Line 3 is inaccurate in advising filing organizations that “indirect” expenses are part of exempt function expenditures; under the Regulations, indirect expenses are not considered exempt function expenses for a section 501(c) organization and are not subject to tax.⁶¹ In addition, Part I-C of Schedule C does not appear to take into account the rule excluding from the computation of taxable exempt function expenditures those expenses that section 501(c) organizations may make under the Federal Election Campaign Act or comparable State election laws, such as to communicate political endorsements to members.⁶²

It would be far more helpful to filing organizations to use the total expenditures for political campaign activities reported on Schedule C, Part I-A as the starting point for the political expenditure calculation required by Part I-C. Expenses to influence judicial and other appointments could be added on Line 1 of Part I-C, and Line 2 could serve to identify those political campaign expenditures that a section 501(c) organization can subtract pursuant to section 527 and the Regulations thereunder.

Accordingly, we recommend that the Service revise Lines 1, 2, and 3 of Schedule C, Part I-C, to read as follows:

- a. Enter the amount, if any, expended by the filing organization to influence appointments of candidates for public offices or offices in political organizations.
- b. Enter the sum of the following expenditures, if any: (a) indirect expenses (including overhead, record keeping, fundraising, etc.) of establishing and maintaining a separate segregated fund under section 527(f)(3); (b) expenditures allowed by the Federal Election Campaign Act (FECA) or similar state statute, such as the costs of internal member communications; and (c) expenditures involving candidates for foreign public offices.

⁶¹ Reg. § 1.527-6(b)(1) to (2).

⁶² Reg. § 1.527-6(b)(3).

- c. Starting with the total of political expenditures reported in Part I-A, add the amount on line 1 and subtract the amount on line 2 to calculate the amount of exempt function expenditures. Enter here and on Form 1120-POL, line 17b.

We also suggest that the Service consider deleting the Instructions for Part I-C, Lines 1, 2, and 3, and replacing the Line 1 Instruction with the following: “Do not include expenses attributable to appearing before a legislative body for the purpose of influencing the confirmation or appointment of an individual to a public office in response to a written request from the legislative body.”

If Lines 1, 2, and 3 of Part 1-C of Schedule C can be made self-explanatory, the Instructions are unnecessary, except for a Line 1 comment on expenses related to appointments. The Regulations exclude expenditures for appearances before a legislative body at the written invitation of the legislative body.⁶³

3. *Reporting payments to section 527 organizations*

Line 5, as drafted, asks non-charitable section 501(c) organizations to:

State the names, addresses and Employer Identification Number (EIN) of all section 527 political organizations to which payments were made. Enter the amount paid and indicate if the amount was paid from the filing organization’s own internal funds or were political contributions received and promptly and directly delivered to a separate political organization, such as a separate segregated fund or a political action committee (PAC).

We do not believe that any Service tax form has ever required section 501(c) organizations to report such payments to section 527 organizations. As drafted, there is no threshold level for the reporting of payments. By contrast, the Form 8872 filed by section 527 organizations only reports contributions received of \$200 or more and expenditures of \$500 or more.

The requirement to list all payments to section 527 organizations, regardless of size, can be extremely burdensome. Furthermore, it is not clear whether payments for goods or services are included. As noted earlier, the phrase “own internal funds” could be misleading.

We accordingly suggest that the Service consider the following revision to Line 5 of Part 1-C of Schedule C:

State the names, addresses and Employer Identification Number (EIN) of those section 527 political organizations to which the four largest amounts were paid in gifts, grants, contributions, or dues. Do not report amounts less than \$5000. Enter the amount paid and indicate whether the amount was paid from political contributions or dues received and

⁶³ Reg. § 1.527-6(b)(4).

promptly and directly delivered to a separate political organization, such as a separate segregated fund or a political action committee (PAC).

The proposed revision limits the information reported to large amounts only, and would include only donative payments, not payments made in exchange for goods or services. We believe that this information would be sufficient to apprise the Service of the major financial relationships that a section 501(c) filing organization may have with section 527 organizations, without requiring the listing of every small donation to a candidate's committee.

D. Part II-B, Lobbying Activity

1. Inclusion of all section 501(c) entities

As drafted, the new Schedule C, Part II-B, which requests information regarding lobbying activity, is supposed to be completed by *all* section 501(c) entities except section 501(c)(3) organizations that have made the section 501(h) election. Organizations are asked to state whether they conducted lobbying activities through the use of volunteers, paid staff, media ads, mailings, contact with legislators, rallies, demonstrations, and other means. In the past, the Form collected this information, but only from section 501(c)(3) groups that had not made the section 501(h) election.

The Code contains no limitations on or definitions of lobbying by non-charitable section 501(c) organizations. Such organizations were potentially liable for the proxy tax on lobbying and political activities under section 6033(e) of the Code as enacted. However, the Service has declared that only section 501(c)(4), (c)(5), and (c)(6) organizations are subject to the proxy tax requirements.⁶⁴ The reporting requirements for these organizations are addressed in Schedule C, Part III.

In the absence of meaningful tax consequences, there does not appear to be adequate reason for Schedule C to require organizations not described in section 501(c)(3) to provide a description of their lobbying activities. Accordingly, we recommend that the Service revise Schedule C, Part II-B, and the related Instructions to read: "To be completed by section 501(c)(3) organizations, except those organizations that filed Form 5768 (election under section 501(h))."

2. New questions under the "no substantial part" test

In order to qualify for federal income tax exemption as an organization described in section 501(c)(3) of the Code, an organization must establish that "no substantial part of the overall activities of [the organization consist of] . . . carrying on propaganda, or otherwise attempting, to influence legislation. . . ." Section 501(c)(3) and the Regulations thereunder⁶⁵ provide little guidance regarding how much activity constitutes a "substantial part" of an organization's "overall activities," or what activities must be measured.

⁶⁴ Rev. Proc. 1998-19, 1998-1 CB 547.

⁶⁵ Reg. §§ 1.501(c)(3)-1(b)(3), -1(c)(3)(ii).

Section 501(h) provides an optional, alternative mechanism for determining precisely what counts as influencing legislation. A non-electing organization that engages in “substantial” lobbying activity risks losing its tax exemption and may owe tax under section 4912.

Under the new Schedule C, non-electing section 501(c)(3) organizations report their lobbying activities on Part II-B, which differs significantly from the corresponding part of the current Form (Schedule A, part VI-B). The most important difference is the addition of Line 2a, which asks the filing organization whether its lobbying activities caused the organization “to be not described in section 501(c)(3).” The Instruction for Line 2a tells the filing organization to answer “Yes” if it “ceased to be described as a section 501(c)(3) organization because the amount on line 1j was substantial.” Lines 2b-d concern the payment of the section 4912 tax.

The test for determining whether an organization’s lobbying activities constitute a “substantial part” of its “overall activities” is vague and counterintuitive. The Service has provided very little guidance, and the court decisions in this regard do not present a uniform standard.⁶⁶ At the same time, the consequences for a non-electing organization of engaging in “substantial” lobbying are severe. This combination of extreme uncertainty and grave risk precludes meaningful self-evaluation and places the filing organization in the position of having to guess whether the Service would, under all of the relevant facts and circumstances, consider the organization’s lobbying activities to constitute a “substantial part” of its “overall activities.”

If an organization answered “Yes” to the question in Line 2a, it would be stating a legal conclusion and admission that it violated one of the conditions for maintaining its tax-exempt status, regardless of whether it owed and paid tax under section 4912. Consequently, most organizations will answer “No” if they have a reasonable basis for believing that their lobbying activity was “insubstantial.” However, if the Service later determines that the organization did engage in excessive lobbying and is no longer described in section 501(c)(3), the Service may also assert that the organization made a false statement on its return.⁶⁷

Until the Service issues comprehensive guidance that describes the meaning of “substantial” in this context, we believe that organizations should not be expected to determine on their own whether they have engaged in substantial lobbying activities. A non-electing organization that is uncertain about the extent of its lobbying should not be forced to choose between making a potentially false statement on its return or making an admission that it is not entitled to exemption. We recommend that, as it has in the past, the Service confine the

⁶⁶ See, e.g., *Haswell v. United States*, 500 F.2d 1133, 1142 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975); *Christian Echoes National Ministry, Inc. v. United States*, 470 F.2d 849, 855 (10th Cir. 1972), *cert. denied*, 414 U.S. 864 (1973); *Kuper v. Commissioner*, 332 F.2d 562 (3d Cir.), *cert. denied*, 379 U.S. 920 (1964); *Dulles v. Johnson*, 273 F.2d 362, 367 (2d Cir. 1959), *cert. denied*, 364 U.S. 834 (1960); *League of Women Voters v. United States*, 180 F. Supp. 379, 383 (Ct. Cl.), *cert. denied*, 364 U.S. 822 (1960); *Krohn v. United States*, 246 F.Supp. 341, 347 (D. Colo. 1965); GCM. 34798 (Mar. 2, 1972); see also GCM 36148 (Jan. 28, 1975).

⁶⁷ Section 6694 imposes penalties on preparers (including preparers of exempt organization returns) unless the preparer reasonably concludes that the position on the return is more likely than not the correct position or, alternatively, if the position has a reasonable basis and is disclosed. I.R.C. § 6694(a). The uncertain state of the law regarding the extent of lobbying activity necessary to be “substantial” would make it difficult for a return preparer to sign a return for an organization that engages in lobbying activity but has not made the section 501(h) election.

organization's tax return reporting to "just the facts" about the nature and cost of the activity. Questions as to whether the activity was truly lobbying and, if so, whether it was substantial, can be resolved in the context of returns selected for examination.

V. COMMENTS ON SCHEDULE D

A. Overview

As stated in the Background Paper, the redesign of the Form 990 is governed by three guiding principles: (1) enhancing transparency to provide the Service and the public with a realistic picture of the filing organization and its operations, along with a basis for comparison to other similar organizations; (2) promoting compliance by accurately reflecting the organization's operations so that the Service may efficiently access the risk of non-compliance; and (3) minimizing the burden on the filing organization. In the Core Form and related Schedules, the Service has sought—with considerable success—to achieve a balance among these goals.

Irrespective of potential burdens on the filing organization, however, achieving transparency and compliance often requires a balance between obtaining information that is informative to readers or needed for compliance and, requesting so much data that *meaningful* or *usable* information is not provided. If too much information is required, because of the complexity in compiling and organizing the data, the information provided may either be inaccurate or may not lead to meaningful comparisons.

The requirement to provide repetitive detail does not necessarily add to transparency. If the organization is selected for audit, it is to be expected that detailed books and records will contain all of the financial information the Service may request or desire. The key factor in requesting information should be whether such information is an important element for transparency because it provides readers of Form 990 and regulators with knowledge of the operation of the organization or whether it is unnecessary information that will not add substantive knowledge to achieve an accurate understanding of the operation of the organization.

B. Part I Investments - Other Securities

1. Listing all "other securities"

Part VI, Line 11, of the Core Form 990 requires organizations with investments in "other securities" that are not publicly traded to complete Schedule D, Part I.

The Instructions to Schedule D, Part I, require that the organization list *each* security, partnership or fund that is not publicly traded, which includes stocks in closely held companies where the stock is not available for sale to the general public or is not widely traded. A requirement exists to describe in Column A the investment including the name of the security and the number of shares held, in Column B the book value for each investment, and in Column C whether the investment is listed at cost or end-of-the-year market value.

Compliance with these Instructions will result in a potential list of a significant number of investments made by the organization. The organization may hold, for example, closely held

stocks, alternative investments and hedge funds, which could run into listings of hundreds of items for many large organizations and, in some cases, a significant listing by a small organization.

We recommend that the Service consider modifying Schedule D, Part I, to simply categorize the investments by group, such as all closely held stocks, hedge funds, and alternative investments. Such a disclosure will permit the Service, state regulators, and other users of Form 990 to determine that the organization is making investments in non-publicly traded securities, and will provide information regarding the types of investments. The Service some years ago abandoned the requirement for a balance sheet schedule listing individual publicly traded securities on the basis that too much unnecessary detail was provided which did not assist users of the annual exempt organizations information return in evaluating the organization's investment policy. We recommend a similar approach for investments that are not publicly traded by requiring a listing categorizing the type of investment, rather than listing each individual investment or security.

2. *Holdings of five percent or more*

The Instructions to Part I of Schedule D require that publicly traded securities for which the organization holds five percent or more of the outstanding shares of the same class be reported on Part I of Schedule D. However, on the Balance Sheet in Part VI of the Core Form, publicly traded securities are listed on Line 10, whereas the investments to be disclosed on Part I of Schedule D will, for the most part, be listed on Line 11 of the Balance Sheet.

Accordingly, we suggest that the Instructions for Form 990, Part VI, Line 10, clarify the appropriate line for reporting publicly traded securities to the extent that the organization owns five percent or more of the outstanding shares of the same class. If the Service indeed wishes these securities to be reported on Line 10 of the Balance Sheet, then a cautionary note in the Instructions might be appropriate to indicate that the total on the Core Form, Part VI, Line 11, will not necessarily equal the total reported on Schedule D, Part I.

In addition to requesting information as to the percentage of ownership of five percent or more of the outstanding shares of any publicly traded securities, we recommend that the Service consider requiring a listing of any individual securities which exceed more than five percent of the value of the total investments reported on Line 10 and Line 11 of Part VI of the Core Form. Such a disclosure should be meaningful to the Service, state regulators, and readers of the Form 990, because this information would disclose high concentrations of the organization's investments in the securities of a particular issuer.

C. **Part II, Investments - Land, Buildings And Equipment; Part V, Program Related - Land, Buildings And Equipment**

Part II and Part V of Schedule D call for schedules of land, buildings and equipment held for investment purposes and used in the organization's exempt activities, respectively. The Instructions are not clear as to whether an organization must list ownership of each parcel of land, each building, and each piece of equipment in Parts II and Part V.

We recommend that the Service clarify the Instructions to specify that in each Part, the organization needs to include only the aggregate amount of land on one line, the aggregate amount of buildings on another line, and the aggregate amount of pieces of equipment on another line. An individual listing for specific parcels of land or individual buildings or pieces of equipment would, for a large organization, produce little or no information that is useful to the public or the Service. By listing these three categories, the public will have sufficient information for purposes of transparency and the Service will have sufficient information to monitor the operations of the organization without the burden of voluminous individual listings of specific parcels of land or individual buildings and equipment. If information as to particularly significant holdings is desired, as suggested above with respect to publicly traded securities, a separate listing of land, building, or equipment accounting for more than five percent of the total for any category (land, building, or equipment) could be required.

D. Part VI, Other Assets

Part VI is required to be completed for assets not reportable on Form 990, Part VI, Lines 1 through 16. We believe the heading is incorrect and it should read: “Complete the table for assets not reportable on Lines 1-15.” Line 16 includes the “Other Assets” that are to be reported on Part VI.

E. Part VII, Other Liabilities

1. *In general*

Schedule D, Part VII, requires the completion of the table for each liability not reported on Lines 18 through 25 of Form 990, Part VI, which reflects the total on Line 26. Consideration should be given as to whether there should be a reporting of any liabilities not on the Part VI Balance Sheet.

On Schedule D, Part XI, there is a request to report assets not included on Form 990, Part VI, Balance Sheet. Correspondingly, the Service may wish to consider requiring the reporting of certain obligations not on Form 990, Part VI, such as long term leases, equipment leases and other similar obligations which may not be recorded as a current liability for financial accounting purposes. Such information might add to the level of transparency of the organization as to its future obligations (including, perhaps, contingent liabilities).

2. *FIN 48 disclosure*

Part VII of Schedule D requests inclusion of the text of the footnote to the organization’s financial statements that would report the organization’s liability for uncertain tax provisions under FIN 48.⁶⁸ FIN 48 was issued by the Financial Accounting Standards Board and is an interpretation of FASB Statement 109. It addresses accounting for uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006.

⁶⁸ Accounting for Uncertainty in Income Taxes, FASB Interpretation No. 48, (Fin. Accounting Standards Bd. 2006), available at <http://www.fasb.org/pdf/fin%2048.pdf>.

The evaluation of a tax position under FIN 48 requires a two-step process. The first step is recognition: the enterprise must determine whether it is more likely than not that a tax position will be sustained upon examination. As used in the interpretation, the term "more likely than not" means a likelihood more than 50 percent. The second step is measurement: the enterprise must determine the amount of benefit to be recognized in the financial statements.

The request for the disclosure of any FIN 48 footnote creates a dichotomy among and between reporting organizations on the proposed Form 990. Those organizations with audited financial statements will be subject to disclosure by reason of the application of FIN 48. Those organizations without audited financial statements will not be subject to such disclosure. We question whether this is an appropriate distinction to make with respect to the sought-after transparency under Form 990.

Uncertainty exists among accounting professionals regarding the application of the principles set forth in FIN 48. FIN 48 applies to tax-exempt organizations, but the issues for tax-exempt organizations are more or less limited. First, have there been any activities which would cause the tax-exempt organization to lose its tax exempt status? Second, has the organization properly reported all of its income which could be taxable as unrelated trade or business income? Third, has the organization engaged in any activities which could subject the organization to excise taxes?

FIN 48 is a relatively recent development, and experience thus far has shown that application of FIN 48 to an issue such as tax-exempt status is a challenging undertaking. One can quantify unrelated business income tax exposure in much the same way as taxable organizations dealing with FIN 48 quantify their risks from uncertain tax positions. However, because tax exemption is an "all or nothing" determination, and the standards for determining what activities might warrant revocation of exemption are unclear in many cases,⁶⁹ organizations and their auditors currently are struggling to determine what should be disclosed under FIN 48 with respect to issues that could give rise to questions about an organization's exempt status. We respectfully suggest that it is too early in the development of appropriate reporting standards under FIN 48 to graft the FIN 48 disclosure requirements onto Form 990.

Instead of asking for the FIN 48 footnote, we propose that the Service consider a variation on the approach it has now taken for some years with respect to excess benefit transaction tax liabilities and the approach taken in the Core Form with respect to unrelated business income tax liabilities. Thus, we suggest that the Service consider setting forth in Part VII a simple question as to whether the organization has engaged in activities which "may" jeopardize its tax-exempt status. If the answer is "yes," the organization would provide an appropriate explanation. This question would not require the organization to reach a definitive legal conclusion as to whether any specific activity indeed jeopardizes the organization's exemption. However, the goal of increased compliance and efficiency in enforcement efforts would be furthered by providing a starting point for possible further examination activity.

⁶⁹ See, e.g., *Orange County Agricultural Society v. Commissioner*, 893 F.2d 529 (2d Cir. 1990).

Second, if the Service requires additional information regarding potential unrelated business income tax liabilities, Part VII could ask simply whether the organization has properly reported all of its income that would be subject to tax as unrelated trade or business income on Form 990-T. If “no,” the organization would provide an explanation. This information would be duplicative of what is already requested on Lines 8a and 8b of the Core Form 990, Part VIII, which inquire whether the organization had unrelated business gross income of \$1000 or more and whether a form 990-T for the year has been filed. We do not think that there are adequate reasons to require more information on this issue.

This approach also has been used in the proposed Core Form 990, Part VIII, Lines 5a, b and c, with respect to excess benefit transactions. Questions are posed as to whether the organization engaged in excess benefit transaction with a disqualified person in the current or prior year and, if “yes,” there is a requirement for the name of the disqualified person, description of the transaction and whether it was corrected.

We suggest that this approach would be appropriate in addressing the issue of whether the organization engaged in any activities that might jeopardize its tax-exempt status and, second, whether it has properly reported unrelated trade or business income.

If the disclosure of portions of the audited financial statements of an organization is deemed necessary to assist in the regulatory review of tax-exempt organizations, then we strongly recommend that the complete audited financial statements (including cash flow statements) be included as part of the Form 990. Selected snippets of audited financial statements, without the complete presentation provided by the full content of the financial statements, are likely not to provide the most accurate picture of the activities of the organization. Many state agencies require, as part of the state annual filing, that audited financial statements be filed with the annual report filed with the state agency. Thus, if the Service believes that a reference to the organization’s audited financial statements in the Form 990 is important, we recommend that the Service consider permitting the organization to include its complete audited financial statements as part of its annual Form 990 filing for transparency purposes.⁷⁰

F. Part X, Organizations Maintaining Collections of Art, Historical Treasures, and Other Similar Assets

Part X requires the text of the footnote to the organization’s audited financial statements that discusses the organization’s holding of art, historical treasures and other similar assets.

The requirement, like the FIN 48 disclosure discussed above, creates a difference between those organizations with audited financial statements and those organizations without audited financial statements.

⁷⁰ The Service also may wish to consider whether certain organizations should be required to submit annual audited financial statements. Various state agencies already impose such requirements, although organizations with gross receipts of less than certain specified amounts are excluded.

We recommend that, rather than requiring information only from organizations that have audited financial statements, the Service require *all* organizations to provide a description of the articles in their collection by category, as opposed to a detailed listing. This will provide information to readers of Form 990 for all organizations that maintain collections, not just those that have audited financial statements. We believe that this arrangement would improve transparency.

Our suggestion above does not include requiring a current fair market value of items in collections and similar assets. There is substantial difficulty in valuing such articles, and the cost of periodic appraisals (beyond those necessary for insurance purposes) could be very burdensome.

We also suggest that the Service consider providing guidance regarding the types of organizations that are required to complete Part X. For example, educational organizations maintaining libraries often have items in their library collection that may have historical value, but that is not the primary purpose of the library. The primary purpose for the library of an educational institution is to provide students and scholars with access to the works in the collection as an adjunct to the educational program of the institution. Such organizations might appropriately be excluded from the application of Part X.

G. Part XI, Trust/Escrow Accounts

According to the Instructions for Line 1 of Part XI of Schedule D, all organizations are required to disclose on Part XI of Schedule D assets that they hold which are not otherwise included on the Core Form 990, Part VI, Balance Sheet. Assets of this nature are assets the organization holds on behalf of some other organization as a trustee, custodian, escrow agent, or other intermediary.

Line 3 on Part VII of the Core Form inquires whether an organization is providing credit counseling or similar services. If the answer is “yes,” then the organization is directed to complete Part XI of Schedule D. The heading to Part XI of Schedule D contains a cross reference to Line 3 of Part VII of the Core Form, noting that organizations which responded “yes” to Line 3 of Part VII of the Core Form are to complete Part XI of Schedule D.

We question why a “yes” answer to credit counseling services requires the completion of Part XI of Schedule D, when completion of Part XI of Schedule D is required of all reporting organizations. The Service may wish to clarify its intentions in the Instructions or, alternatively, remove what appears to be an inappropriate cross reference. The cross reference is likely to confuse organizations that should complete Part XI but that do not provide credit counseling services.

H. Part XII, Endowment Funds

Part VII, Line 16 of the Core Form asks if the organization holds “term or permanent endowments.” The Glossary distinguishes between these types of endowments based on whether they are held pursuant to stipulations (presumably donor stipulations) that the assets be held to produce income for either a specified period of time or permanently.

If the organization answers “yes,” then the organization is directed to complete Schedule D, Part XII. The Instructions to Part XII provide minimal guidance as to the proper completion of the table provided, although it appears that a five-year period is to be compared.

We note that there may be an error in the cross reference in the heading of Schedule D, Part XII, which references Line 6 of Part VII of the Core Form. We suggest that the correct reference should be to Line 16.

Endowment assets are comprised of temporarily restricted net assets and permanently restricted net assets. We suggest that transparency would be improved by reporting balances in each category of such accounts on an ongoing basis. Maintenance of such separate endowment accounts would, in our view, provide greater transparency of the assets available to the organization. In addition, information regarding investment return on endowment assets might be a useful addition to Schedule D.

We also suggest that the Service consider clarifying in the Instructions whether Part XII is to include only endowments arising from donor restrictions, or whether “board designated” endowments are to be included. A board designation that can be reversed in the future does not give rise to a permanently restricted endowment fund. However, without greater clarity, there is likely to be a lack of comparability among reporting organizations, since many organizations hold “board designated” funds for endowment purposes, and such organizations will be uncertain as to whether to include these funds.

I. Part XIII, Reconciliation Net Assets

Part XIII is a new and expanded version of the calculation of changes in net assets that appeared on the first page of the return in prior years. Part XIII expands the calculation to include changes in unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

We recommend that the Service reconsider whether the calculation of changes in unrestricted, temporarily restricted, and permanently restricted net assets is necessary. This information is only available to those organizations that follow SFAS 117. Further, we believe this requirement is somewhat redundant, because the information regarding the changes between the beginning and ending balances of these assets is readily available from the Balance Sheet in the Core Form 990, Part VI, which already shows beginning of year and end of year totals for these items.

A more concise reconciliation calculation may be found in the Analysis of Changes in Net Assets or Fund Balances contained in part III of the 2006 form 990-PF. We suggest that the Service consider using this calculation, rather than the new Schedule D, Part XIII.

VI. COMMENTS ON SCHEDULE E

Schedule E, Schools, replaces the private school questionnaire found in Schedule A of the existing Form. There are no significant changes.

VII. COMMENTS ON SCHEDULE F

A. Introduction

We note that Schedule F may be confusing because it covers activities conducted by grantmakers, operating organizations, and hybrid organizations such as “American friends of” organizations that may conduct activities within and without the United States and grantmaking within and without the United States. This may result in confusion and double counting (*e.g.*, accounting for an employee resident in the United States who provides services within and without the United States). The Comments below are based, in part, on the suggestions we have elicited from representatives of public charities that conduct significant activities overseas or make numerous grants to individuals or organizations overseas.

B. Part I: General Information on Accounts and Activities Outside the United States

1. *Line 1*

a. *Country-by-country reporting*

The table in Line 1 asks the organization to list its “activities per country,” specifically showing: (a) the country, (b) the number of accounts or offices per country, (c) the number of employees or agents per country, (d) the activities conducted per country (by type), (e) a description of specific services per country, and (f) total expenditure per country.

Because many organizations maintain data on expenditures and program activities on a regional or continental basis, rather than on a country-by-country basis, the information required in this table may necessitate the creation of new accounting, tracking and information systems. Reporting by country may impose significant burdens on organizations operating in a number of countries. We recommend that organizations be given sufficient time to build up the necessary accounting, tracking and information systems. Specifically, we suggest that the Service consider postponing the effective date of the Schedule F filing until fiscal year 2009 for those organizations that do not at the present maintain data on a country-by-country basis. In the alternative, those organizations could report on a regional basis for one year.

We further suggest that the Service consider requiring organizations that provide educational, medical, or humanitarian services in numerous countries only to use their reasonable best efforts to report this data. We ask for a “reasonable best efforts” standard because completing the table will require extensive record keeping to compile an exhaustive list of all the activities of all the employees or agents in every country.

b. *Period covered*

The numbers provided in the table required by Line 1 may not be representative of full-year program activity because the Instructions for Line 1, Column C, ask that the number of employees in each country at the end of the tax year be listed. Thus, the numbers will provide a snapshot of only that one day. Similarly, aid organizations responding to natural disasters or

crisis situations may end up reporting information as of a day that falls outside crisis periods, thereby underreporting their activity levels.

We recommend that the Service consider giving organizations the option of reporting the year end numbers, the numbers as of a particular date selected by the organization, or the average numbers over the course of the year.

c. *“On-site visits”*

The scope of the information required for each of the fields in each country is unclear. For instance, the Instructions for Line 1, Column C, state that the organization should not include employees whose presence in the foreign country is to “conduct on-site visits.” The term “on-site visit” is confusing and it is unclear what kinds of visits the Service intends to include or exclude under this definition.

For example, medical and humanitarian aid organizations often send employees into different countries for exploratory, site scouting or technology visits. These visits may last from several days to several months in duration. Are such visits to be considered “on-site visits”?

Moreover, if a visit is determined to be reportable, how is the organization to calculate the amount to be reported per employee per visit? Would the reportable amount be a fraction of the employee’s salary, calculated by dividing the time spent in a particular country by the employee’s estimated total hours worked for the year? If so, are benefits and travel expenses included?

We question whether the term “on-site visit” refers to a grantmaker’s site visit to review use of a grant. If so, it is not clear how the term applies to an operating organization. This reporting could be unduly burdensome and result in double counting. We suggest that the Service clarify the reporting criteria and how expenses of employees and organization based in the United States will be reported. We further recommend that only the employee’s travel expenses, and not the fractional salary and benefits, be reported on Schedule F.

d. *Security issues*

Form 990 is publicly available, via the Internet, to viewers on computers around the globe, and many of those viewers could be hostile to the charities working in their countries. Part I, Line 1, has the potential to compromise the security of an organization’s overseas grantees or the organization’s own employees.

For example, if an organization has employees working in countries unfriendly towards the United States, the information required in this table would allow people in that country to know which organizations have how many people working there. This could create security risks for the organization’s employees and agents who could then be targeted.

For organizations that have reason to fear public disclosure of the detailed information in Part I, we recommend that the Service consider providing the alternative of filing a Schedule F-1, which would not be subject to public inspection. This schedule could be handled in a manner similar to the way Schedule B is not subject to public inspection.

We further recommend that, if an alternative filing mechanism is provided, the decision to report on Schedule F or F-1 be left to the discretion of the filing organization. To the extent that any statutory changes may be necessary to authorize a non-public Schedule F-1, we would welcome the opportunity to provide further comments with respect to the need for such a non-public schedule.

In addition, despite a Schedule B that is not subject to public inspection, the information is sometimes inadvertently included in publicly disclosed filings, such as those available on the Guidestar website or attorney general files. As an alternative to our recommendation above with respect to a non-public schedule, we recommend the implementation of a detailed record retention and Service review policy that could replace disclosure of certain information requested in this table in highly sensitive cases. We would welcome the opportunity to work with the Service on an appropriate Revenue Procedure to implement this suggestion.

e. *Grantmaking recipient location issues*

The Instructions to Schedule F state that, for purpose of reporting on Schedule F, “a grant to an organization if more than one-half of its activities are conducted in a foreign country or directed to persons in a foreign country” counts as grantmaking to grant recipients located in a foreign country. As written, this provision suggests that Schedule F must include grants to domestic section 501(c)(3) organizations with current determinations that they are public charities if one-half of the organization’s activities are conducted outside of the United States.

If the Service intends to require reporting by organizations making grants to domestic organizations that have significant activities outside of the United States, we suggest that the Service provide guidance as to the information that a grantor can rely upon in determining the scope of a grantee’s foreign activities. For example, could a grantee rely on the representation of the grantee, a letter from counsel, or information returns from prior years?

In addition, it is not clear where on Schedule F such information would be reported. The Instructions for Part 1, Line 1, Column F, provide that organizations are not to “report expenditures paid in the United States.” Presumably, a well-advised grantmaking domestic section 501(c)(3) organization making a grant to another domestic section 501(c)(3) organization with operations outside of the United States will make the payment of such grants in the United States. Thus, it is not clear where, if at all, grants to a domestic organization with significant foreign operations will be reported on Schedule F. The Service may wish to consider clarifying what it wants reported or deleting from the Instructions the direction referenced in the first paragraph above.

A similar issue arises with respect to payments by educational organizations for scholarships. The Schedule F Instructions provide that reportable grants include grants made primarily for “benefiting persons in a foreign country.” This Instruction might be interpreted to suggest that a grant made to an individual in the United States for the purposes of travel or education outside of the United States should be reported on Schedule F. The Instructions for Part I, Line 1, Column F state, as noted above, that “expenditures paid in the United States” are not to be reported. The Service may wish to consider clarifying the application of the Schedule F Instructions to make it clear that payments to students in the United States for study abroad are

not to be reported. The specific Instruction for Part I, Line 1, Column F might also be repeated appropriately in the Instructions for Part III for the reporting of grants to individuals outside of the United States.

f. *Other Comments*

The Instruction to Part I, “General Information on Accounts and Activities Conducted Outside the United States,” Line 2, states “See *Purpose of Form* above, for definition of a foreign country.” It appears that no such section exists.

2. *Line 2*

Line 2 asks for the organization’s procedures for selecting grant recipients located outside the United States. The information sought by Line 2 is very broad, and a response will be extremely burdensome for large organizations with extensive and detailed grantmaking procedures.

For example, one organization informed us that their internal grantmaking procedures run approximately ten pages in length. Other organizations’ grantmaking procedures are guided by, for example, USAID’s Automated Directives System (ADS). A complete response to Line 2 as written would require the attachment of many pages of internal procedures or, perhaps, the relevant chapter or section of the ADS. Such voluminous responses seem more likely to make the Form 990 less transparent, rather than informative.

We recommend that rather than request an organization’s specific procedures for selecting grant recipients or its detailed, multi-page grant procedures, the Service consider asking a limited number of “yes” or “no” questions that are consistent with good grantmaking procedures. We suggest that the Service replace Line 2 with the following questions:

- (a) Is there a written grant agreement that restricts use of funds to qualifying section 501(c)(3) purposes?
- (b) Does the organization receive a follow-up report from the grantee reporting how the funds were spent?
- (c) Do these reports continue until the earlier of the funds’ expenditure in full or the date that is three years from the date that the grant was made?
- (d) Are there procedures in place so that the board of directors is informed of all organizations that receive grants and is in a position to control the approval of such grants?

3. *Line 3*

Line 3 asks whether the organization made any grants directly or indirectly to finance political or lobbying activities outside of the United States

a. *Political activity*

There is no definition provided for "political or lobbying activities." As noted above in the Comments with respect to Schedule C and the related portions of the Core Form, developing a uniform definition is a daunting task, even for organizations with activities wholly within the United States. Because the political systems and legal frameworks under which charitable organizations operate outside the United States differ greatly, the issue of whether an organization based in the United States but operating in other countries engages in political or lobbying activities could be very confusing. For example, readers could conclude incorrectly that organizations that respond affirmatively to this question are violating the law, when this may not be the case if the financed activities are lobbying.

The phrase "political activity" is not defined in the Glossary and differs from the usual term, "political campaign activity." The phrase "political campaign activity" is defined in the Glossary; we have suggested, in the Comments to Schedule C and the related portions of the Core Form, various clarifications to the definition. Therefore, we recommend that this question be reworded to ask about "political campaign activity" or lobbying.

b. *Direct or indirect activity*

There is no definition provided for "directly or indirectly," and confusion may result due to various interpretations of the terms. For example, if an organization based in the United States makes a grant to support salaries paid by a charity outside of the United States that is permitted by law to engage in lobbying, is "financing" that organization indirectly funding lobbying?

We recommend that the Service rephrase Line 3 to ask whether the purpose of the organization's grant is to support political campaign activity or lobbying activity. Also, we recommend deletion of the verb "finance." Alternatively, if this recommendation, and our suggestions regarding clarification of Line 3's references to political campaign activity and lobbying, cannot be implemented, we suggest that the Service consider deleting Line 3 from Part I until further clarification of the laws and expectations in this area can be provided.

C. Part II: Grants and Other Assistance to Organizations or Entities Outside the United States

1. *Line 1 table*

The table in Part II asks the organization to list, for any recipient which received more than \$5000, the: (a) name of the organization; (b) IRS code and EIN; (c) city and country; (d) purpose of grant; (e) amount of cash grant; (f) manner of cash disbursement; (g) amount of non-cash assistance; (h) description of non-cash assistance; and (i) method of valuation.

a. *"Friends-of" organizations*

The table in Line 1 makes no distinction between "friends of" organizations that support one or a small number of operating affiliates outside the United States and organizations that make grants to a large number of unaffiliated organizations. "Friends of" organizations typically know their affiliates, the affiliates' employees and operations well and are subject to Service

jurisdiction in the United States. For example, one “friends of” organization informed us that in 2006, it granted over \$100 million to fewer than ten affiliated organizations outside of the United States. Compiling the data for such large sums granted to affiliates in block amounts in order to complete this chart could present a formidable task, unless the organization is allowed to use broad or general terms.

The reporting requirements for “friends of” organizations should be less detailed because the organization is typically very familiar with its non-U.S. affiliates’ policies and personnel and is subject to Service jurisdiction in the United States. In these situations, we believe that the amount of the grant, along with a general description of the purpose of the grant, would be sufficient to inform readers of the Form 990 and the Service. We accordingly recommend that the Service clarify the Instructions to Schedule F to provide for the reporting suggested.

The proposed reporting on Schedule F also goes beyond what the Service now requires of private foundations on Form 990-PF. We believe that reporting by public charities should be no more onerous than reporting by private foundations. Therefore, we recommend that the Service consider clarifying that “friends of” organizations in particular, but public charities more generally, not be burdened with having to create overly detailed purpose descriptions. In situations where the grantor and grantees are not affiliated, more detailed information could be requested.

b. *Security concerns*

For the reasons discussed above in connection with our recommendations with respect to Schedule F, Part I, Line 1, we suggest that the Service consider providing a Schedule F-1, which would not be subject to public disclosure, and which could be filed by organizations that determine that disclosure of certain information would pose a danger to their employees or agents. Alternatively, the Service instead might consider detailed recordkeeping requirements that organizations must adopt but that do not result in information reporting on Form 990.

2. *Lines 2 and 3*

Part II, Lines 2 and 3, ask the reporting organization to enter the total number of section 501(c)(3) organizations and the total number of other organizations or entities to which it provided grants or other assistance.

The answers to these questions may not provide a realistic picture of the reporting organization’s assistance to charitable organizations, given that hardly any foreign organizations have formally been recognized as exempt by the Service. Those organizations not recognized as a charity by the Service will all appear on this report as “other organizations” even though those organizations may be charitable under the laws of their respective countries. For example, even organizations which have qualified as charities registered by the Charity Commission for England and Wales (where the charity registration process may require a more detailed examination of the organization’s activities than may be required by the Service) would be reported as “other organizations” if such organizations have not also qualified for section 501(c)(3) status by filing an appropriate application with the Service.

We recommend that the Service add a third category for organizations that are either recognized as charities in their own countries or where the organization or counsel has provided an equivalency letter stating that the recipient operates under another country's laws in a manner that is equivalent to a section 501(c)(3) organization. Adding this additional category would provide a more accurate reflection of the reporting organization's grantmaking.

D. Part III: Grants and Other Assistance to Individuals Outside the United States

The table in Part III asks the organization to list, for any individual who received a grant or other assistance: (a) types of assistance; (b) city and country; (c) number of recipients; (d) amount of cash grant; (e) manner of cash disbursement; (f) amount of non-cash assistance; (g) description of non-cash assistance; and (h) method of valuation.

The table in Part III presents the same security concerns as Schedule F, Part II, Line 1, and Part I, Line 1. For the reasons discussed above in connection with our recommendations with respect to these provisions of Schedule F, we suggest that the Service consider providing a Schedule F-1, which would not be subject to public disclosure, and which could be filed by organizations that determine that disclosure of information would pose a danger to their employees or agents. Alternatively, the Service might consider detailed recordkeeping requirements that organizations must adopt but which do not result in information reporting on Form 990.

VIII. COMMENTS ON SCHEDULE G

A. General Comments

In general, Schedule G provides information useful to the Service and the public regarding the fundraising and gaming activities of an exempt organization. Part I is arranged in a logical format and asks appropriate questions that should be effective in disclosing potential excess benefit transactions, private inurement, or private benefit.

B. Part II - Events

Part II includes space for the organization to list the three largest fundraising events in its fiscal year. The Instructions do not provide any guidance as to how an organization should complete the unused Columns B and C in years in which it does not have three events. We suggest that the Service consider indicating the appropriate response for this situation in the Instructions for Schedule G.

We believe the Instructions for Schedule G would be more helpful, especially to smaller organizations, if they included a definition of "charitable contributions" as distinguished from other forms of revenue raised at an event to assist with proper reporting in Lines 1, 2, and 3 of Part II. For example, at a dinner event for which a contributor pays \$1000 and in exchange receives a dinner valued at \$100, the Instructions should clarify that only \$900 should be reported as a charitable contribution on Line 2. Although similar examples are provided in the Instructions relating to the Core Form, Part IV, Lines 1c and 11a, the format of the information

presented in Schedule G is sufficiently different from the Statement of Revenue in the Core Form that the information warrants repeating.

C. Part III - Gaming

1. Lines 9 and 10

A significant portion of Schedule G is devoted to determining whether gaming winnings and compensation to those involved in gaming activities have been properly reported for income tax purposes and whether or not proper amounts have been withheld from such payments. While these questions certainly are valid questions in an examination by the Service, it is unclear that it is necessary for the Service to be devoting space on Form 990 for such questions. Similar questions instead could be asked on the compensation schedule to the Form 990.

The Schedule G Instructions do include guidance regarding the withholding and return filing obligations for topics such as gaming, unrelated business income tax, and wagering. If Schedule G is going to include questions regarding proper withholding and other employment tax practices, the Service may wish to consider including in the Schedule G Instructions references to the applicable Service publications and Forms that need to be filed.

2. Lines 11, 12, and 19

Lines 11, 12, and 19 ask whether an organization is properly licensed to conduct gaming activities and whether an organization is required under State law to make charitable distributions from gaming proceeds. The Instructions do not provide any guidance as to how the responses to these questions relate to the organization's tax-exempt status, the calculation of unrelated business income, or any other information shown on the Form 990. The Service may wish to consider providing further guidance in the Instructions as to these matters; otherwise, the questions may best be left for individual State and local governments to address.

D. Part II and Part III Instructions

The Instructions to Part II and Part III reference certain expense items in bold text such as **Labor Costs and Wages, Employment Taxes, and Excise Taxes**. The Instructions appear to mean that these are costs that should be included in the "Other direct expenses" line item (Line 7 in Part II and Line 6 in Part III). As written, however, the bold typeface may cause the reader to look fruitlessly in Schedule G for corresponding line items.

IX. COMMENTS ON SCHEDULE H

A. Part I – Community Benefit Report

1. *Lines 1 through 4 - calculation of charity care*

Lines 1 through 11 of Part I of Schedule H comprise a table for the reporting of a hospital's "community benefit" activities. Each Line asks a specific question relating to potential sources of "community benefit."⁷¹

The first four lines in Part I (and Worksheets 1, 2 and 3) relate exclusively to the calculation of the "charity care" that a hospital provides. Line 1 provides for the inclusion of "charity care" at cost, Line 2 provides for the inclusion of unreimbursed Medicaid costs, and Line 3 includes unreimbursed costs from other government programs.

a. *Permit reporting of "charity" portion of "bad debts" and "Medicare shortfalls"*

In making charity care calculations, we recommend that the Service consider allowing hospitals to also report "bad debt expense" and "Medicare shortfalls" on Schedule H to allow comparison of organizations by showing all items that might be regarded as costs of uncompensated care.

Schedule H ignores the fact that "bad debts" and "Medicare shortfalls," in fact, often include significant amounts of "charity care." Because "charity care" provided has become such a significant factor, it is inappropriate to truncate the "charity care" information to be reported without permitting reporting hospitals to identify the portions of their "bad debts" and "Medicare shortfalls" that are properly classified as "charity care," including the opportunity to describe the supporting rationale for those conclusions. In fact, many would argue that the entire amount of any "Medicare shortfall" should count as "charity care," because the elderly constitute a clearly-recognized charitable class.⁷²

According to the Hospital Compliance Project - Interim Report,⁷³ 44 percent of respondents said they treat bad debts as uncompensated care. In reporting uncompensated care, hospitals generally make determinations on qualification for uncompensated care throughout the billing/revenue cycle (i.e., prior to receiving treatment, upon presentation for treatment, upon discharge, during the billing process, during the collection process, etc.). Due to the issues associated with identifying individuals who qualify for uncompensated care, hospitals continue to have difficulty separating traditional uncompensated care from true bad debt.⁷⁴ In making

⁷¹ Rev. Rul. 1969-545, 1969-2 C.B. 117.

⁷² See, e.g., Rev. Rul. 1972-124, 1972-1 C.B. 145.

⁷³ Internal Revenue Service, Hospital Compliance Project Interim Report (2007), available at http://www.irs.gov/pub/irs-tege/eo_interim_hospital_report_072007.pdf.

⁷⁴ Some states require hospitals to include bad debt expense in reporting uncompensated care. See, e.g., Hospital Uncompensated Care Program Uniform Reporting Requirements, 32 Pa.B. 3672 (Doc. No. 02-1317) (2002).

these decisions, much depends upon hospital billing cycles, the ability reasonably to obtain patient financial information necessary to make informed decisions about billing matters on a timely basis, and the ability subsequently to make appropriate changes to initially erroneous classifications.

One problem stems from the fact that audit guidelines may be interpreted to require a level of proof of eligibility for free or reduced price care that is not practical in determining charity care. A poor, sick person often is not in a position to provide the requisite proof of income or assets in order to determine his or her eligibility for free or reduced charge care, and has little incentive to do so if the hospital provides or has already provided care.

We believe that some portion of bad debt undoubtedly constitutes “charity care” in the sense that the recipient of care would have qualified for free or discounted care under hospital policies, and the hospital would have provided such care in accordance with its policy, but such qualification cannot be documented with reasonable cost in light of the amount involved. If, as Schedule H suggests, bad debts in general do not count in determining “charity care,” perhaps the Service could consider adopting a flexible standard or rule of thumb to permit hospitals to properly recognize the amount of charity care they have provided which, after reasonable efforts, cannot be documented with certainty as charity care without unreasonable cost. For example, a percentage of bad debt by zip code might be counted as charity care to the extent that persons within that zip code generally qualify for charity care under the hospital’s charity care policy. Thus, if one-half the individuals in a particular zip code who present income and asset information qualify for charity care under the hospital’s policy, one-half the bad debt write-offs of other residents of that zip code who do not present income or asset verification information might be considered to qualify as charity care.

b. *Offset for philanthropy*

The “charity care” to be reported on Line 1 is calculated on Worksheet 1, which provides the method for calculating “charity care” reported on Schedule H, but is not filed with Schedule H. Worksheet 1 indicates that if philanthropy has been received and/or used to provide charity care, the cost of the charity care so funded should not be counted or included on Schedule H.

We suggest that the treatment of philanthropy or grant revenue suggested by Worksheet 1 is fundamentally inconsistent with the approach taken by analogous portions of Form 990. For example, Part IX of the Core Form, relating to program service accomplishments, suggests that organizations record in Column A the fee for service revenue associated with the costs of particular programs. However, the description of amounts included in Column A in the Instructions does not appear to include any donated or grant funds. In addition, Part IX shows program service revenue and expense side-by-side. The approach suggested by Worksheet 1 would obscure the true cost of “charity care” shown on Schedule H by netting the cost with certain philanthropic revenue.

We recommend that the Service permit the cost of charity care to be reported without any revenue offsets on Schedule H. If it is thought that philanthropic revenue applied to pay for charity care needs to be reported on Schedule H, the Service may wish to consider having this amount reported on a separate line in order to produce greater transparency

In addition, on Worksheet 1, the footnote to Line 12 suggests a different treatment for hospitals that do their own charitable fundraising from those in systems in which fundraising has been delegated to a separate legal entity. If the philanthropy offset can be eliminated by use of a related fundraising foundation, there will be no comparability between hospitals that have such a foundation and those that do not.

c. *Defining “charity”*

One of the announced goals of the Form 990 redesign is the enhancement of transparency, and the greater use of Form 990 as a tool for comparability of exempt organizations. However, in two respects with respect to “charity care,” it seems likely that Schedule H will, at least initially, produce results which are not comparable.

First, although Schedule H, Line 13a, calls for a description of the hospital’s charity care policy, no specific guidance is provided in the Instructions as to how a hospital is to determine whether the persons to whom a hospital’s medical services are provided on a free or below cost basis are properly classified as eligible members of a charitable class for this purpose. The charity care results of a hospital that provides free care to individuals with income of up to 100 percent of the federal poverty level (“FPL”) thus will presumably differ from a hospital that provides free care to individuals with income of up to 150 percent of FPL.

We do not suggest that Schedule H serve as a straightjacket to prevent hospitals from determining what charity care policies best meet the needs of their communities. However, the Service might wish to consider some further guidance in the Instructions as to what income levels, as compared to FPL, might presumptively be treated as evidencing that individuals are members of a charitable class and appropriate recipients of charity care.

In addition, Worksheet 1 indicates that the “cost” of charity care may be based either on a ratio of cost to charges or costs determined under the hospital’s cost accounting system. The Instructions provide no further guidance as to the proper items to be included in costs (including the various categories of “unreimbursed costs” properly included) to be included as the measure of “charity care.”

Over time, the variation in cost measurement methodology undoubtedly will lead to differences in comparability. If uniformity in reporting is considered to be desirable, the Service may wish to provide objective criteria to guide those required to prepare and submit Schedule H. Otherwise, the information addressed is likely to be much less useful.

2. *Lines 5 through 10 – other community benefits*

Lines 5 through 9 list various other community benefits that count towards the amount of the hospital’s total community benefits on Line 11, which is the sum of total charity care and total other benefits. As currently designed, this portion of Schedule H could result in unwarranted changes in behavior, with hospitals allocating funds to support only activities for which they get community benefit credit and abandoning other important programs that benefit the community.

a. *Community building*

We recommend that Schedule H include space to report other types of community benefits that do not fit precisely within the categories on Lines 5 through 9. The listing of community benefit programs is not comprehensive enough to encompass all categories of community benefit. In the Catholic Health Association guidelines for determining hospital community benefits, the category of “community building” is included.⁷⁵ Activities such as reading programs, parenting programs, homeless shelters, programs to remove lead paint, housing assistance, programs to reduce violence, and programs to provide education, food, and heat, all might be considered as community benefit activities because they all contribute to improved health.

Many activities, even if they do not involve the direct provision of healthcare services, contribute importantly to better community health. Line 9, which includes contributions to community groups, also recognizes that benefits to the community often come from more than directly providing healthcare services or education. Thus, we suggest that space be added to permit the reporting of such activities and their costs on Part I of Schedule H.

b. *Research*

Research is a component of community benefit and is reported on Line 8. However, under Worksheet 7, it appears that hospitals are allowed to include only uncompensated expenses relating to research they have conducted.

Many hospitals engage in research that serves the community; some research activities are funded by government, most notably the National Institutes of Health. It has always been understood that scientific research conducted in the public interest, which includes research performed for the United States, is an exempt purpose under section 501(c)(3).

We recommend that the Service consider modification of the calculation of “research” to allow hospitals to include in the calculation of community benefit the value of scientific research in the public interest, irrespective of the source of funding.

c. *Facilities for the benefit of the community*

No information is requested concerning the application of surplus or excess earnings to the improvement of a hospital’s facilities and the purchase of new equipment in order to expand a hospital’s ability to provide healthcare services to the community it serves. We suggest that these types of expenditures, which can bring new technologies and expanded services to the community, are relevant to satisfaction of the “community benefit standard” and should be taken into consideration.

⁷⁵ Catholic Health Association, Reference I. Community Benefit Categories 13, http://www.chausa.org/NR/rdonlyres/68057062-B902-420D-BB04-C5B1597E64BB/0/CBCategories_Hospitals.pdf (last visited Sept. 5, 2007).

3. *Part I, Column A*

Column A of Part I of Schedule H requests information regarding the “number of activities or programs” reported on each Line. We recommend that Column A be deleted.

The number of programs and activities is subject to manipulation and interpretation and is highly likely to result in meaningless data. In addition, it will be difficult for organizations to measure the number of their activities or programs. Every department within a hospital might be viewed as including multiple programs. We suggest that the Service consider eliminating Column A or instead providing more guidance in the Schedule H Instructions as to how programs and activities are to be measured.

4. *Part I, Line 12*

Line 12 asks if the hospital prepares an annual community benefit report. If so, the hospital is asked whether it makes the community benefit report available to the public.

Integrated health systems are composed of separately incorporated hospitals, as well as other health care organizations. Such systems commonly calculate and report community benefit on a system-wide basis to provide clear information on the total community benefits they provide. In addition, certain integrated healthcare systems may not have the ability to report each item of information for Part I on an entity by entity basis. Further, the costs for some activities (*e.g.*, costs of conducting a community needs assessment) may be shared across the various entities in the system.

We recommend that the Service consider allowing combined community benefit reporting for integrated systems. An entity also could have the option of reporting charity care and community benefit on a separate entity basis. However, if a system elects to use combined reporting, we suggest that all entities within the combined group be required to use combined reporting. Further, if combined reporting is elected, all entities included in the consolidated financial statements of the system under generally accepted accounting principles (GAAP) might be required to be included in the combined community benefit reporting. Such combined reporting for an entire healthcare system would provide more transparent information regarding the charity care and community benefit provided by all the component parts of the system, and is consistent with the integral-part test for exemption.

Integrated health systems can be structured with their operations in few or many corporations for historical, regulatory, or other reasons. It is highly unlikely that integrated health systems would restructure their operations so that they can report on an individual or consolidated basis to reduce transparency of their operations.

5. *Part I, Line 13b*

We recommend that the Service consider making Line 13b, which asks for an explanation of the reporting hospital’s charity care policy, a more guided question to address specific areas of concern. With more targeted questions, transparency and comparability will be enhanced, and

the information gathered can be statistically meaningful and can serve as a standard of comparison between organizations. We suggest the following questions:⁷⁶

- a. Is the charity care policy the same for all of your facilities? If not, answer the following questions based on the policies applicable to your facilities serving the greatest number of patients.
- b. What information is taken into account in making charity care determinations?
 - (i) Income data
 - (ii) Assets data
 - (iii) Medical expense data
 - (iv) All of the above
- c. What are the income cutoffs for complete write-off for charity care?
 - (i) Less than 100 percent of FPL
 - (ii) 100-149 percent of FPL
 - (iii) 150-199 percent of FPL
 - (iv) 200 percent or more of FPL
- d. Do you provide partial write-offs for patients above these levels on a graduated scale?
- e. Does the policy address catastrophic medical expenses for those not otherwise eligible for assistance under the charity care policy?
- f. Do you receive grants or contributions restricted to the purpose of rendering care to charity patients?
- g. Do you receive governmental payments (other than Medicare and Medicaid disproportionate share payments) for the purpose of rendering care to charity patients?
- h. Do you limit the amount of charity care (aside from required emergency services) that will be provided

⁷⁶ Medicare Cost Report Form CMS 2552-96, Schedule S10.

during the year or other period at one or more of your facilities? If so, describe.

- i. Does your charity care policy direct how patients will be informed of the policy's existence and the availability of charity care?

B. Part II –Billing and Collections

1. *Section A*

Most hospitals will find Section A, which asks for a summary of gross charges, discounts, expected receipts, and actual collections for various types of payors, very difficult to complete. Section A would be more useful, and would be less daunting to filers, if the approach were to reconcile and provide more detail as to the contractual allowances and similar information provided in the hospital's financial statements. For example, a hospital might be asked to show gross Medicare charges, Medicare contractual allowances booked, and accrued Medicare revenue.

The categories of payors also may be unclear in some respects. The chart requires information as to insured and uninsured, but does not mention the underinsured. Underinsured patients are a critical category in measuring charity care in the area of billing and collections.

The "fees collected" amount called for by Line 4 is unlikely to be a figure that corresponds to anything hospitals maintain. If what is sought is bad debt amounts, then a figure that is regularly kept in financial statements—such as bad debts written off—might be more appropriate at getting at the information sought, even though it may not correspond to services provided during the reporting period.

Line 5 asks how the hospital computes its bad debt expense. The Service also may wish to consider, as part of this question, eliciting an explanation of how bad debt is distinguished from charity care.

2. *Section B*

Line 6b requests information regarding the hospital's debt collection policy. We suggest that the Service consider making Line 6b a more targeted question to address specific areas of concern so that the information gathered can be statistically meaningful and can serve as a standard of comparison from one hospital to another. Questions that the Service might wish to include are as follows:

- a. When during the revenue cycle can care be identified as charity care?
 - (i) At admission
 - (ii) At time of first billing
 - (iii) After billing but before sent to collection

- (iv) After sent to collection
- (v) All of the above
- b. Does the organization offer plans for payment over time?
- c. Does the organization refer patient accounts to outside parties for collection?
- d. Does the organization inform outside collection agencies of standards to be followed in collection efforts, including making the patient aware of the organization's charity care policy?
- e. Does the organization generally cease collection efforts for amounts determined to be charity care?

C. Part III

Part III asks for information regarding a hospital's interaction with "Management Companies and Joint Ventures." The table in Part III, however, appears to require information only with respect to entities in which the hospital is a partner or other investor, so the heading might appropriately be changed to simply refer to "Joint Ventures."

We previously have recommended in these Comments that Part VII of the Core Form be modified to require information as to the joint ventures in which the reporting entity participates that produce income which is substantially related to the exempt purposes of the reporting organization. In addition, Schedule D requires reporting of an exempt organization's investments, and Schedule R requires reporting with respect to related organizations.

The information requested in Part III is equally relevant to tax-exempt organizations other than hospitals because the legal concepts and attendant consequences are the same for all types or categories of tax-exempt organizations (or at least all types of section 501(c)(3) organizations). Moreover, the issues related to exemption and unrelated business income tax when organizations enter into arrangements with officers, directors, or employees are the same for hospitals and any other organization described in section 501(c)(3). Accordingly, we recommend that the Service consider eliminating Schedule H, Part III. To the extent that there is any information on Schedule H, Part III, which is not already incorporated in Part VII of the Core Form, Schedule D, or Schedule R, the Service might consider adding such information to one of these other parts of Form 990.

D. Part IV

1. Line 1

Line 1 asks how the hospital assesses community health care needs. The general nature of this question on needs assessment is very likely to generate a predictable and meaningless

response from all organizations. We suggest that this question be deleted or converted into a more specific question that addresses areas of particular concern.

2. *Lines 2 and 3*

Lines 2 and 3 ask about the patient intake process and emergency room policies.

We suggest that the Service replace Lines 2 and 3 with more guided questions to address specific areas of concern. With more targeted questions, the information gathered can be statistically meaningful and can serve as a standard of comparison from one filing organization to another. Useful questions might include the following:

- a. Does the organization provide emergency services 24 hours a day, seven days a week?
- b. Are patients screened for emergency medical conditions before inquiry as to payment sources?
- c. Are all patients with emergency medical conditions stabilized without regard to ability to pay?
- d. How are patients made aware of the availability of charity care and of the organization's collection policies?
[Check all that apply]
 - (i) Notice on bills
 - (ii) Web site
 - (iii) Notices posted in admission areas
 - (iv) Notices posted elsewhere in the facility
 - (v) Handouts on admission
 - (vi) Handouts on discharge
 - (vii) Brochures or handouts made available in admission areas
 - (viii) Brochures or handouts made available elsewhere in the facility
 - (ix) Other

X. COMMENTS ON SCHEDULE I

A. General Comments

1. Organization and approach

By collecting information regarding domestic grants into a schedule with a fixed format, Schedule I increases the likelihood that the requested information will be properly provided. In general, this approach is to be commended, as it is likely to increase compliance and decrease confusion among taxpayers.

Schedule I sets a \$5000 threshold, thus allowing organizations with very small levels of grantmaking to avoid completing Schedule I. The expansion of information collected over that required by the 2006 Form 990 creates a minimal added burden. Organizations will now have to report the EIN of tax-exempt grantees and the applicable Code section. For individuals, organizations will need to report the specific number of recipients of each type of grant provided to individuals.

2. Heading

On the Core Form, Part V, Lines 1 and 2 clearly indicate that Schedule I must be completed only if the total entered on either line exceeds \$5000. The Instructions to Schedule I say that completion of Schedule I is required for those that enter “more than” \$5000 on the Core Form, Part V, Lines 1 or 2.

The heading of Schedule I suggests that Schedule I is to be completed if the total of the amounts entered on the two lines taken together exceeds \$5000. The Core Form Instructions similarly state that Schedule I is required if the total of the two lines exceeds \$5000. The Core Form Instructions for Lines 1 and 2, Part V, state that Schedule I is required if the total of the two lines exceeds \$5000.

These directions would benefit from clarification to make them consistent.

Another problem with the Instructions to Part V, Line 1 of the Core Form is in the second paragraph, which indicates that “the organization must complete Parts II and III of Schedule I” if “the total” of the first and second lines exceeds \$5000. This is again inconsistent with Schedule I and the Schedule I Instructions, which require all organizations filing Schedule I to complete Part I, while Part II applies only to those reporting more than \$5000 on Part V, Line 1, and Part III applies only to those entering amounts on Part V, Line 2.

B. Part I

Part I, Line 2a, asks whether any grant recipient was “related to any person with an interest in the organization,” including “a donor.” This requirement is not new, and is consistent with what the current form requires to be disclosed in an attachment. Nevertheless, it raises the question of whether there should be a threshold for including donors in this list.

While organizations reasonably may be expected to have knowledge of the identities of their major donors, an organization may well not be aware that a family member of a scholarship recipient has also made a small contribution to the organization. It may be nearly impossible to discover this relationship. Excluding donors of less than some amount would not undermine the purpose of this disclosure and would avoid creating unnecessary obstacles to compliance. A reasonable threshold could be set at the lower of \$5000 or two percent of the organization's gross receipts, for example.

In addition, the term "related to" is not clearly defined in the Instructions. Without any definition, taxpayers must guess how close a relationship will be considered relevant. This definition could reasonably be drawn from section 4946(d). We suggest that the Service consider including such a definition, either in the Schedule I Instructions or by cross reference to a definition elsewhere.

C. Parts II and III

Parts II and III require information regarding grants to governments and organizations within the United States and grants to individuals in the United States, respectively. In a number of areas, the space provided is insufficient to enter the information required.

Part II likely provides adequate room to enter the EIN, Code section and amount of the grant in the boxes provided. But two lines two inches long to enter an organization's name and address (Column A), or a one-inch block to describe a non-cash grant (Column G) or explain the purpose of a grant (Column H) is likely not enough space. Columns D and F of Part III are short on space for similar information.

Organizations filing Schedule I will be forced to attach additional pages, thus increasing the likelihood of error and inadvertently omitted information. We recommend that the Service provide additional room for Parts II and III by, if necessary, increasing the page count for Schedule I in a manner similar to the listing of contributors on Schedule B, which runs for several pages that can be discarded if they are not needed. If increasing Schedule I's page count is not an option, we suggest that the Service consider reducing the number of lines provided in each section, so that at least one complete entry can be made without attaching additional pages.

D. Interaction with Schedule F

Schedule I includes only grants "in the United States." Grants to foreign organizations are included in Schedule F. Schedules F and I require different levels of detail. For instance, Schedule F asks for a description of procedures for selecting grant recipients, while Schedule I simply asks for an affirmation that the organization maintains records to substantiate the amount of the grants, grantees' eligibility, and the selection criteria used.

For governmental and organizational grantees, according to the Schedule F Instructions, Schedule F asks for "manner of cash disbursement," but not the address of the grant recipient (only city or region and country). For individuals, Schedule F breaks out each type of assistance by city and country, as well as asking for information about the manner of cash disbursement.

The Instructions to Schedules F and I, and the Core Form Part V, Line 3, however, treat an organization as located in a foreign country “if more than one-half of its activities are conducted in foreign countries or for the benefit of persons in foreign countries.” Similarly, under the Schedule F Instructions, a grant “made primarily for the purpose of benefiting persons in foreign countries” is considered a foreign grant.

As discussed above in the Comments on Schedule F, these definitions apparently could apply to domestic organizations governed by a board of directors based in the United States (who may all be citizens of the United States) and whose offices and bank accounts are in the United States. The typical “friends of” organization, based in the United States and subject to oversight by the Service and state regulators in the United States, will be considered a foreign grant recipient if it primarily operates by making grants to foreign organizations or for the benefit of foreign residents.

We suggest that the Service consider making all grants to domestic organizations, irrespective of where such organizations carry out their activities, reportable on Schedule I. Domestic organizations are subject to examination by the Service, and any such organization making overseas disbursements will have to report them on its own schedule F. Requiring an organization making a grant to a domestic organization that in turn uses it for foreign grantmaking seems likely to result in double-reporting of the extent of grants made to “foreign” organizations—creating a reduction, rather than an increase, in transparency with respect to the exempt sector.

In addition, singling out “friends of” organizations for special reporting treatment may create the misleading impression that such domestic organizations are inherently less reliable than other domestic organizations confining their grantmaking activity to the United States. We thus encourage the Service to consider eliminating special reporting requirements for grants to domestic organizations that spend more than 50 percent of their funds overseas.

XI. COMMENTS ON SCHEDULE J

A. Line 1

1. Column C

The Schedule J Instructions indicate that the amount of nonqualified deferred compensation to be reported in Column C includes earnings accrued on deferred amounts or increases in actuarial value. We recommend that the Schedule J Instructions be revised to require only the reporting of deferred amounts, without including earnings or increases in actuarial value with respect to previously accrued and reported deferred amounts.

Including earnings and actuarial increases would result in a perpetual reporting of the same amount of deferred compensation until paid out; an amount initially deferred and reported would increase in value each year, and that value would represent only the time value or actuarial equivalent value of the amount already earned and reported. Further, for deferred compensation plans that use an offset approach (*i.e.*, where the benefit at a specified retirement

age is offset by other forms of retirement income provided by the reporting organization), the amount earned in a particular year may be a negative number.

If organizations are required to report increases in actuarial value or increases in earnings, we suggest that such reporting not be limited to increases only. Organizations thus would also be able to report decreases in value or negative earnings, even if that means offsetting accruals in deferred compensation during the year.

We believe this complexity could be avoided by limiting the disclosure required to newly deferred and accrued amounts, and by omitting the disclosure of earnings and changes in actuarial value. We recommend that the Service consider this approach.

2. *Column D*

The Schedule J Instructions for Column D, relating to nontaxable fringe benefits, indicate that the entry for each individual should include *every* type of nontaxable fringe benefit. This requirement would represent an enormous tracking and reporting burden for reporting organizations.

Several types of fringe benefits are not subject to tax under section 132 *precisely* because tracking and reporting them is administratively burdensome or because they are not readily capable of measurement (*e.g.*, de minimis fringe benefits and no-additional-cost fringes).⁷⁷ Other fringe benefits, such as working condition fringe benefits, could be interpreted to include a wide array of employer-provided “benefits” that are a necessary part of the job, but that would not be considered a benefit by the general public (*i.e.*, business travel reimbursement, office supplies, office furniture, computer equipment, and the like).⁷⁸

We suggest that the Service consider limiting the fringe benefit disclosure required by Schedule J to very specific items that are capable of being tracked and reported without undue administrative burden. For example, qualified moving expense reimbursements must be substantiated, and an exempt organization should have information regarding this benefit.

3. *Columns D and E*

Nontaxable expense reimbursements (such as business travel) appear under the Schedule J Instructions to be included in both column D and column E, because the reimbursement of such expenses qualifies as a working condition fringe benefit. Because all entries in columns B(v) through E are totaled in column F, we do not believe it is the intent of the Service to encourage duplicate reporting in these columns. Certainly, duplicate reporting would be confusing and misleading to the reader of Schedule J. We recommend that the Instructions to columns D and E of Schedule J be revised to clarify that the same amounts are not to be reported in one column, but not in both columns.

⁷⁷ Reg. §§ 1.132-2, 1.132-6.

⁷⁸ Reg. § 1.132-5.

4. *Column E*

Reporting all legitimate nontaxable expense reimbursements in column E, and including that amount in the total reported in column F, implies to the reader of Schedule J that the amount in column F is the total “compensation” of the listed individual. Because the nature of the organization, and the listed individual’s position and responsibilities, will have an enormous impact on the types and amounts of nontaxable expense reimbursements incurred, listing these reimbursements separately and as part of a total compensation number will be misleading and will not provide meaningful information to the Service or to the public regarding executive compensation.

While total compensation is the total that an individual receives (and that would appear to be consistent with the purpose of Schedule J), the amount disclosed in column E represents what an individual spends. Spending on reimbursable business expenses is far different from receiving amounts that can be devoted to an executive’s personal purposes. We recommend that the separate listing of nontaxable expense reimbursements be removed from Schedule J. Alternatively, if the Service determines that this information is necessary, we suggest that the total compensation reported in column F should be limited to the sum of columns B(v) and C, consisting of Form W-2 compensation and nonqualified deferred compensation.

5. *Column H*

The Schedule J Instructions for Column H of Line 1 define “equity-based compensation” to include “stock, stock options, stock appreciation rights, phantom stock, and restricted stock or shadow stock.” The Instructions go on to refer also to participation in “any equity compensation plan.”

Without further clarification, this reference to equity compensation plans could cause confusion. Many incentive compensation plans provide incentive pay awards based in part on the net income or other indicator of the value of the organization. We recommend that the Schedule J Instructions be clarified to indicate that this required disclosure refers only to actual or potential ownership interests in the organization or any related organization.

The headings for Part II of the Core Form and Line 1 of Schedule J refer to “highly compensated employees.” This reference may be misleading because it appears intended to refer to those employees who are the five highest paid employees (other than officers, directors, trustees and key employees) who received more than \$100,000 from the organization in the reporting year, rather than to other possible definitions of this term in the Code.⁷⁹ We suggest that the Service consider clarification of these heading references.

B. Line 3

Line 3 asks whether the organization paid or reimbursed for first-class travel, club dues or use of an individual’s personal residence. An organization would have to answer “yes” to this question if there was even just one instance in which the listed individual upgraded to first-class

⁷⁹ See, e.g., I.R.C. § 414(q)(1).

airfare (perhaps under very compelling circumstances involving the ability to work on confidential matters involving the organization, and perhaps even with the use of the executive's own upgrade certificates) and was reimbursed by the organization, or if there was one instance in which the organization reimbursed the individual for a legitimate business function that took place at the individual's personal residence. While the "yes" answer to this question may be for a very limited and very legitimate reason, the misleading perception created by the "yes" answer will be that the organization's funds are used to support a lavish and extravagant executive lifestyle.

As a result, we recommend the Service consider the addition of one or more of the following revisions:

- a. Add the term "regularly" before the words "pay or reimburse,"
- b. Define "first-class travel" to mean the purchase of a first-class ticket (and to exclude expressly the use of upgrade certificates), and
- c. Define use of a personal residence to exclude substantiated business expenses reimbursed in accordance with the employer's policy for reimbursement of appropriate business expenses.

Alternatively, we recommend that this question either be deleted from Schedule J or be reworded as follows:

Did the organization become aware that a person listed in Form 990, Part II – Section A was directly or indirectly paid or reimbursed during the year or a prior year for country club initiation or membership fees, personal use of the person's personal residence, other personal expenses, or expenses that were expressly nonreimbursable under the organization's expense reimbursement policies? If yes, see instructions [which would instruct the organization to attach an explanation of the circumstances and the remedial steps taken, as is currently done under line 89b of the current form 990 for excess benefit transactions].

C. Lines 4 and 5

These lines require the disclosure of any compensation determined to any extent by the revenues or net earnings of the organization. Many reporting organizations have incentive compensation arrangements that determine either participation or actual compensation amounts based on revenues or net earnings of the organization. In addition, hospitals and other exempt healthcare organizations frequently have physician compensation arrangements that measure compensation by reference to a physician's personal professional revenue production. These arrangements have been accepted as providing legitimate means of making sure that compensation is "reasonable" in relationship to the value of services provided. Although Lines 4 and 5 represent an appropriate subject of inquiry for Schedule J, many organizations will answer "yes" to Lines 4 and 5 of Schedule J for these very legitimate reasons.

XII. COMMENTS ON SCHEDULE K

A. Part I

1. *In general*

This section includes a series of questions requesting information reported to the Service on Form 8038. The Service may wish to cross reference the specific line from Form 8038 on which the requested information may be found.

2. *Column E*

Form 8038 typically is filed by bond counsel, and the taxpayer may or may not have received evidence of the filing date. If the taxpayer is expected to maintain records with this information, such a requirement should be effective only for bonds issued in the future. If the Service determines that this requirement should apply to existing bonds as well, transition relief in the form of a delayed effective date would be appropriate to allow organizations time to obtain the information. Moreover, it is not clear that organizations will, in all cases, be able to obtain this information. Thus, appropriate transition relief may also simply provide that this column need not be completed for bonds issued prior to a specified date.

3. *Column G*

Many bond issues finance multiple projects, each with a separate placed in service date. Schedule K should allow for a range of dates and the Instructions should specify how to complete this column if one or more projects have not yet been placed in service (*e.g.*, indicate the expected placed in service date).

B. Part II

1. *Line 1*

The Instructions for Line 1 set forth the technical definition of the term “issue price.” However, this definition likely will not be meaningful for most organizations. The Service may wish to consider allowing the taxpayer to report the issue price as reported on Form 8038 and the Instructions should cross reference the specific line on which the information may be found.

2. *Lines 2-11*

Many of the terms used in these questions are consistent with the terminology used in sections 103 and 141 through 150 and the related Regulations. However, many exempt organizations will not be familiar with these terms or their application and the limited Instructions do not provide sufficient clarification. For example, most organizations are not familiar with the technical requirements for the various temporary period exceptions for project funds, bona fide debt service funds, investment earnings on various funds, etc. The Service should include plain language definitions of these terms and expanded instructions. As noted previously, because only organizations who have outstanding tax-exempt bonds will answer these questions, the plain language definitions and expanded Instructions could be included in

the Instructions to Schedule K or in an appendix that would also be used in completing the Core Form and Schedule K.

3. *Lines 2 and 3*

An organization generally will have information regarding total balances in a particular fund or account, but will not separately track principal and investment earnings. As expenditures are made from the fund, they typically would not be allocated between principal and earnings; both are treated as bond proceeds. In addition, a reserve fund could have amounts that are neither original bond proceeds nor investment earnings on bond proceeds. The Service should clarify what amounts it is requesting for these line items, recognizing that without the creation of some sort of arbitrary “principal spent first” or “earnings spent first” convention, it will be not be practicable to specify principal only.

4. *Line 10*

The definition of an advance refunding should refer to bonds issued more than 90 days “before” rather than 90 days “after” the past payment on the prior issue. Because there can be technical issues in determining whether bond proceeds were used to pay principal and interest on another obligation, the Service may wish to consider allowing an organization to answer this question by reference to the Form 8038 filed for the issue. In that case, the Service should indicate the line item of Form 8038 on which the specific information may be found.

C. Part III

1. *Lines 1-5*

We suggest that the Service consider transition relief in the form of a delayed effective date for completion of Part III. Many organizations do not yet have in place the tracking and monitoring mechanisms necessary to address these items. While most organizations are cognizant of their ongoing compliance responsibilities, they do not have the formal mechanisms in place to facilitate providing the information requested. For example, contracts may be located in various departments, rather than in a single location. Multiple bond issues may have financed a single project over time. A transition period of two or three years would provide organizations with the time necessary to develop systems to capture the relevant data. This transition relief should apply to all bond issues, as organizations will need to implement appropriate systems even for new issues.

2. *Lines 2a, 2b, 3a, and 3b*

Many healthcare organizations enter into a wide variety of management and service contracts with respect to their facilities. The Service may wish to consider rewording these questions and expanding the instructions to address the likelihood of multiple contracts.

3. *Line 2a*

Although Rev. Proc. 1997-13⁸⁰ uses the term “management contract” to include any contract involving the use of bond financed property in the trade or business of a non-exempt person, organizations may read the term in its more common, narrow sense. The Service may wish to consider using the phrase “management or services contract” on Line 2a to avoid confusion.

4. *Lines 2b and 3b*

The fact that a contract does not meet a safe harbor is not necessarily indicative of private use. Thus, it is not clear that the answer to this question would achieve a compliance objective. If the Service determines to retain these questions as drafted, an organization that answers "no" to either should have the opportunity to explain why the contract does not result in private use.

5. *Line 3b*

Line 3b refers to the safe-harbor regarding research agreements under Rev. Proc. 1997-14,⁸¹ which recently was superseded by Rev. Proc. 2007-47.⁸² Accordingly, the Service may wish to update this reference.

6. *Lines 4 and 5b*

These lines require the organization to measure the highest percentage of the project that was subject to a management or research contract or used by a non-exempt person at any time during the year. An organization typically would not track such use for any contract or other use that met the applicable safe harbor or which was otherwise determined not to result in private use. We believe it is not clear whether this question looks to all uses or only those uses classified as private uses and request that the Service clarify what information it seeks.

Is this question intended to address the amount of private use for the entire issue? In many cases, a single issue will finance multiple projects. Thus, the amount of use of a specific project does not indicate the amount of use of bond proceeds. This will also be the case where a single project has different costs for different portions of the project (e.g., different floors of a building may have different costs). The Service may wish to clarify what information it is seeking and provide expanded guidance, as appropriate, to assist organizations in completing Line 4.

⁸⁰ Rev. Proc. 1997-13, 1997-1 C.B. 632.

⁸¹ Rev. Proc. 1997-14, 1997-1 C.B. 634.

⁸² Rev. Proc. 2007-47, 2007-29 I.R.B. 108.

D. Part IV

1. *Instructions*

This section asks for information about the compensation during the year of third parties involved in the issuance of the bonds. The Instructions could benefit from clarification as to whether information is requested only for issues identified in Part I or for both Part I issues and potential issues (the Instructions seem contradictory on this point).

2. *“Formal Selection Process”*

The last column asks whether these participants were selected through a “formal selection process.” Guidance would be helpful on the meaning of the term “formal selection process.” In developing that guidance, the Service might consider whether there are some roles for which the lack of a formal selection process presents little to no tax-exempt bond compliance risk. In that regard, the Service may wish to consider the following common fact patterns:

- a. The organization pays compensation to underwriters’ counsel or issuers’ counsel. The organization has no control over or possibly even knowledge of the process by which these parties were selected.
- b. The organization has outside counsel and investment bankers that it regularly uses in connection with its financings. While a decision is made for each transaction to continue to use this team, there is no specific process.

XIII. COMMENTS ON SCHEDULE L

Schedule L collects information on loans. We have no comments with respect to Schedule L.

XIV. COMMENTS ON SCHEDULE M

Two of the goals of the redesigned Form 990 are to increase transparency and to minimize the filing burden on tax-exempt organizations. Schedule M attempts to increase transparency by asking each filing organization to identify and value various types of non-cash contributions received.

A. Filing Requirements

An organization must complete Schedule M if it has total non-cash contributions reported on Part IV, Line 1g, of the Core Form of greater than \$5000. As a separate matter, the Service requires that organizations acknowledge non-cash gifts of \$5000 or more that are reported on the donor’s Form 8283. Charities must then report to the Service on Form 8282 if any of these items are sold within two years (or in some cases, within three years).

1. *Filing threshold*

Schedule M has a different threshold than Form 8283 and Form 8282. We recommend that the Service require reporting of non-cash gifts of \$5000 or more on Schedule M, instead of more than \$5000.

Further, Schedule M would require an organization that has several small non-cash contributions to provide quantity, revenues recognized, method of valuation, and year-end value reported on the balance sheet for these small non-cash contributions. We suggest that instead of triggering Schedule M if the *aggregate* non-cash contributions total more than \$5000, the Service have Schedule M report *individual* non-cash contributions of \$5000 or more. Organizations will not need to list smaller contributions, and the Service will obtain information about larger contributions, which are more likely to be a fruitful source of examination activity.

2. *Consistency of Schedule M and Instructions*

Schedule M and the Schedule M Instructions provide an inconsistent message as to who must file Schedule M. The Instructions say an organization is required to file Schedule M “if it received any contributions of art, historical treasures, other similar assets, or qualified conservation contributions, regardless of whether it reported any revenues for such contributions in Part IV.” However, Schedule M itself and the Service’s written overview both say that Schedule M is to be filed if the organization reports more than \$5000 in non-cash contribution revenue on Line 1g of Part IV of the Core Form, with no reference to the required filing of Schedule M if certain types of assets are received, irrespective of their value. In addition, the Schedule M Instructions’ reference to “other similar assets” is not further clarified in the Instructions and will likely result in confusion and inconsistent reporting, thus reducing transparency.

We recommend that the Service make Schedule M and the Instructions to Schedule M consistent with each other and delete the reference to “other similar assets.”

B. Valuation

Exempt organization recipients of non-cash gifts are not required to and generally do not participate in the valuation of non-cash contributions for ascertaining the amount of the donor’s deduction. The donor normally arranges for any needed appraisals. However, the Instructions to Schedule M, Part I, Column C, imply that the exempt organization will have engaged in some valuation process when it receives such gifts.

For purposes of preparing financial statements, organizations are allowed to use reasonable estimates for the value of donated property that continues to be held by the organization for use in performing its exempt function. One of the strengths of the new Form 990 is that it requires less variation from the audited financials than in prior years. We recommend that the Service consider allowing organizations to use values based on audited financial statements for Form 990, Part IV, Line 1g, and also for the related Schedule M. In addition, we recommend that Column C, which assumes that an organization receiving a non-cash gift will have done an extensive (and expensive) valuation of all such items, be deleted.

C. Reported Asset Categories

Section 501(c)(3) organizations frequently receive donations of technology equipment and other types of office equipment. These have not been listed in Schedule M. We suggest that the Service consider adding lines for technology equipment and office equipment.

XV. COMMENTS ON SCHEDULE N

A. Part I

Line 1, Column C, asks for either the fair market value of assets distributed (in liquidation, termination or dissolution) or the amount of transactional expenses.

If a significant transaction occurs, such as the sale of substantially all of the assets of a hospital, and, among other things, several professional firms were involved in both the sale transaction and the subsequent liquidation and/or eventual dissolution of the reporting entity, it is not clear whether the reporting entity is required to ask each involved professional firm to reconstruct or prepare an allocation of their fees and expenses between those relating to the sale and those relating to dissolution. In addition, the point of this question, and the question on Line 1, Column D asking for the method of determining the fair market value of the assets distributed, is not clear for section 501(c)(3) organizations.

The fair market value of the distributed assets or the amount of transaction expenses do not appear to have any federal tax consequences so long as the remaining assets are distributed to another section 501(c)(3) organization. What use the Service will have for the information called for with respect to liquidations of organizations not described in section 501(c)(3) also is not clear.

We suggest that the Service consider eliminating Columns C and D on Line 1 of Part I, since the information appears to serve no purpose.

B. Part II, Line 8

Line 8 of Part II asks for information concerning a substantial contraction of net assets during the year involving the transfer of more than 25 percent of the net assets of the reporting organization.

It is not clear whether Schedule N applies to a restructuring of the reporting entity dividing it into two or more similar exempt entities. In such a case, there may not be a “disposition” of net assets (because the creation of a new nonprofit entity to perform portions of the functions of the transferor entity constitutes a mere change in the form in which the reporting entity continues to conduct its activities). We suggest that the Schedule N Instructions clarify this point.

XVI. COMMENTS ON SCHEDULE R

Schedule R is intended to capture the increasingly complex organizational structures of tax-exempt organizations and to improve transparency with respect to these organizational structures. To do so, Schedule R separates related entity reporting into various types of tax entities, such as disregarded entities, exempt entities, partnerships, taxable corporations, and trusts, so that exempt organizations can provide information specific to relationships with each type of entity in a more organized fashion.

Schedule R does not call for an express description of the relationship between the tax-exempt organizations and organizations to which they are related. Instead, Schedule R requires that the tax-exempt organization simply identify the direct controlling entity. However, this identification requirement does not include any requirement that the tax-exempt organization provide additional details—such as state or foreign country where organized, a tax identification number, or any other information—about the controlling entity. We recommend that the Service consider adding this information, because it will be important in properly identifying the controlling entity for purposes of analysis of the controlled group as a whole.

1. *Part II*

Column F of Part II asks for a brief description of the public charity status of an identified, related tax-exempt organization. It further asks, if the related organization is a Type III “supporting organization,” whether or not it is “functionally integrated.” The Service has not yet provided any formal guidance concerning qualification as a “functionally integrated” Type III “supporting organization.”⁸³ It will be difficult for some organizations to complete this question for the 2008 tax year if guidance has not yet been provided.

2. *Part V*

Organizations are required to report if they engaged in any of the transactions listed in Part V with a related organization (other than a disregarded entity). The definition of “related organization” for purposes of Schedule R expands the disclosure requirements of section 6033(h), which requires disclosure of transactions between controlling and controlled organizations within the meaning of section 512(b)(13). In general, “control” under section 512(b)(13) requires more than a 50 percent ownership interest. However, the Schedule R Instructions, in defining a related organization and control with respect to taxable organizations includes: (i) being a managing partner or managing member in a partnership or limited liability company which has three or fewer managing partners or managing members, and (ii) being a general partner in a limited partnership which has three or fewer general partners. By requiring organizations to complete Part V with respect to transactions with these organizations, the Service is requiring organizations to disclose more than what is required by the statute, because control under section 512(b)(13) could be lacking. The Service may wish to consider removing

⁸³ Comm. in Response to IRS Notice 2007-21, ABA Tax Sec. *Comments in response to IRS Notice 2007-21 on the Treasury Study on Donor Advised Fund and Supporting Organizations*, (August 1, 2007), available at <http://www.abanet.org/tax/pubpolicy/2007/070801irs200721treasurystudy.pdf>.

these two categories of organizations from the definition of "control" or providing an exception to completing Part V with respect to transactions with such organizations.

3. *Part V, Line 1*

Line 1 of Part V asks if there were grants or loans between the related organizations described in Schedule R. However, the Schedule R Instructions for Line 1 indicate that nothing has to be reported if the related organizations are both section 501(c)(3) organizations and the transactions were gifts or grants. This is an important exception, and we recommend that the Service include in Line 1 of Schedule R a description of the excepted transactions.

In addition, the Schedule R Instructions for Line 1 of Part V indicate that transactions of a particular type (loan, grant, sale of assets, lease, performance of services, or other transaction) between two organizations do not have to be reported if the aggregate amount involved for the year does not exceed \$5000. This threshold is similar to the threshold for reporting transactions on a number of other Schedules, such as Schedules F and I. While this amount may be a material amount for a small organization, larger organizations may exceed this threshold for a number of types of transactions with a variety of organizations. The volume of transactions reported is likely to create challenges to large organizations in compiling the relevant data and also make Schedule R (and similar schedules where a comparable threshold is used) difficult to interpret by readers of Form 990. We suggest that the Service consider incorporating a percentage threshold for determining the transactions to be reported on Schedule R and comparable Schedules based on the size of the organization and the aggregate volume of similar transactions involved.⁸⁴

XVII. RESPONSES TO SPECIFIC SERVICE QUESTIONS

In the Background Paper, the Service specifically requested comments and suggestions regarding the following issues. These issues have in large part been addressed in the preceding sections of these Comments. Our responses to the specific questions raised by the Service are set out below to the extent that the questions have not been covered in prior sections of these Comments.

A. Other ways to minimize the reporting for the sector and for individual organizations, including electronic filing concerns

See the response to Question B below.

B. Raising the Form 990 filing thresholds for certain organizations. For example, raising the current \$25,000 annual gross receipts threshold to \$50,000, and allowing these organizations to file a Form 990-N (a new annual electronic information notice for small organizations with annual gross receipts under \$25,000) in lieu of the Form 990 or 990-EZ

⁸⁴ Schedule B applies a comparable approach in some cases. An organization which meets the section 170(b)(1)(A)(vi) public support test is required to report on Schedule B only those contributions which exceed *the greater of* \$5000 or two percent of total gifts, grants, and contributions.

We support this recommendation. The \$25,000 filing threshold was last raised over twenty years ago. Doubling the filing threshold would adjust the threshold for inflation and minimize burdens on smaller organizations.

C. Whether certain portions of the discussion draft Form 990 can be used as a substitute for the current Form 990-EZ

We recommend that the Service use Parts I, III, VII, and VIII (modified as we have recommended herein), as well as Schedules A and B, as the foundation for a new Form 990-EZ. Ideally, the questions on the Form 990-EZ would be self-explanatory, avoiding the need for reference to lengthy instructions, so that the return could be completed without professional help.

D. The efficiency indicators contained on the summary page (lines 19b, 24b, 25 and 26)

As noted in the Comments with respect to page one of the Core Form, we believe that the so-called efficiency indicators are not indicative of efficiency and will, in many cases, be misleading. We suggest that they be eliminated.

E. Additional items regarding governance and management best practices (Part III of the core form)

See the Comments regarding Part III of the Core Form for our recommendations regarding modification and expansion of the questions regarding conflicts.

F. The reporting of community benefit by hospitals in Schedule H, and the extent to which the Catholic Health Association's reporting format on which Schedule H is largely based should be modified.

As noted in the Comments regarding Schedule H, we recommend inclusion of some reporting of the charity care portion of amounts reported as bad debts, and the inclusion of various other community benefit items.

G. Defining relatedness for compensation and other purposes, including arrangements in joint ventures and with for-profit subsidiaries

We have recommended various modifications in our Comments on the Core Form and Schedule D.

H. Whether transition periods are necessary in order to ease the burden of implementing the new reporting requirements for certain form components (such as the tax exempt bond schedule)

For organizations that will be required to gather additional information that they do not now collect in the ordinary course, we urge that some transition relief be provided. This may be particularly true for certain classes of organizations that are likely to see the most significant increases in their reporting burdens, such as large multi-entity organizations. Schedule K may require a phase-in.

Our Comments with respect to Schedule F recommended certain transition relief for organizations required to complete Schedule F.

Many hospitals use different models for aggregating and reporting community benefits, charity care, and bad debt amounts. In addition, for the reasons set forth elsewhere in these Comments, Schedule H may need revision, and the final version may not be released until next year. We suggest making completion of Part I, and Part II, Section A, of Schedule H optional for three years while discussion continues as to revision of these parts and hospitals adjust their recordkeeping systems to collect the required information. If hospitals wish to complete these parts but maintain their community benefit and other records on a different basis, the Service might consider permitting hospitals to complete Parts I and II using this different information during the three-year transitional period (with disclosure of the basis on which they are completing these parts).

I. Whether adequate care has been given to privacy concerns

As noted in the Comments with respect to Schedule F and Part II of the Core Form, we recommend that identifying information be withheld in certain circumstances where it could subject individuals identified to security risks or harassment.

J. Whether the Service should preclude group returns

Group returns provide an efficient and transparent way for organizations with multiple entities to meet the Form 990 reporting requirement. We accordingly recommend that the Service continue to permit, and indeed encourage, group returns.

Group returns provide the reader with the opportunity to view the activities of the included entities in a consolidated manner rather than in a fragmented fashion. This consolidated approach more accurately reflects the organization as a whole—a perspective that would only be available by going through the process of combining all of the separately filed returns. Also, group returns provide the reader with the opportunity to view all compensation paid by the organization as a whole all in one location. Moreover, group returns often provide for more accurate disclosure by smaller organizations that are affiliated with a larger group, since such organizations often receive useful instruction from the group “parent” on compilation and reporting of the financial information that goes into the group return.

If there is a concern in obtaining certain information on an entity-by-entity basis for organizations included within a group return, the Service could require consolidating schedules for such disclosures to be included within the group filing. The elimination of group filing would likely reduce, rather than increase, transparency. Accordingly, we recommend that the Service retain group returns.